Final report

International Growth Centre

Consortium for Development Policy Research

Implementing policies for competitive garments manufacturing

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January 2017

When citing this paper, please use the title and the following reference number:
F-37211-PAK-1

DIRECTED BY

FUNDED BY

Implementing Policies for Competitive Garments Manufacturing

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January 23, 2017

This report documents the technical support provided by the two lead authors mentioned above and CDPR's research team that includes Fatima Habib and Zara Salman for reforming Punjab's garments manufacturing sector.

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1 Background and Context

1.1 Introduction

Within the textiles chain, ready-made garments manufacturing is the most labor and least energy intensive, and the highest value addition segment[1] and best suited to Pakistan's comparative advantage. Properly positioned, garments manufacturing can contribute significantly to the country's objective of creating modern, well-paid jobs and improving the trade balance. Moreover, in view of China's gradual withdrawal from garments exports due to its rising labor costs, a large export market is opening up for countries like Pakistan. So the potential is significant.

This report presents the findings of Phase II of the study on Pakistan's garments manufacturing as a continuation of the work done in the previous phase. This study, however, makes some new contributions to the analysis presented earlier in Phase I. Firstly, it describes the policy engagement on the key recommendations of study in Phase I. Secondly, it assesses the performance of garments following the attainment of GSP+ status, an important milestone that has eased access of garments manufacturers to the EU market. Thirdly, it expands coverage by including firms located in Sialkot, an important garments cluster and not covered in Phase I of the study. Lastly, it covers additional firms from the Lahore and Faisalabad cluster that were interviewed to corroborate the main findings of Phase I, by getting their perspective on the impact of GSP+ and their assessment of the progress made on implementing the reforms resulting from deliberations following Phase 1.

1.2 Presentation of Key Recommendations of Phase I to Chief Minister, Punjab

Phase I of the study was conducted between 2012 and 2013 and assessed the performance of garments manufacturing in Pakistan through a country-wide survey of 234 firms[2] and an additional more detailed study of 33 firms[3]. The country-wide survey was conducted for firms across three major manufacturing clusters: Lahore, Faisalabad and Karachi. Firms in Lahore and Faisalabad were identified using the Punjab Directory of Industries 2010 while the sample for Karachi was drawn using lists provided by Pakistan Ready-Made Garments Export Association (PRGMEA) and Pakistan Hosiery Manufacturers Association (PHMA). A more detailed round of interviews with 33 firms helped to dig deeper to understand the industry's potential, the challenges faced by

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[1] Nabi and Hamid, "Garments as a Driver of Economic Growth: Insights from Pakistan Case Studies", IGC, March 2013

[2] Hussain et al "A Comparative Analysis of the Garments Sector of Pakistan", IGC, April 2013

[3] Nabi and Hamid, "Garments as a Driver of Economic Growth: Insights from Pakistan Case Studies", IGC, March 2013)

firms and way forward.

Findings from these two studies of Phase I were shared with the Chief Minister (CM) of Punjab in July 2013 via a presentation made to him at the CM Secretariat in Lahore. The meeting was attended by a wide group of stakeholders including representatives from political parties, leading academics and economists, along with the private and public sector.

Attendees from private and public sector for the meeting at CM Secretariat

Private sector

1. Mr. Sajid Salim (CEO Delta Garments)
2. Mr. Shahzad Salim (CEO Style Textiles)
3. Mr. Waseem Akhtar (CEO CottonWeb)
4. Mr. Tariq Mahmood (Vice President Raaziq International)
5. Mr. Azfar Hasan (CEO Matrix Sourcing)

Public sector

1. Mr. Irfan Elahi (Chairman Planning & Development Department, GoPb)
2. Mr. Ali Sarfaraz (Chairman Punjab Skills Development Fund)
3. Mr. Maratib Ali (Vice Chairman PBIT)
4. Mr. Jehanzeb Khan (Secretary Finance)
5. Mr. Shoukat Ali (Secretary Transport)

These studies highlight the role of garments manufacturing as a modernizing industry, with intensely competitive international value chains, skilled labor employment, and stringent compliance requirements with global standards. Garments manufacturing resonates with the country's resource endowment constraints to generate economic growth and employment, as it is a least energy- and capital-intensive and most labor-intensive industrial activity. The study recognizes the need for garments manufacturing to move up the value chain via greater diversification of product and price range in order to realize its full potential. To that end, the following challenges were identified:

1. **Market access:** Negotiating GSP+ status for easier market access to the European Union and securing lower duties in the US market.
2. **Trade policies and customs procedures:** Tariff and non-tariff barriers on man-made fibre (MMF) yarn and various kinds of fabrics and accessories limit the manufacturers to products that are based primarily on local raw materials, reducing the diversity and value addition of garments exports and consequently, their price range. Customs procedures cause delays and are costly.
3. **Skills:** Poorly educated work force translates into poor trainability of workers; In addition, the shortage of formal vocational training institutions results in a skills gap that firms must try to fill themselves.
4. **Energy:** Growing energy shortages have compelled owners' large firm to install generators at a substantial cost to meet their basic power needs, but most small

firms cannot afford to make this investment. This has prevented efficient sub-contracting arrangements and has increased the cost of production for garment manufacturers in Pakistan, making them less competitive.

5. **Cluster formation:** Firms look to the government for the provision of basic infrastructure that promotes cluster formation and the agglomeration economies that flow from it. This requires setting up state of the art industrial estates that provide clear land rights, reliable energy, world standard quality of water and waste treatment and facilitates access to skilled workers.

Private sector representatives discussed each of the challenges highlighted above. Mr. Sajid Salim, ex-chairman of PRGMEA, highlighted the importance of having attained the GSP+ status for Pakistan and its implications on the garments manufacturing industry. He further assessed progress made towards filing the application for the scheme and raised a concern that the deadlines may not be met.

Mr. Shahzad Salim (from Style Textiles) drew attention to the issue of energy crisis and its impact on the garments industry. Since garments manufacturing is not energy intensive, and captive power generation is not a viable option for many firms (especially small to medium scale), it was urged that the government identify ways of providing uninterrupted power supply, even if at a slightly higher tariff, to reduce unnecessary costs to the industry.

Mr. Waseem Akhtar (from CottonWeb) discussed the importance of developing industrial clusters / economic zones to ensure better provision of infrastructure and to provide connectivity and access to markets. He argued that since SMEs do not have the capacity to invest at the pace the industry is expected to develop, the role of public investments become even more critical. Also as firms' access to the labour is critical, clusters should be set up close to labour colonies or both set up simultaneously. Mr. Akhtar further highlighted the inefficiencies of import policies (causing delays in production) and limited product lines. He suggested, as the process of duty exemptions on re-exported items is lengthy and cumbersome and most of the imported inputs are not generating sizeable revenue for the government, it should consider making import of such inputs duty-free.

The presentation ended with the CM declaring full support for the recommendations of the study. He instructed senior civil servants present at the meeting to attend to the concerns raised by the stakeholders. He was very keen to receive more specific recommendations along with a detailed implementation plan. He asked that sub-committees be notified immediately for each of the five broad areas of recommendations listed above. A steering group was announced to be led by Chairman Planning and Development, to oversee progress on implementation.

1. Phase II Sample of firms and the Sialkot Cluster

As mentioned earlier, Phase I of the study[4] was based on detailed interviews of 33 garment manufacturing firms in Pakistan in three major manufacturing clusters: Lahore, Faisalabad and Karachi. In Phase II, seven of the firms based in the Lahore cluster were revisited to elicit their views on government's policy response to the recommendations made in Phase I of the study and assess the impact of GSP+ status. Four additional firms were interviewed in Faisalabad and five in Sialkot a region that has emerged as an important cluster for sportswear and was not part of phase I. The overall sample for Phase II was representative of small (employing less than 100 workers), medium (100-1000 workers) and large firms (over 1000 workers)

Sialkot differentiates itself from other industrial hubs in the country because of some exceptional characteristics. Its extraordinary entrepreneurs are world-class exporters with complex global relationships. Sialkot entrepreneurs have shown great flexibility in adapting to changing world demand and have successfully transitioned to sophisticated products and a diversified export base. Being part of an outstanding industrial cluster, Sialkot firms have now been covered in Phase II including their views on growth potential, challenges to realizing that potential and Punjab government's response to the challenges.

There are a variety of products that firms in Sialkot are producing and exporting. Sialkot's Leather tanning and leatherwear industry along with knitwear and sportswear brings about $500 million worth of exports of the country.[5] Cricket and hockey gear is being manufactured in Sialkot since pre-partition days. It is also the hub for manufacturing and exporting surgical instruments. Sialkot is most well known for soccer balls, producing more than 42 million of them, including Brazuca (used in FIFA World Cup in Brazil 2014) and contributing $300 million to total exports of Pakistan.

Sialkot has recently emerged as a center for manufacturing sportswear, especially for baseball and American football. This new product line demonstrates the dexterity of Sialkot entrepreneurs. When demand for hand stitched soccer balls, for which Sialkot emerged as a world leader, fell in favor of machine made balls from China and Thailand, Sialkot entrepreneurs found a new niche for themselves. Workers, trained to stitch soccer balls, were re-trained to combine leather hand stitching skills with textiles to manufacture baseball and American football sportswear.

Here are some insights from entrepreneurs who switched their product line:

"In 1999, sports' garments' production was initiated with one to two customers and now it amounts for 95 percent of the total production," Senior Marketing Manager at firm S1.

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[4] Ijaz Nabi and Naved Hamid, "Garments as a Driver of Economic Growth: Insights from Pakistan Case Studies", March, 2013 (Draft).

[5] http://tribune.com.pk/story/756189/the-miracle-that-is-sialkot/

"We produce baseball pants, shirts, football pants, girdles, padded and unpadded shorts, sliding shorts, and compression shorts. Very few companies are making padded garments so we get good customers due to low competition," Director Finance and Purchase at firm S3.

Sialkot is located far from the seaport and to become successful exporters, Sialkot entrepreneurs have had to address this logistics problem on their own. The highway linking Sialkot with Lahore, the closest international airport, was heavily congested causing delays in shipments and an unpleasant travel for international buyers. Sialkot responded to this in a unique manner. Demonstrating rare private enterprise, they pooled their resources and built a private airport that operates international passenger and cargo flights. It was built without any public funds. They also built their own dry port at Sambrial.

Despite the many accomplishments of Sialkot entrepreneurs, there are number of areas where government support or policy reforms are needed:

Skills

The firms interviewed in Sialkot raised concerns about workers trained by existing institutions, i.e., TEVTA and PVTC. They felt that as the standard of the workers trained by TEVTA or PVTC was poor, and other training providers have not yet penetrated the Sialkot market, they have had to train the workers on their own or rely on workers travelling from other areas. Moreover, acquiring skilled workers for sportswear (that demands a specific skill set) has been difficult.

According to Director Operation at firm S5:

> *"At this time, the biggest problem is getting a skilled worker. We have to train them ourselves and we need government support here. We have 45 percent that are completely untrained and then our minimum wage is increasing which is also another issue. Today's situation is that most skilled workers are going abroad."*

Senior Marketing Manager at firm S1 also stated that:

> *"It is a problem getting trained stitchers. Stitchers are not well trained and need training."*

In view of issues faced by firms in hiring skilled workers, Punjab Skills Development Fund is now expanding its training activities to Sialkot.

Customs procedures

Another barrier for firms is absence of a 24/7 custom clearance facility. Although officially these facilities are being provided, staff is generally absent and collectors are available only five days a week. Hence, the facility cannot be availed properly. In addition, offices are under staffed and do not operate regularly. While on paper the Sialkot dry port should take only a day to clear consignments, in reality it takes approximately three days as there are no scanners at the office. Director Exports at firm S2 stated:

> *"Since there is no scanning, shipment is opened and pieces get stolen."*

Moreover, the Anti Narcotic Force (ANF) takes two days to clear shipments that they mark, forcing factory owners to send it by air, in order to avoid delays. The marked shipment is often repackaged improperly after being checked, which has led to issues with clients. When interviewed by the research team, Director Exports at firm S2 also mentioned:

> *"The problem is ANF in Karachi, which does random checks and holds [up] your container. This is despite the clearance from ANF in Sialkot. Also the dry port [still] does not work 24/7, they [now] work [only] at night. Even ANF comes late at night."*

Delays caused by the ANF were also a concern of *Senior Marketing Manager at firm S1*:

> *"ANF issues are bothersome and cause delays which do not exist in Karachi; In Karachi, scanners are used. Here, there are no scanners."*

Due to the delays caused as a result of lack of efficient custom clearance facilities, firms have incurred losses.

> *"Our customer fines and charges us if we delay and we lose a considerable amount of money per container. Overall 35% of our shipments are delayed so you can see how much loss we are making,"* Director Finance and Purchase at firm S3.

Energy

Energy shortage is another big concern for firms. The garments industry of Pakistan is operating below capacity as most of the industry in Punjab experiences power outages for both electricity and gas.

> *"Our problem is energy shortage and gas shortage. This delays the ability to meet our targets. Our vendor, which dyes our material, delays orders,"* Director Exports at firm S2.

Director Operation reported that firm S5 faces the same issue:

> *"Biggest problem is energy. We need some relief. And then we need to change the bureaucratic process."*

Tax regime

There are substantial import duties on most raw materials and the Duty and Tax Remission Scheme (DTRE) requiring approval before importing raw materials has increased lead-time by 35 to 45 days. While, in the case of duty draw back scheme, there are significant delays and costs involved in the refund process. Because of delays in refunds from Federal Board of Revenue, capital is held up and unusable for additional investment. The recent proliferation of provincial taxes and levies has added to this problem. These costs reduce Pakistan's competitive advantage. According to Director Operation at firm S5:

> *"There is another issue that is sales tax on services, which we pay to Punjab Revenue Authority and claim it back from the federal government. But they have no link between the two, so when we apply to FBR for a refund, it gets rejected. Therefore, we have up to Rs. 5 million stuck till today [on this account]."*

2 Tracking Progress on Implementing Recommendations of Phase 1

Currently, the implementation of recommendations from Phase I, is underway. However, the process of implementation has shed light on the complexities of the proposed reforms and has required following up on firms' perspective elicited on the success of reform and its follow up. Some firms in Lahore interviewed earlier were revisited to investigate if their concerns had been addressed. In Faisalabad new firms were interviewed. Findings from Sialkot have also been appended to the analysis. Due to time and funding constraints, it was left out of the analysis done during Phase I. Additional interviews were also conducted with government officials involved in the committees responsible for pushing the reforms through.

A revised questionnaire, taking into account post-Phase I developments as well as progress on Phase I's recommendations, was developed for this Phase (see Annexure A). Questions on the impact of GSP+ status, cluster formation (Quaid-e- Azam Apparel Park (QAAP)), benefits of the new roads / infrastructure projects and the type of international expertise required were added in the new questionnaire. The revised questionnaire also includes questions on to determine any changes in a) size of company in the last few years, b) exporting countries and c) exports after GSP+ and a scale to gauge the seriousness of possible constraints. Questions on skills training, including their internal skills training facility, knowledge of Punjab Skills Development Fund (PSDF), interest in relocating to QAAP and understanding land requirements were also added. The findings of this new survey would allow for policymakers to make some new interventions, deepening the findings of the earlier study.

2.1 Impact of GSP Plus

2.1.1 Lobbying for GSP+

In the last study several firms highlighted that Pakistani exporters lacked market access, which was why the garments industry in Bangladesh was performing so much better than in Pakistan. Bangladesh had already attained the GSP+ status that provided its garment's industry duty free access to the EU market. Bangladesh had also been successful in negotiating lower duties in the US market. Firms pointed out Pakistan's failure several times in the past to seize the opportunity for improved access to EU and US markets. One such example follows right after 9/11 when the US had offered duty free access to Pakistan garment's industry but since the government insisted on duty free access for all textiles, US withdrew the offer and instead signed the Trade and Investment Framework Agreement (TIFA) 2003 to enhance bilateral economic relations. Since then, negotiations have dragged on for a Bilateral Investment Treaty (BIT) with the US. Similarly, EU had offered preferential access to Pakistani exports following massive floods in 2010, but again the negotiations dragged for a long time and only in 2012 was duty free access granted for a few items most of which the garment industry in Pakistan is not exporting. In this context, garment manufacturers stressed on the urgent need to attain GSP+ status as it would be a major boost for the industry.

After the presentation to the CM, the government took up these concerns and initiated the process of lobbying for GSP+ plus status. The CM formed a sub-committee to oversee progress of the application and ensure it was successfully submitted.

TORs of the committee on GSP+

a. Critically evaluate the progress being made towards filing the application for GSP+ by October 2013.
b. Outline a clear-cut series of steps that can be taken to ensure application is filed well within time.
c. Develop methodology to ensure evidence of compliance to the 27 international conventions is produced.
d. Develop a work plan with clear timelines and deliverables towards achieving the above.

The sub-committee was headed by Mr. Maratib Ali, (Ex-Vice Chairman PBIT) and included representatives from the Industries Department, Finance Department and Ministry of Commerce. It also includes private sector participation from Mr. Sajid Saleem (Ex-Chairman PRGMEA / Delta Garments), Mr. Shaikh Shafiq (PRGMEA — Karachi), Mr. Ijaz Khokhar (PRGMEA Chairman) and Mr. Azfar Hassan (CEO Matrix). The sub-committee held monthly meetings until GSP+ status was secured (Table 1).

However, the frequency of meetings declined once the role of the sub-committee was relegated to only ensuring compliance of GSP+.

To benefit from the scheme, Pakistan was required to ratify and give binding commitment to comply with 27 international conventions on human rights, political rights, labor rights, environment, narcotics control, and good governance. The sub-committee proposed the following actions:

- Lobbying by a high-level delegation together with the private sector to counter potential threat from Spain and Italy not in favour of Pakistan receiving GSP+
- Lobbying to countries such as United Kingdom, Germany and France
- Expeditiously submitting the overdue five technical reports
- Holding Pakistani ambassadors accountable in respective EU countries for successful lobbying
- Proactively engaging with the EU Ambassador to Pakistan
- Requesting all Pakistan missions in the EU to provide feedback on how their respective host country is likely to vote and what needs to be done to increase likelihood of a possible vote

Timeline of GSP+ Meetings

Sr#	Meeting Date
1	**17-07-13**
2	**22-08-13**
3	**18-09-13**
4	**22-10-13**
5	**27-06-14**

Although the necessary conventions were ratified, submission of the required implementation reports was delayed as they could only be submitted after necessary steps by the federal and four provincial governments to address shortcomings. The application for GSP+ status, supported by the completed reports, would then be evaluated by the European Commission's technical team and subsequently approved by the European Parliament.

Pakistan's application had to be processed by the relevant EU staff before the vote that was to take place in the EU parliament in December 2013. In light of this, the sub-committee proposed that federal government be involved and action taken by the Foreign Minister / Prime Minister. The federal government would need to expedite overdue reports pertaining to GSP+ conventions. The Committee recommended that the CM lead the lobbying effort to motivate the federal government to work harder towards securing the status. Punjab government took the following actions:

- A four-page pamphlet on why Pakistan deserves GSP+ status was printed and circulated to EU Missions in Islamabad and Pakistani Missions in EU.
- Some suggestions were passed on to the federal government such as:
    - Requesting all Pakistan missions in the EU to provide feedback on their opinion of how their respective host country was going to vote.

- Sending a lobbying team to various EU capitals and Brussels. Relevant names of counterparts were identified for the federal Government for such targeted lobbying.

The private sector representatives in the sub-committee were of the view that while efforts were being made to attain GSP+ status, there was also a need to develop a well-thought out strategy for marketing exports to EU. The benefits of the status would not be enough on their own. The issue of lack of diversification in Pakistan's exports had to be addressed, since Pakistan was competing with India and Bangladesh. Furthermore, lack of skilled workers and low capacity utilization of manufacturing facilities, which was caused by energy shortages, also had to be attended to. Moreover, Pakistan would also have to address security concerns of foreign clients.

2.1.2 Securing GSP+ Status

GSP+ status was successfully obtained in December 2013. This meant that the following benefits were realized:

- Duty free treatment for Pakistani products – covering 96 percent of products exported to the EU by Pakistan
- Pakistan would be the only second country in all of South and South East Asia to have duty free access to European Union. Competitors in the Textile and Clothing sector such as China, India, Vietnam, Thailand, Indonesia do not have duty free access nor any preferential access – 10 percent to 14 percent duty advantage.

The GSP+ status will be valid for a period of ten years to be reviewed every two years. The European Commission would present a report on the status of implementation of the Conventions to the European Parliament and the Council every two years.

Number of Conventions Implemented

The following conventions have been ratified and implemented.

Category	No. of Conventions
Human Rights	7
Labour Rights	8
Environment	8
Narcotics Control	3
Corruption	1

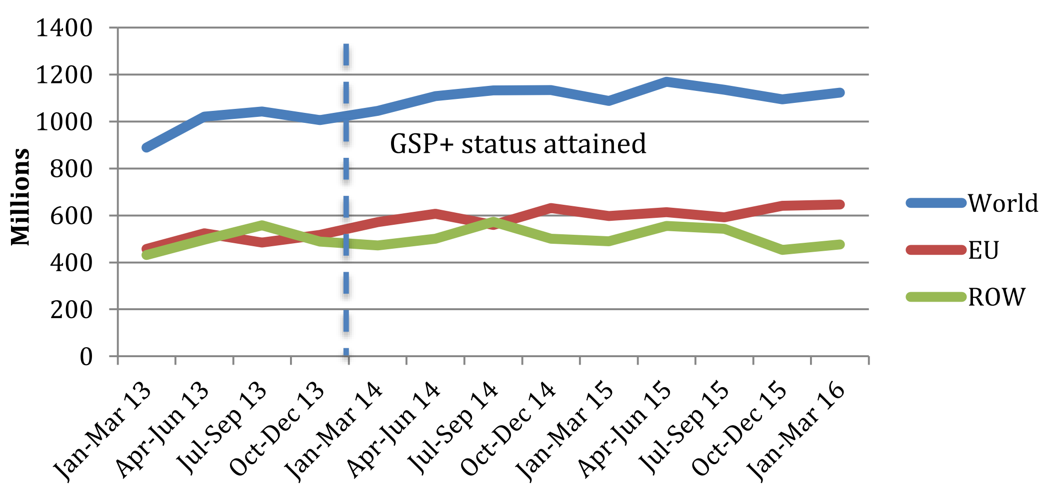
2.1.3 Progress on Compliance of Conventions under GSP+

In order to ensure compliance to the above-mentioned conventions, particularly relating to labour, relevant labour statutes and policies had to be framed. The labour department identified gaps in legislation, which once addressed would make these laws and their enforcement more effective. Moreover, the inspection regime, earlier inactive, was reactivated. Focus on health and safety was stressed. While fines on violations were increased, adjudication capacity for disposal of submitted fine was limited. Members of the sub-committee suggested establishment of a provincial task force to track legislative initiatives, monitor factory inspections and level of compliance of ILO conventions and propose and implement corrective measures, but no action has been taken in this regard. For preparing of the bi-annual review, the members of the sub-committee recommended developing a methodology to ensure evidence of compliance to the 27 international conventions, but none has been developed so far

2.1.4 Impact of GSP+ on Export Performance

Attainment of GSP+ in 2014 has had a significantly positive impact on Pakistan's garments exports to EU. However, due to the adverse internal conditions faced by the industry, particularly the substantial appreciation in the real exchange rate and continuing energy shortages, the impact was probably less than what it could have been. The effect of GSP+ is clearly visible from the difference in the performance of Pakistan garment exports to EU and to the rest of the world (ROW) during 2014 and 2015 (see Figure 1). Garment exports to EU grew much faster than to ROW in the first two years of the years of GSP+ (i.e., on average 11 percent p.a. to EU compared with 1.5 percent p.a. to ROW in 2014 and 2015). As a result, EU's share of Pakistan's total garment exports also increased from 50 percent in 2013 to 54 percent in 2015.

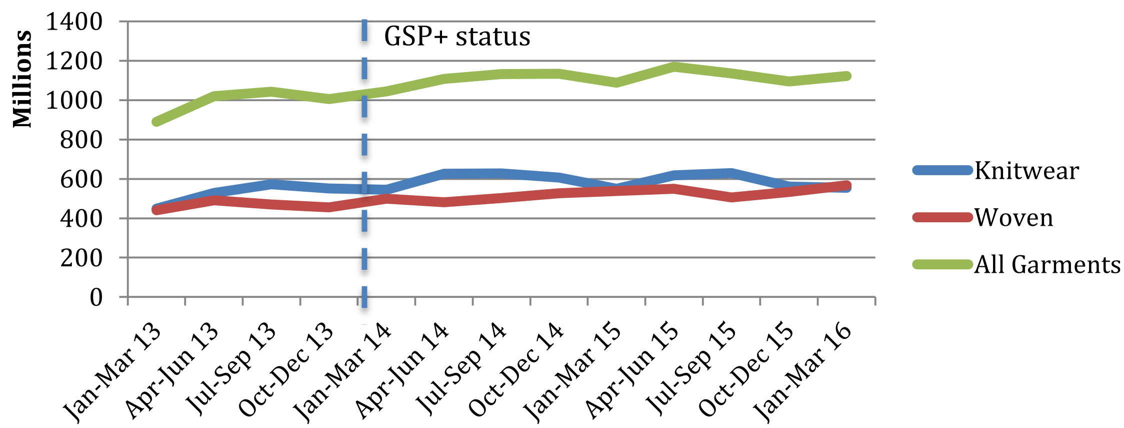
Figure 1: Pakistan's Garments Exports



Source: UN Comtrade

Pakistan's garment exports can be divided into two broad categories, knitwear and woven, with knitwear accounting for 53 percent of the total exports in 2013 (Figure 2). However, woven garments are far more important in the case of EU, accounting for 61 percent of garment exports in 2013. While exports of knitwear to EU during this period expanded somewhat faster than those of woven garments (6 percent p.a. versus 5 percent p.a.), because of the relatively modest growth in exports to the rest of the world, Pakistan's total knitwear exports grew at a slightly slower rate than woven garment exports (6 percent p.a. versus 7.5 percent p.a.). Since most of the growth in knitwear exports, particularly in the US, was due to sportswear exports from Sialkot, most knitwear firms elsewhere in the Punjab continued to be in a state of crisis.

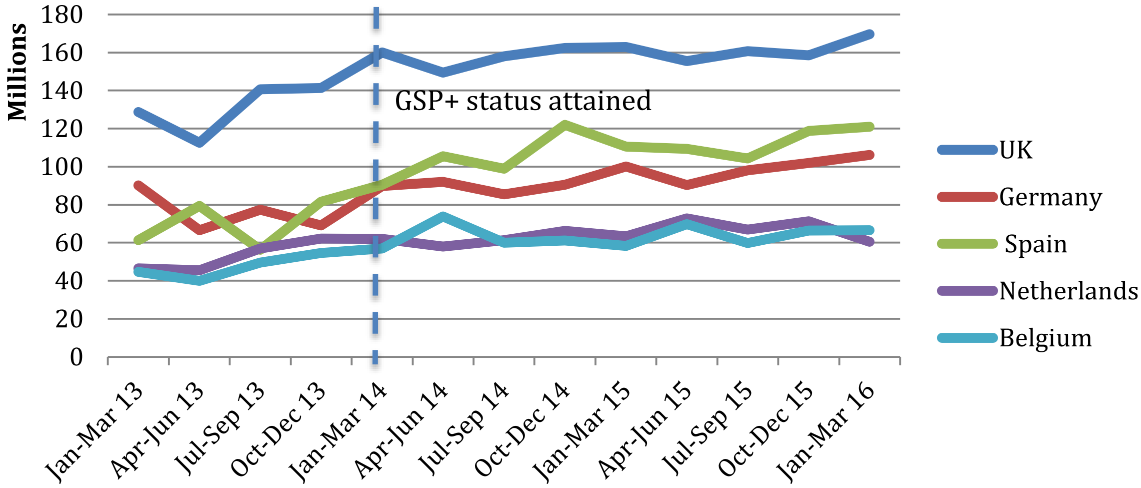
Figure 2: Pakistan Garments Exports by Categories



Source: UN Comtrade

With regards to countries within EU, UK accounted for 26 percent of Pakistan's garment exports to EU in 2013. While garment exports, to other EU countries grew somewhat more rapidly in 2014 and 2015, UK remains by far Pakistan's largest garments market in EU (Figure 3). UK has traditionally been Pakistan's most important supporter in EU and it played a lead role in the attainment of GSP+ status in 2013. At the time of each biannual GSP+ review, Pakistan has to show evidence that it is in compliance on all conventions required under GSP+. Support is therefore needed from major EU players for waivers in case Pakistan falls short on compliance. Following Brexit, Pakistan will be deprived of UK's clout in the EU and as a result at the time of the next GSP+ review the government will have to work harder to ensure it is able to maintain that status.

Figure 3: Top 5 EU countries for Pakistan's Garment Exports



Source: UN Comtrade

2.1.5 Firms' Perspective on GSP+ Status

Overall, as shown above attaining GSP+ status has not boosted exports as much as was expected due to issues such as appreciation of the Pakistani Rupee and increased costs due to energy shortfall and rising wages. According to the firms interviewed in Phase II, appreciation of the exchange rate caused considerable reduction in the profit margins of most firms and dampened further expansion of exports.

> *CEO at firm L7, "Any benefit that we would have received from GSP+ has been offset by the change in exchange rate."*

Pakistani exports have been facing the disadvantage of an appreciating currency since December 2013. In November 2013, Pakistan's Finance Minister, Mr. Ishaq Dar, announced in the parliament that the government's goal was to bring the down the Rupee to Rs 98 / $ (the rate at the time of May 2013 elections) and then maintain its parity with the dollar (the rate had depreciated to Rs 108.47 / $ by end-November 2013). Such policy statements reflect the priority of the government, which is mainly to support the consumer, particularly the urban middle class, rather than the producer and improve the fiscal balance by keeping prices of imported goods and the Rupee cost of external debt servicing low. This was in direct contrast to what other competing economies have done, which is devaluing their currency or allowing their exchange rate to depreciate. For example, between January 2014 and December 2015, the Indian rupee and Chinese Yuan fell by approximately 7 percent, the Turkish lira by 26 percent and the Vietnamese dong by 76 percent. The policy of maintaining a soft peg with the

US Dollar (the nominal rate was Rs105.48 / $ on 31 December 2013 and Rs 104.74/$ on 31 December 2015) during a period when the dollar was appreciating significantly against the Euro and the Pound resulted in Pakistan's real effective exchange rate (REER) to appreciate by over 20 percent between December 2013 and December 2015 (between June 2013, i.e., before the large decline in value of the Rupee in the second half of 2013, and December 2015 the REER appreciated by over 14 percent). This policy had a negative impact on Pakistan's exports, including garments. According to firm L9, in the last three years, the value of exports has declined by 7 to 8 percent, specifically due to the impact of exchange rate.

Another factor adversely impacting exports has been the security concerns of buyers, particularly new clients in EU that hesitate to visit Pakistan. Conferences and exhibitions for international investors and buyers also had to be canceled due to the prevailing security situation. Reports of terrorist acts and political instability from strikes and protests also created a negative image of the country and an environment that was not conducive for attracting new buyers. Firms blame the media in helping promote a more negative image, than what is on-ground reality of the country. More importantly, no marketing strategies have been put in place by the Government to present a positive side of Pakistan to help attract buyers and create more business. According to the Director Operations of the firm S5:

> *"It's important that we present our country in a positive way. We don't have marketing offices abroad, but a natural marketing office would be our foreign offices, which have a zero role in all of this."*

Pakistan is categorized as an extremely high-risk country for investment, based on the ratings by the international agency, Maplecroft. The agency analyzes countries at different risk levels on a scale of 1 to 10 (1 being the best and 10 being the worst). It ranks on *economic risk, political risk, social compliance* (including for example, labour and safety laws, human rights), and *infrastructure* (power, roads, climate change, disaster management)[6]. Table 1 below compares Pakistan's ratings with those for Bangladesh where in most categories Pakistan is rated worse than Bangladesh. With these ratings, international buyers are not willing to risk their investments in Pakistan and prefer vendors in neighbouring countries where clients can interact face to face and factories physically inspected with ease. This issue was raised by the private sector during the proceedings of the sub-committee on GSP+ where they suggested that a strategy be formulated to attract international investors. The private sector predicted that GSP+ would not be enough without a coherent strategy that addressed major issues of access for clients such as security. Their prediction has come true, since growth post GSP+ has not been as high as initially projected.

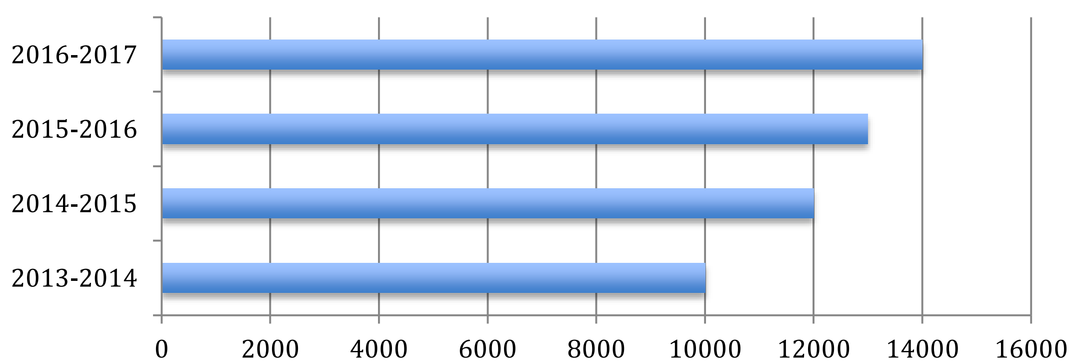
[6] Based on information provided by CEO of firm L8

Table 1: Risk Rating for Pakistan and Bangladesh

	Pakistan	Bangladesh
Political Risk	8.34	7.21
Social/Compliance Risk	8.82	8.46
Economic Risk	6.42	6.22
Infrastructure Risk	9.47	9.62
Adjusted Country Risk Score	8.26	7.88
Overall Risk Rating	Extreme	Extreme

Firms highlighted how Pakistan's minimum wage rule was hurting exports. The minimum wage in Pakistan has increased considerably since 2011. In 2013, the minimum was only Rs. 8,000 per month, raised to Rs 13,000 by 2015 (figure 4). In the past four years minimum wage increased by over 60 percent and since after GSP+ the minimum wage went up by another 30 percent. This has resulted in an increase in the unit labour cost for the garments industry, making their products less competitive in the global market. As reported by the two firms based in Lahore, L5 and L6, in just a few years labour costs have increased from just 12 to 13 percent of the total cost to 18 to 25 percent. This cost burden is also largely on those firms that export as they have to demonstrate compliance to international standards including applicable minimum wage laws. Most non-exporting firms are not paying the minimum wage. For political reasons there is no effective lobby against unrealistic increases in the minimum wage by the Government.

Figure 4: Minimum wage in Pakistan



Source: Various newspaper articles

Attaining GSP+ status has helped the export of garments, benefitting the woven sector more than the knitwear sector. However, to realize the full export potential, other supporting measures such as exchange rate management, addressing energy shortages, providing skilled workers, undertaking trade policy reform etc to strengthen the capacity of garments firms, will need to be implemented.

2.2 Quaid-e-Azam Apparel Park (QAAP)

2.2.1 Decision to Develop an Apparel Park

A key recommendation under Phase I of the study and also accepted by the CM was the need to develop a state of the art garments cluster. To that end, a sub-committee was setup:

TORs of the sub-committee on Garments Cluster

a. Identify ways in which the labor department, housing department and industrial department can work together to develop or improve existing garments clusters while ensuring access to labor and requisite infrastructure.
b. Clarify the role of Special Economic Zones to facilitate the garments industry.
c. Focus particularly on recommendations to support the SME's.
d. Develop a work plan with clear timelines and deliverables in light of the above.

The members of the sub-committee include Secretary Industries, CEO Punjab Industrial Estate Development and Management Company (PIEDMC), representatives of the Labour Department and Punjab Board of Investment and Trade (PBIT) and private sector members (Waseem Akhtar from Cotton Web and Iqbal Bhatti from US Apparel).

The sub-committee's action plan proposed collaborating with the private sector in surveying existing garment clusters and the kind of facilities that should be integrated. The survey would lead to the development of a project proposal, which would include the development of labour colonies, a water treatment plant and creation of a special economic zone. The action plan also tasked PIEDMC to finalize a suitable piece of land near Lahore. A Board was set up with public and private representation to oversee progress towards operationalization of the cluster - to be called Quaid-e-Azam Apparel Park (QAAP) - that would attract foreign investment but also, importantly, encourage existing firms to either relocate or undertake expansion projects in the park.

Timeline of QAAP Meetings

Sr#	Meeting Date
1	**23-06-2013**
2	**12-08-2013**
3	**22-08-2013**
4	**22-10-2013**
5	**10-11-2013**
6	**10-01-2014**

2.2.2 Planning of the QAAP

The main objectives behind establishing QAAP are:

- To provide a structured platform to the garments industry.
- To provide state-of-the-art infrastructure facilities including roads, electrical networks, water supply system, wastewater collection and drainage system including combined effluent treatment plant, power plants etc.
- To ensure availability of skilled manpower.
- To have a pleasant and secure environment by providing green areas, parks, and enforcing National Environment Quality Standards (NEQS).
- To provide social compliance facilities including schools/ hospitals and residential facilities.
- To comply with health safety.

The initial plan proposed by the sub-committee constituted a Pak-China zone, which would have a bifurcated estate, 200 acres for local investors and 800 acres for Chinese investors. This Public Private Partnership (PPP) was in response to the Chinese company, Shendong Ruyi Group's interest in exploring business and investment opportunities in Punjab's textile and energy sectors. They offered to provide technical assistance in developing QAAP without any charges. The CM responded by constituting an autonomous company, Quaid-e-Azam Apparel Park Company (QAAPCO), to oversee development of QAAP and cooperation with Shendong Ruyi Group. However, cooperation with Shendong Ruyi Group could not materialize due to political unrest in Pakistan in 2014, as well as delays by the PPP cell at the Planning and Development Department, Punjab. The initial plan of dividing the land between the local and the Chinese investors was abolished and the estate was directed to be open for all garment firms on a first come first serve basis. Following this, the CM Punjab assigned PIEDMIC to oversee the setting up of QAAP.

The experience of Sundar Industrial Estate assisted the careful planning of QAAP. The speculative buying that occurred in Sundar led to the establishment of a more transparent system for QAAP. As directed by the CM, a board has been setup, with members from PIEDMC and private sector. Their mandate is to ensure that plots are allotted to genuine buyers, by utilizing the services of a legal retainer. This way only firms that want to build their factories will be given land. The estimated time period for allotment of plots will end by 2016.

The land has been purchased and QAAP is being developed on 1500 acres near Sheikhupura, 40 km from Lahore. The site selection team visited the following areas:

- Kalashah Kaku Interchange (Mouza Kot Pindi Dass).
- Sheikhupura Interchange (Mouza Kot Ranjeet) on Lahore-Islamabad Motorway M-2.
- Upper Chenab Canal (Mouza Bhamb) on Lahore-Islamabad Motorway M-2.

After analyzing these sites, the team selected the site at Mouza Bhamb, on Lahore-Islamabad Motorway M-2 near Sheikhupura. The site has the advantage of being 30 minutes away from Thokar Niaz Baig, Lahore. It has access from the Motorway / GT Road which means easy mobility of labour and goods. The Government of Punjab has decided to make access easier by expanding link roads in the vicinity around QAAP. By end of 2016, improvement work on the link road from Johinawala to Monoopur and from Monoopur to Saikham is expected to be completed. In 2017, further construction of roads will be undertaken which will include the 2.5 KM link road from Johianwala to QAAP, link road from Sheikhupura Interchange (M-2) and 4.5 KM front road of the QAAP. There will also be an interchange to connect the park to M-2.

The location of QAAP makes it accessible to skilled labor from nearby areas. The draft plan for the park has been made by NESPAK and the process of hiring a foreign consultant to vet the draft plan has also taken place. PIEDMC has engaged China National Textile Company (CNTEX), a Chinese consultancy firm, in a joint venture with Engineering Consultancy Service Punjab (ECSP), a public sector consultancy firm of the Government of Punjab. The consultants have been asked to create a master plan, a strategic development plan, the design of infrastructure works, business and financial model, a marketing plan and tender documents. Based on the directions of the CM, the QAAP is to be planned in a manner that ensures provision of substantial green area and serve as a model for all other industrial estates. The park would provide space for over a 100 garment manufacturers and 134 SMEs including accessories suppliers. It also includes a dedicated power plant, with a capacity of 100 MW for uninterrupted power supply to the estate. The energy department will also be asked to assist PIEDMC in obtaining approvals from LESCO for providing electricity and for approval of a Grid Station. Furthermore, a 1000 MW LNG power plant is also being setup by the government in Sheikhupura. PIEDMC has proposed using this plant to meet some of the power needs of the park. Common facilities such as effluent waste treatment plant, clean drinking water, and solid waste disposal will also be provided. However, the cost of the waste treatment plant will be included in the cost of land to be purchased by firms.

The Punjab Skills Development Fund (PSDF), in conjunction with the Pakistan Institute of Fashion Design, was asked to plan a garments center of excellence for skills. This would ensure that the labour needs of the firms are also met. However, the task of planning a vocational training institute (VTI) has been handed over to CNTEX. After various rounds of meetings and exchanges of ideas with CNTEX, the QAAP committee has decided that instead of developing only a VTI, a complete degree awarding university should be developed, which will include a VTI. CNTEX will undertake the engineering design of the institute, formulate training/ degree programs, and develop curriculum and criteria for selection of faculty. It will also oversee the operational management plan of the university

In addition, the QAAP will have labour colonies for which 200 acres of land had been earmarked initially. The process of acquiring this land has been given to District Coordinating Officer (DCO) Sheikhupura, who will hand over the land to the Labour Department after acquiring it. The proposed colonies will have the capacity to construct flats for 9,500 families or hostels for 40,000 persons. The QAAP was proposed to be a special economic zone in accordance to the Special Economic Zone Act of 2011. The status of a special economic zone has been approved now. The QAAP will have a one-window operation under which all agencies will have branch offices in the park to ensure efficient processing of paperwork and ease of doing business.

2.2.3 Current Status

Work has started on QAAP sites. The boundary wall and the temporary office sites are being constructed. The M-2 interchange design has been completed and the land for QAAP has acquired. CNTEX was hired to design the park, which has been completed and submitted. Hiring of a contractor for construction of the park was recently in process. The estimated cost of QAAP is Rs 42 billion, with Rs 18 billion allocated just for infrastructure. Part of the cost will be financed through a returnable loan given by the government to PIEDMC (Rs 9 billion). The remaining balance will be arranged by PIEDMC through the Bank of Punjab. Once the land is sold to firms and profits generated, it will be used to pay off the loan. However, the government has taken up some of the financing, such as the cost of roads and labour colonies, directly.

The aim of building the QAAP is to integrate in one industrial estate the entire garments value chain, currently fragmented in different locations. The garments sector will benefit from the spillovers of locating different operations ranging from fabric manufacturing to dyeing, printing and accessory manufacturing.

2.2.4 Firms’ Perspective on QAAP

There has been conflicting feedback on the establishment of the Apparel Park. While some firms are eager to buy land, others do not deem it as a realistic proposition. These fears stem mainly from the fact that all terms of setting up QAAP have not been met as it is being operationalized. Several concerns were raised by the firms.

Previous experience with industrial estates, such as Sundar, has discouraged firms from buying land in QAAP. They are afraid that the promise of uninterrupted electricity supply will not be upheld. They feel that energy supply plans have been erratic and unrealistic, particularly the plan to build a coal power plant. They also assert that the promised benefits such as expedited customs and streamlined regulations are not realistic and will not be realized.

CEO at firm L2 says:

> *“I feel that unless there is infrastructure, no one will relocate to the Quaid-e-Azam Apparel Park.”*

However, in April 2016, the CM declared QAAP as a Special Economic Zone. This is a step in the right direction as the CM himself explains[7]:

> *"Industrial activities and investment will increase once special economic zones are set up. All facilities will be provided to industrialists and investors on priority-basis in the province."*

SMEs, in particular, have not been given the right incentives to shift to the apparel park. Chairman PRGMEA explains the cost of shifting is too high, especially in the case where cheap skilled labour is not available it will be difficult for SMEs to bear the cost of training unskilled workers themselves. However, the plan to have a vocational institute can help address some of SMEs' concerns related to skilled labour. Moreover, according to PIEDMC the advantages gained from tax holidays and cheaper land will help lower the SMEs' costs. Investing in an industrial estate will increase firms' credibility with foreign clients, as they will be considered compliant to laws and regulations.

Whereas investing in industrial estates can have a positive impact on the firms' credibility, similar projects in other cities have not been successful. The Head of Human Resource of firm L2, commented on the earlier garments city projects that did not succeed:

> *"They failed because the Garments City Board had no representation of private firms, only bureaucrats. They (bureaucrats) develop their own interests and they don't understand these initiatives."*

The original timeline specified QAAP would be operational by August 2015. However, the timeline has been pushed by more than a year due to frequent changes in the management of the project. Essentially, the boundary wall has been built and the offices are on site. However, key international contractor remains to be selected for the main construction, which is planned to commence on April 2017 as per Public Procurement Regulatory Authority (PPRA) rules. [8]

Table 2: Timeline for QAAP

Description	**Completion Date**
Procurement of Consultant	23 Dec 2016
Road Shows	1st Week Jan 2017
Advertisement for Contractor's Prequalification	10 Jan 2017
Submission of Pre-Qualification Applications	10 Feb 2017
Submission of bids	31 Mar 2017
Award of Contract & Ground Breaking	30 Apr 2017

[7] *The Express Tribune*
[8] Mr. Sajid Saleem, Board Member QAAP Committee

Based on the firms' feedback, QAAP is more likely to attract large firms and may not be attractive to SME's. But this, as well the success in attracting foreign investment, will be best assessed after infrastructure investments are undertaken and a few firms begin to locate to the cluster.

2.3 Skills

Taking up another recommendation of the last phase of study, the CM setup a sub-committee on skills for creating a better skilled workforce and addressing the shortage of formal Vocational Training Institutes (VTI).

TOR's of the Sub-Committee on Skills:

a. Identify areas of skills deficiency (such as middle management, the logistics chain specific skills on the production line etc,) in the industry.
b. Identify steps that can be taken by the Punjab Skills Development Fund (PSDF) to respond to the industry's needs.
c. Develop a work plan with clear timelines and deliverables for a) and b).

The PSDF steers the sub-committee on skills along with members from the Pakistan Readymade Garments Manufacturers and Exporters Association (PRGMEA), Punjab's Technical Education and Vocational Training Authority (TEVTA), and the Punjab Vocational Training Council (PVTC). The private sector has significant representation and includes some major garments manufacturers, including Style Textile, Nishat Mills, Cotton Web and Delta Garments, while members of Raaziq International represent the perspective on logistics[9].

An initial meeting of the skills committee was held to propose a short-term action plan:

[9] Raaziq is Pakistan's leading logistics and ancillary services provider. It provides customers with tailor-made solutions for their unique supply chain challenges, including air and ocean freight forwarding, custom brokerage, intercity transportation, cold chain process management, warehousing and distribution.

1. PSDF would conduct a workshop that would allow interaction with the industry to ascertain its immediate need for specific skills in the industry.
2. A 'Skills for Garments' scheme would be initiated to offer training courses based on the feedback from the workshop. PSDF would accordingly dedicate funds for this during its scale up.
3. A ''Garment Sector Study" would also be initiated by PSDF to explore the medium term skill requirements of the industry.

Timeline of Skills Meetings

Sr#	Meeting Date
1	**17-07-13**
2	**23-07-13**
3	**22-08-13**
4	**22-10-13**
5	**10-11-13**
6	**10-01-14**

A number of initiatives were undertaken as part of the process initiated with the establishment of the skills committee. Some of the important developments with regards to skill training are:

Training providers: The establishment of PSDF in 2010 was an effort to improve the skills training industry. Before its inception, players such as Technical Education and Vocational Training Authority (TEVTA) and Punjab Vocational Training Council (PVTC) were the only public sector organizations responsible for skills training. However, the garments industry was not satisfied with the standard and volume of trainings that were being provided. PSDF, with its independent board and demand driven mode of skills provision, has now created the expectation of higher standard of service delivery in this sector. PSDF is a unique model as it does not provide trainings itself, instead it funds its provision by other training institutes in the public, private and non-profit sector. It also engages the industry to provide these trainings.

To streamline implementation of the training strategy, each organization was assigned a particular role. Overall supervision and guidance was to be provided by PSDF, that is, responsibility for executing the TORs and following up on the road map developed. It would also finance the training to be provided by the garments manufacturing firms. TEVTA was given the role of developing the curriculum and providing training through PSDF's and its own resources. PVTC was tasked to strengthen its capacity to deliver trainings for the garments sector. At the same time, PRGMEA would ensure that the industry is supporting the skills initiative and would provide input to the sector study and curriculum development. It would also provide skills training through Pakistan Readymade Garments Technical Training Institute (PRGTTI).

Skills Workshop: PSDF's model differentiates itself because its schemes are vigorously demand driven. Since it encourages training provision by the private sector, courses offered under its schemes are based on evidence of need. To identify these needs, PSDF conducted a 'Skill Needs Assessment' workshop, for the garment sector in September 2013. It was hosted by PSDF in collaboration with PRGMEA, the latter helped to design and organize the training. Pakistan Hosiery Manufacturers Association (PHMA) also took an active part in it. The workshop specifically focused on identifying human capital deficiencies at the worker and middle management level. The workshop was represented by all segments of the garments industry - small, medium and large - under one roof. Representatives from the garments industry were requested to:

a. Estimate a target number of trainees for the short and long term.
b. Provide feedback on the development of the curriculum.
c. Develop linkages with training institutes for training.
d. Undertake assessment and job matching.
e. Provide on the job training.
f. Offer jobs to the trainees.
g. Share feedback on their quality.

The workshop agenda consisted of sessions that targeted different garments categories (woven, knitted, sportswear, technical wear, etc.) and logistics, warehousing and international freight forwarding. An industry expert led each session. The participants filled a short structured questionnaire to identify their firm's status with regards to skilled labour. Industry representatives also carried out detailed discussions on open-ended questions, shared with them prior to the workshop and highlighted key hurdles faced by them.

The workshop allowed industry trends to be identified and for firms to make recommendations to address the skills gap. Firms identified that the existing selection of courses on offer were inadequate and demanded new courses in areas such as industrial engineering, merchandizing management, stitching supervisors, hand-embroidery for knitwear, and denim washing and special effects. They also identified a strong need for well-trained industrial stitchers. The participants highlighted the absence of linkages between training institutes and the industry. It was further pointed out that workers with higher skills, like designer graduates from universities and institutes that would add value to garment exports, were not being directed to the export market.

Based on this feedback an action plan for skills training was developed and used in the design of a garments related skills scheme.

Skills study: PSDF also commissioned a Garments Sector Skills study to survey the garments sector. The study identified both current and potential skill deficiencies, which if addressed, would enable Punjab specifically and Pakistan generally to tap into a bigger share of the global garments market. For this purpose, PSDF hired the services of an independent firm to administer a comprehensive survey covering 250 garment manufacturers, divided across woven and knitwear firms, 25 training service providers (TSPs) and 50 business experts. The study maps the garment sector in terms of size, revenue trends, product compositions, plans for capacity enhancements and other aspects.

It highlights that the garments sector consists mostly of small and medium sized entities, with few large-scale integrated value chains in place. It also shows that the training providers are mainly concentrated in Lahore, which has 64 percent of all training institutes. The study points out that only 32 percent of the firms have a formal system in place to train their workforce, from which they are able to tap into only 4.36 percent of the existing workforce. Only 33 percent of the firms providing training have a system of allocating budget specifically for training purposes. 52 percent of the firms do not believe in the need for any specialized internal training system and consider it a waste of organizational resources, while the remaining declare lack of resources as the major reason for not undertaking the training activity.

The study also emphasizes the proficiency level of the workforce and rates 63 percent of the firms as possessing workers with "average skills". This signifies the immediate need to redesign training programs to match the proficiency level of the workforce of competitor countries like China, Bangladesh and Vietnam. It further identifies underlying reasons for the lack of adequate skills in TSP graduates, which point to lack of coordination between industry and TSPs at different stages. This lack of coordination starts from the design of the curricula to the placement of graduating students, limited and outdated training infrastructure of TSPs and untrained trainers. Thus, the sector study provides clear evidence for developing a skills-for-garments roadmap for medium to long term. It has aided PSDF in allocating courses for its schemes, based on demand. Furthermore, the study can potentially improve curriculum development particularly in terms of filling the gap between supply and demand and can, therefore, be used by TEVTA and PVTC.

Skills for Garments Scheme: Following the 'Skill Needs Assessment' workshop, PSDF successfully launched the' 'Skills for Garments' scheme in 2013. Under this scheme, PSDF started its first program for training over 9,000 individuals using a private-provision government-finance model. The 14 skills training providers in this program included some of the country's largest garment manufacturers (such as Crescent, Nishat, and Style textiles), the Pakistan Readymade Garment Technical Training Institute, and public sector training institutions such as TEVTA and the PVTC.
Before the scheme, skills trainings for the garments sector were very limited. GAMTI, an existing facility of TEVTA, was one of the few centres dedicated to garments sector trainings. However, with the initiation of this scheme, PSDF offered an extensive variety of garments related courses (around 35 different courses). It allocated 24 percent of its funds to all garments related courses. These courses go beyond the basic industrial stitching machine operator course and include trainings on computer pattern design, fashion designing, pattern drafting and cutting, production planning and control, quality control in garments, knitting machine operator and apparel merchandizing. The aim of introducing these courses was to equip firms to become more competitive in the global market.

With the introduction of this scheme, the number of students graduating from all garments related courses has increased. In 2013-2014, before the “Skills for Garments” scheme was launched, few students were completing garments related courses. Since then, as table 3 below shows, the number of students graduating annually has increased to almost five thousand.

Table 3: Total individuals trained from garments related schemes

Year	Total Trainees
FY12-13	118
FY13-14	339
FY14-15	4,793
FY15-16	4,885
Total	**10,135**

PSDF initially started skills training in southern Punjab, particularly in Bahawalpur, Bahawalnagar, Lodhran and Muzafargar in 2012-13 and 2013-14. As the total number of trainees from all courses was low, it was also low for garments related courses. When the skills for garments scheme was started in 2014-15, PSDF expanded to Lahore and Faisalabad, the two hubs for garments industry. As a result there was increased demand for garments related trades, which raised the pool of trainees. However, this pool plateaued in 2015-16. PSDF argues that this was due to lack of expansion to other cities. It is now expanding to all cities of Punjab, including Sialkot. In Sialkot, training providers have not yet penetrated the market, thus, firms in Sialkot train workers on their own or rely on workers travelling from other areas. Moreover, acquiring skilled workers for sportswear is difficult, since it requires a different skill set. Therefore, PSDF’s entry in Sialkot will address these issues and help them reach their target of 10,000 trainees in garments related skills in 2016-17.

Another reason given by PSDF for slowdown in the process of scaling up was the hesitation of firms to become Training Service Providers (TSPs). While all relevant institutes are being used as TSPs, private sector participation is low. Initially, only PRGTII and TEVTA were offering limited garments related skills. However, the industry did not feel that the quality of their trainings was up to the required standards. Thus, when PSDF entered the market, they had to fight against this stigma associated with existing government training provision. The industry did not want to participate in their scheme. So very few TSPs from the industry came on board initially. Firms’ hesitation also stemmed from their unwillingness to go through the bidding process and the lack of confidence in receiving long term funding. Furthermore, for some firms as long as they were located in an area where skilled labour was readily available, on-job training was sufficient and they saw no need to become a TSP.

Overall, the feedback from firms on the Skills for Garments scheme collected in Phase II of the study remains mixed. While many firms see value in the program, others felt more needed to be done for training to contribute to product improvement. Skills related to new fashion trends are not available and PSDF trainings need to focus on introducing these skills. This will allow innovative techniques to develop more complex and higher value addition products. PSDF management states that it is open to initiating new courses based on demand from firms.

Another reason the industry has been hesitant in taking part in these trainings is because of the huge opportunity cost involved in putting resources aside for training. Firms would need to invest in teaching tools, such as machinery and raw materials. Thus, only large firms are participating in this scheme as they can bear these costs and they benefit the most since they take in most graduates[10]. Smaller firms cannot afford this cost. However, even some large firms that are able to invest hesitate because they do not want their processes to become public. This is particularly the case when they have big clients. However, PSDF is starting to overcome these issues by demonstrating their success with big names such as Masood Textiles and by partnering with smaller firms.

A Firm's Experience with PSDF

According to firm L9, a large knitwear firm in Lahore and an initial VTI with PSDF, some changes are needed for a more rewarding partnership with PSDF. PSDF imposes a minimum requirement of 3 months' training. This firm generally takes up to a month to train the labour itself. Furthermore, the stipend offered by PSDF was insufficient for a firm that has to comply with minimum wage law. This meant that about 40% of the cost had to be covered by the firm itself. In terms of the curriculum, firm L9 should have the flexibility to choose the courses best suited to its needs.

PSDF is currently talking to firm L9 in order to address their concerns. With regards to the period of training, PSDF has designed the general terms in a way that can be applicable for all types of training. Hence, it suggests one month for classroom training and two months for on the job training. PSDF also allows flexibility in curriculum as long as it is approved by TEVTA.

TEVTA's Contribution to Skills Development: A protocol was signed in December 2013 between Turkish Cooperation and Coordination Agency (TIKA) and Industries Department, Punjab for collaboration in the skills sector. A "garment institute" was to be setup in one of TEVTA institutes as a pilot project, with TIKA experts providing technical and financial assistance for developing the scope of studies, teaching learning

10 Firm L9

materials, training of trainers, international accreditation, machinery and equipment as well as providing technical assistance for refurbishment / up gradation of existing buildings and labs. The funding for this project would be TEVTA's responsibility. There were two visits made by TIKA experts to Punjab in December 2013 and May 2014 to assess the feasibility for setting up a Training Centre. The second team inspected potential sites for the garment institute. They also visited business enterprises, local industry representatives, officials from chambers and private training service providers in Lahore and Faisalabad to assess the needs of the garment industry. TIKA has agreed to the proposal of housing the Garment Training Centre in GATTI (Government Advanced Technical Training Institute) in Sunder Industrial Estate.

TEVTA's agreement with TIKA was at a standstill in the last two years. TIKA changed its agreement from setting up a holistic garment program, to focusing mostly on Denim Finishes. There was also a delay in the establishment of the lab at GATTI, Sunder Estate due to political changes in Turkey. The political turmoil, thus, brought changes in commitments of the Turkish Government. However, work has started again. The training centre has been setup and will be operational in 2016.

TEVTA currently has limited trainings related to garments and offers very basic courses. There are no courses that can help firms move up the value chain. For instance, in 2015-16, 841 students were enrolled as industrial machine stitching operators and 204 for machine embroidery. There is no other garments relevant course being offered. With TIKA establishing a centre, the proposed capacity of trainees for industrial machine stitching operators is expected to increase by 1000. It will also help denim manufacturers to become more competitive in the global market.

However, firms have raised the concern that standards of TEVTA trainees are not very high.

Future of the Sector: PSDF explains that their effort to involve the industry in reducing skills shortage is a gradual process. The number of TSPs doubled from the initial 14 to 28 in the Skills for Garments scheme, but the increase was due to participation of universities and institutes instead of firms. Efforts are now being made to induct more training providers from the industry. For this purpose, PSDF has launched a separate scheme "Skills for Industry 2016" where only industrial entities/ establishments can offer trainings. Under the scheme, out of a total of 42 qualified organizations, 24 entities are from garments sector. This increase has come after the industry witnessed how the PSDF model was different from other government training provision and that the standard of trainings was under industry's own control.

Skills that push firms higher up the value chain, such as merchandizing, were not offered prior to the Skills for Garments scheme. Once this scheme was implemented, there was a steady demand for these courses, particularly merchandizing management techniques, in 2014-15 and 2015-16. For fashion design related courses, there were initially eight courses available in 2013-14, but enrollment was low (317). After the skills for garments scheme, these courses went up to 20 with 1225 students enrolled. The sophistication of these courses has also changed, with new courses offering computerized pattern designing and cutting. Courses on production planning and quality control, which were offered in the Skills for Garments scheme, were also offered to help firms push to the next frontier

Firms in Phase II of the study also identified the need for skills such as dyeing, printing and knitting. This is important for improving quality and reducing rejections that occur due to colour differences in manufactured products. According to CEO of firm F1:

> *"Skill development has been confined to stitching operators. But we also need to look at gray areas in the industry. If our worker can stitch 100 pieces per day and a Chinese operator does 120 per day, improving that will not make much of a difference because the [labour] cost isn't that high. The cost is in the fabric making, in thread, dyeing and printing. That is where we need technical know how."*

They further highlight how middle and higher management continues to be a problem for firms because currently the only way to train management level employees is through on-job training. Training providers can offer courses related to computer skills or knowledge about imports/ exports for middle management. But they do not provide courses that enhance soft skills. Pertaining to the skills of his management employees, the CEO of firm L3 stated:

> *"A bigger problem is middle management and training them."*

Therefore, firms are looking to training providers to fulfill these needs in the future.

The interviews in Phase II also highlight that low female participation is limiting the labour pool. Many international clients prefer gender diversity, but the cost of training female workers is high in Pakistan. This is due to the fact that their turnover is higher than male workers and, therefore, firms are unwilling to hire and train them. They also require special perks such as pick and drop service and a salary system instead of per piece rate, which is costly for firms. Many firms do not yet see the productivity benefits of female workers. But many others do, as seen in higher female employment. Trained female workers will hasten the trend. Yet firms still face many challenges.

2.4 Energy

2.4.1 On-going Energy Crisis

Firms interviewed in Phase II reiterated some of the issues highlighted in Phase I, energy being one of them. Firms feel that the energy crisis remains one of the biggest challenges for the industry and little has changed in the last few years. The industry continues to operate at below capacity, with capacity utilization at less than 70 percent. For example, in 2015 most of the industry in Punjab experienced power outages of up to eight hours a day, while the supply of natural gas was limited for months during winters.

According to firm F2, while many large firms can afford to rely on off-grid electricity generation to meet their power needs, small firms continue to struggle. Not only have energy shortages considerably increased costs, but also resulted in increased uncertainty in terms of production planning. According to Director Operations of firm F3:

> *"The biggest issue is the energy constraint. We fear that if we take orders and we can't meet that order in time, our customer will leave us. And when we use alternative energy, it is too expensive."*

Vendors, generally small firms supplying materials and services to garment exporters, are less able to make alternate arrangements to deal with power and gas shortages. This can cause delays in the entire value chain and the possibility of such delays often leads to the exclusion of Pakistani firms from buyers' list of 'reliable' suppliers. Clients move their business to neighbouring countries where production uncertainty is lower. Pakistan is the only country, compared to Bangladesh, China and India, where electricity is not available to garment manufacturers 24/7. Tariff on energy in Pakistan is also much higher (Table 4).

Table 4: Cost of Doing Business in Terms of energy

	Bangladesh	China	India	Pakistan
24/7 energy availability to textile industry	Yes	Yes	Yes	No
Energy tariffs cents/KWh	7.3	8.5	9	14
Installed capacity utilization	90%	90%	90%	<70%

Source: Study funded by APTMA and conducted by IBA

The supply of electricity has increased marginally in the last 2 to 3 years (reducing load shedding from 12 to 8 hours a day) but not by enough. The problem for firms is compounded by existing policies and bureaucratic processes, which make it difficult for firms to find feasible alternatives. According to firm L1, firms that are generating their own electricity have the capacity to supply the excess to another factory but are not permitted to do so. Director operations at firm L1 highlighted this issue in the context of a new unit, which they have set up a short distance from the existing facility:

> *"Excess energy can't be transmitted out of the boundary walls of one factory without a power generation license, and to get that is a long process. I am trying to have this done for the last 2 years."*

From the experience of firm L9 (see box below) it seems that this regulatory hindrance is applicable not only to the power sector but to provision of other infrastructure as well.

Challenges faced by firms as Government creates Hurdles in Providing Infrastructure

The government has a fundamental role in providing energy and road infrastructure. However, firms in Punjab have taken this responsibility on themselves since the government is unable to facilitate them. Firm L9 reports that it has set up its' own power generation plant of 18MW and the firm is no longer dependent on the national grid. So far, the total investment in overcoming energy crisis for the firm has been PKR 1.2 billion.

In addition, the firm has also invested in constructing a bridge for better connectivity to the factory. It requested the government to widen the road leading to the factory. Several firms in the area were even willing to contribute to the construction costs, if the government could not. Yet, the government has been reluctant to take any decision. The firm also wanted to build a new factory and the government verbally approved construction in the area, saying the approval would come within 7 days. However, it has been months and the approval is still pending, while the construction of the factory is nearly complete.

In recent years, gas load shedding has also increased; further raising costs and production uncertainty for firms. In 2010 gas was unavailable for 100 days in a year and since 2014 this has increased to 260 days (on the SNGPL system). This has created another barrier particularly for knitwear firms. Firms generally outsource the dyeing of yarn to smaller vendors who do not have alternatives to cope with gas shortages, compounding the reasons that are forcing knitwear firms to shut down. Only large firms with in-house dyeing facilities have been able to cope.

In Punjab specifically, there is an energy demand-supply gap of about 4000 MW, which is increasing at a rate of 6 percent per annum.

2.4.2 Sub-committee proceedings

Since, Phase I of the study raised the issue of energy shortage and its impact on cost competitiveness of garments firms, the CM formed a sub-committee on energy and tasked them to embark on projects utilizing different sources of energy and methods.

TORs for the Committee on Energy

a. Provide recommendations and identify alternative means of resolving the energy crisis to the current interrupted supply from the national grid. This includes options such as captive power generation, uninterrupted power supply from the grid etc.
b. Earmark government interventions (standalone or in partnership with private sector) that can ensure energy supply to the garment sector.
c. Develop a work plan with clear timelines and deliverables towards resolving the energy crisis.

The committee constituted the following members: Secretary Energy, Representative of Mines & Mineral Department, Representative of Livestock & Dairy Development Department, Representative of Agriculture Department, Representative of Irrigation Department, Representative of WAPDA, Representative of National Electric Power Regulatory Authority (NEPRA), and private sector representatives (Mr. Shahzad Saleem (Style Textile), Mr. Saeed Alvi (Director Nishat Real Estate Development), Mr. Yousuf Abdullah (Sapphire group), and Mr. Tauseef Rana (Fatima group).

Timeline of Energy Meetings

Sr#	Meeting Date
1	23-07-2013
2	06-08-2013
3	22-08-2013
4	22-10-2013
5	10-11-2013
6	10-01-2014

Keeping in mind that the objective was to improve power supply to the garments industry, an action plan was proposed which would resolve the issues that the industry faces. The energy department took the lead and planned to involve Sui Northern Gas Pipelines Limited (SNGPL), National Transmission and Dispatch Company (NTDC), various DISCOs, NEPRA and Central Power Purchasing Authority (CPPA).

Proposed actions:

- Reduce processing time of new connections.
- Dedicate electricity feeders for the industry.
- Formulate dedicated wheeling policy.
- Standard wheeling documents like "Energy Wheeling Agreement" (EWA) to be prepared.
- Permit clubbing of gas connections.
- Sale of bulk power and joint schedule of gas and electricity load shedding in the proposed garment city.

Energy policy comes under the purview of the federal government and provincial governments have a limited role in policymaking particularly on the regulation of electricity. However, because of the pressure of the Punjab Government, in the last year or so, the textile sector has been given greater priority in power allocations and as a result the load shedding faced by the garments industry in Punjab has declined. In addition, during this period the power supply situation has improved slightly with a few new generation projects coming online and, because of major ongoing investments in the power sector, it is expected to improve significantly in the next couple of years. Under the China-Pakistan Economic Corridor (CPEC), a number of projects have been initiated in Punjab in which the provincial energy department will play an active role. These include, coal power plants of 1320 MW each being set up in Sahiwal and Rahim Yar Khan and the Quaid-e-Azam Solar Park, which is already generating power of 100 MW in its first phase and is to be expanded to 1000MW in subsequent phases as part of CPEC[11].

The Punjab government has also initiated a number of other projects in the public and private sectors. For example, small hydropower projects under Punjab Power Management Unit (PPMU) constituting up to 80MW are being setup and Taunsa hydel power under the private sector is underway with the aim of producing 135 MW. While these projects will improve the supply of energy considerably, they will take time to become functional. In addition, two LNG power projects are currently in the development phase in Balloki and Haveli Bahadur Shah, which would collectively produce 1,200 MW by the end of 2017.

The Federal Government has also introduced some policy initiatives, which could lead to a reduction in the impact of energy shortages. NEPRA issued a notification for countrywide net metering regime in 2015, which allows those generating their own power to sell their surplus production. A license from NEPRA is required for this. In addition, a new policy has been introduced on ‘wheeling’, under which NEPRA has now allowed electricity-generating companies (GENCOs) to sell directly to bulk power consumers (BPC). The consumers and generators can mutually agree on the price of electricity being supplied, to which is added the cost of transporting electricity or ‘wheeling’, i.e., for using the National Transmission and Dispatch Company (NTDC) and/or DISCO systems. This cost is to be set by the organizations involved and will be announced in advance The DISCO concerned will be responsible for maintaining the distribution system. This policy will reduce the load on the system and allow firms that have been producing surplus energy to be transmitted to its other factories or sold to other firms. According to the notification issued by NEPRA:

> *“With the new regulations, wheeling meters with technical specification specified by the DISCO will be installed at entry and exit points of DISCOs to measure the electrical power entering and exiting the DISCO network. Now many BPCs*

[11] http://www.dawn.com/news/1217587/solar-park-producing-12pc-more-power-than-target

including real estate projects and industrial zones can easily get uninterrupted power supply from a GENCO that falls in the DISCO jurisdiction."[12]

In addition, the Energy Department, under its Energy Efficiency and Conservation program, is increasing its focus on energy audits in Punjab. Under this initiative, a team of specialists from Germany was invited to conduct energy audit trainings in Lahore in July 2016. This training targeted domain specialists, electricity inspectors, and people in the industry. The PSDF was also engaged for such trainings. The department is planning to target the garments sector in particular. By involving associations such as PRGMEA and the Chamber of Commerce for each city that is an industrial hub, the government plans to encourage the industry to undertake energy audits. The garment sector would benefit from energy savings, which would potentially translate into financial savings. It would also help them improve their reputation with global buyers, as it would show the buyers they are energy efficient and environmentally conscious.

Recently, there has also been some improvement in the availability of gas to the industry because of the initiation of LNG imports. Engro Energy Terminal Limited has set up the first LNG terminal at Port Qasim, where Pakistan receives LNG from Qatar and Gunvor. Imported RLNG is being transmitted through existing networks of the Sui Southern Gas Company and Sui Northern Gas Pipelines Limited, and currently the textile industry in the Punjab is getting 35MMcfd[13] of LNG, which supplies energy for four hours per day. The textile industry is requesting for 300MMcfd LNG supply to meet 24/7 requirements of the textile industry. Major investments are underway in new LNG terminals and pipelines so it is likely that in the next couple of years there will no constraint on the availability of gas for industry. However, issues of cost and regional inequity will need to be sorted out for this problem to be fully resolved as natural gas prices (being paid by the industry in Sindh) are only Rs 600 per MMBtu while Punjab-based industries are being charged about Rs 900 per MMBtu of RLNG,

There is no doubt the firms interviewed in Phase II pointed out that the energy crisis continues to be one of the biggest impediments to the garments industry, but a number of initiatives to address the crisis are being undertaken by the Government and it is expected that in the next couple of years there will be a noticeable improvement in the availability of both power and gas for the industry in the Punjab.

2.5 Trade Policies and Custom Procedures

2.5.1 Committee on Trade and Customs

Many of the firms surveyed in Phase II experienced problems pertaining to trade policies that were also pointed out by firms surveyed in Phase I. This section first outlines the TORs of the sub-committee formed on trade policies by the Chief Minister and progress

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[12] http://www.dawn.com/news/1264044

13 Million cubic feet per day

made under each TOR. It then highlights the continuing problems firms face concerning trade policies and custom clearance.

TORs of sub-committee on trade policies

In Phase I, the private sector highlighted the importance of ease in custom procedures and tariff regimes. At the instruction of the Chief Minister, a sub-committee was formed on trade policies, for which the TORs are as follows:

a. Assess if the revenue loss from zero rating re-export items necessary for garments manufacturing, is worth the potential benefit generated for exporters.
b. Identify bottlenecks in processing import duty refunds and simplify procedures.
c. Develop a work plan with clear timelines and deliverables in light of the above.

The members of the sub-committee include: Secretary Finance, Representative of Industries Department, Representative of Ports & Shipping Department, Representative of FBR/Customs, Sohail Afzal (Sialkot Chamber of Commerce), Waseem Akhtar Khan (Cottonweb), Sajid Saleem (Chairman PRGMEA), Tariq Mahmood (Raaziq). The committee met regularly in the early stages, however the meetings have not been active since then.

Timeline of Trade and Tax Policies Meetings

Sr #	Meeting date
1	23-06-2013
2	12-08-2013
3	22-08-2013
4	22-10-2013
5	10-01-2014

Consistent with the third item of the TORs, the sub-committee created an action plan with the objective of reducing product delivery response time and costs. The plan required actions to be taken by FBR (Member Customs), Ministry of Commerce (Secretary Commerce), Secretary Narcotics Control, while Industries Department would coordinate.

Proposed action:

- 24/7 Customs clearance service.
- Implement Web Based One Customs[14] (WeBOC) system for custom clearance.
- Open IOCO (Input Output Coefficient Organization) office in Lahore.

[14] WeBOC is the paperless Pakistan Customs system that provides real time integration of agents, brokers, terminal operators, cargo handlers and customs.

- Declare low tax yield HS Codes e.g. tags as [import] duty-free.
- Allow wastage of fabric [imported for re-export] as per international standards in calculating firm costs.
- Set & implement time bound framework for settling return of Indemnity Bonds [provided against imports for re-export]
- ANF to set & implement time bound framework for clearance procedure

2.5.2 Progress on Sub-committees' Proposed Areas of Action

Based on first and second items of the TORs, the surveyed firms were particularly questioned on the tax regime and custom clearance system that exist for the garment industry. It was identified that a higher duty was levied on raw materials compared to other countries and that led to more expensive final products for the local exporting firms. In addition, there were holdups in processing import duty refund that involved financial and time costs. These delays lower competitive advantage for local firms.

Import Duties and Tax Policies

In Phase I report, one of the key constraints identified to the growth of garment exports was the failure of the government to provide exporters with easy access to imported raw materials at world prices. Despite efforts of the CM Punjab to connect garment exporters with FBR to resolve this problem, no improvement has taken place so far. Import of fabric and yarn is allowed under Duty and Tax Remission Scheme (DTRE). However, this requires approval from IOCO of the input-output ratios and permitted wastage allowance to determine the quantities of raw materials that can be imported. This increased the required lead-time by 35-45 days on export orders for firms, but as the only IOCO office was in Karachi the lead-time for Punjab based firms was even greater. On the intervention of the CM, following Phase I, an IOCO office was opened in Lahore. However, the situation with regards to delays in getting permission for importing raw materials hasn't improved, as the Lahore office has to refer everything back to the Karachi office. An additional issue, pointed out by firms interviewed in Phase II, is that garments produced using these imports have to be exported within a year or FBR can encash the post-dated cheques (equivalent to the value of import duties exempted) deposited at the time of import of the raw materials. Due to the energy crisis and other barriers, firms often have difficulty in exporting the entire quantity within a year. Extending the permissible period through FBR takes time.

Garment firms in Sialkot specialize in export of sportswear because of their traditional market links with the sports goods sector. Lycra, the main raw material used in sportswear, has to be imported from China since it is not readily available in Pakistan. Besides problems with the DTRE scheme discussed above, firms in Sialkot raised another issue. They pointed out that importing raw material from China takes time. However transport time could be reduced if these materials were imported from India. Materials like polyester are on the negative list for trade with India. According to Director Operations at firm S5:

> *"We have setup an office in China to solve our problems rather than develop something here. But customers are also reducing their time for orders and then it takes time for us to order from China. And we can't even import polyester from India because it's on the negative list, which could make things easier for us in reducing our lead time."*

Due to such cumbersome procedures and high duties on the import of artificial fibres and PTA (a raw material for the manufacture of polyester) the garments industry has been unable to move from the existing cotton concentrated 80:20 mix in its exports. Global trends demand that Pakistani firms move to a 50:50 mix to stay competitive. High duties on the import of yarn or fabric made from artificial fibres also prevent firms from diversifying their product range or reaching out to new high-end clients.

Firms also face the problem of having to first pay import duties on small items such as tags, zips and other trimmings used in manufacturing of garments and then getting these refunded after exporting the garment. These items have to be imported because of the specifications of clients, usually from suppliers nominated by the buyer. Since they have a low tax yield for the government and claiming refund for them is a hassle for firms, garment exporters have been demanding removal of this tax. Despite, several meetings between exporters and FBR on this issue facilitated by the Punjab Government there has been little progress in this regard.

An additional barrier that has arisen recently is that the government, in response to the demands of the spinning industry, has imposed a duty on imported cotton yarn ranging from 5 to 15 percent. According to Matrix Sourcing, the cost of yarn on average is one-third of the total cost of the garment and, therefore, if the import duty is 15 percent more in Pakistan than is in its competitors such as Bangladesh, its final product becomes 5 percent more expensive than Pakistan.

Finally, taxes paid by exporters on local raw materials are eligible for refund but significant delays and costs are involved in the refund process, which at minimum is 10 percent of the value of the claim. Such additional costs lower Pakistan's comparative advantage. According to CEO at firm F1:

> *"As you know we give sales tax on the raw material we buy and then we ask for refund if we export it. But for a genuine claimant you have to give 10 percent to the lawyer who files the claim on your behalf. If you go yourself, then you have to bribe everyone at every step of the way, starting from the guards at the gate, then the peons."*

To address this issue of delays in sales tax refunds, in the last budget speech, June 2016, the Finance Minister, Mr Ishaq Dar, announced a zero-rated tax regime would be applied to five major export-oriented sectors, including textiles, leather, carpet, sports goods, and surgical instruments from the next fiscal year. Under this scheme, the government will zero-rate local as well as imported supplies that are re-exported. Until a few years ago, these sectors were under a zero-rated tax regime, but based on FBR's arguments that exporters were also selling these goods in the domestic market, it was decided that these sectors would be taxed and refunds would be paid upon verification of export receipts. However, the problem of these refunds being blocked by the FBR, sometimes for over a year, resulted in a chronic liquidity crunch due to increased working capital requirements of these sectors. Despite FBR's opposition for the proposal of zero-rated tax regime, the announcement was finally made to reinstate this regime, particularly following a decline in exports. The garments exporters believe that while the regime is a great step forward, it will not immediately solve their problem because refunds worth billions of rupees are pending with the FBR.

To boost exports, the Prime Minister announced, in January 2017, a new incentive package for exporters. The package includes removal of both customs duty and sales tax on the import of cotton, of customs duty on man-made fibres other than polyester and of sales tax on the import of textile machine. In addition textile exports will be eligible for duty drawbacks at the following rates: garments 7 percent, textile made-ups 6 percent, processed fabric 5 percent and yarn and grey fabric 4 percent - other manufactured exports such as sports goods, leather and footwear will also be eligible for a duty drawback of 7 percent[15]. However, to receive these incentives, the government has placed the condition on exporters to increase exports by 5 percent from January to June 2017 and then by a further 10 percent during FY 2017-18[16]. According to firms, even though a package of this sorts was seriously needed it will be difficult to show an immediate increase in exports as a lead time of three to five months between getting new orders and actual shipment of goods is usually required. Also, as there will be an increase in the domestic price of yarns and fabrics due to the duty drawbacks on those items, and since these constitute about 50 percent of the cost of a unit, the full benefit of the 7 percent rebate will become diluted. Despite, these reservations, most exporters agree that this is a timely intervention, and it provides some breathing space to garment exporters to invest into fundamental improvements.

Custom Clearance

The previous study identified the absence of a 24/7 custom clearance facility as a major bottleneck in delivering orders on time. As mentioned earlier, even though this facility is officially available, staff is commonly absent and collectors available only five days a

[15] http://www.dawn.com/news/1307569/pm-announces-rs180bn-incentive-package-for-export-sector

[16] https://www.thenews.com.pk/print/178324-Rs180-billion-package-announced-for-exporters

week. In addition, the offices are also under staffed. As mentioned earlier, the Sialkot port also takes longer than a day (often three days) to clear consignments due to lack of scanner facilities. The Anti Narcotic Force (ANF) takes around two days to clear shipment marked by them. Sometimes factory owners are forced to send their shipment by air to avoid delays. Often marked shipment is repackaged improperly at Sialkot and Karachi after being checked. According to CEO of firm L3, ANF's clearance method had serious consequences for his business:

> *"Our products were trodden upon and thrown. You can see the footprints on them and I can't describe how badly it was left after they were done. And I can show you pictures as evidence. We used these pictures to complain to the authorities, but no one took any action. You can see the email chain I have sent. And as a result my customer stopped doing business with us. It was a huge setback."*

Of the seven actions proposed by the sub-committee on trade policies and custom procedures, there was slight progress in two areas; provision of a 24/7 customs clearance service and opening an Input Output Coefficient Organization (IOCO) office in Lahore. For the other five areas progress was negligible. The Punjab Government facilitated a number of meetings between private sector representatives and FBR, particularly with regards to exempting low tax yield HS codes, such as tags and trimmings, but FBR resisted making any relaxation in the import regime for exporters. However in 2015-16 due to the rapid decline in exports and resulting pressure on the balance payments, the government did provide a number of incentives to exporters that should improve their competitiveness and volume of exports in the short term. However, the need to address underlying problems such as providing duty free access to raw materials for exporters and a more business friendly custom procedures remains a fundamental concern.

3 Conclusion

Phase I of this study presented the case that garment manufacturing was well suited to Pakistan's comparative advantage, being the most labor intensive, least energy intensive and highest value added segment in textiles, where textiles account for over 50 percent of Pakistan's total exports. Garments manufacturing can contribute significantly to Pakistan's objective of creating modern, well-paying jobs and at the same time improving the trade balance.

The focus on garments, if anything, is even more important today as, since the Phase 1 report was written.

Employment in Pakistan's large scale manufacturing sector has stagnated while overall exports declined considerably since the last study was complete. However garments exports have continued to grow. Garment exports accounted for over one-fifth of total exports by 2015. Earlier report also indicated towards a window of opportunity that may be opening up for Pakistan as China withdraws from this sector mainly because of rising labor costs. Since then China's garments exports have declined by 6 percent as of 2015 indicating and must Pakistan must gear up to take its place. In 2014, China's garment exports were over USD 170 billion and even a small percentage decline in its exports would translate into a substantial increase in the market available to other developing countries, including Pakistan. There is also increasing evidence that China's garment industry has begun to relocate to other developing countries and Pakistan should be able to attract some of this industry especially as CPEC materializes. However, Pakistan can only seize this opportunity if it stays competitive in terms of production costs, availability of energy and ease in importing inputs and exporting garments. The ability to address the concerns raised in Phase I of the study is of considerable relevance to this situation. Phase II primarily focused on assessing progress on this front and identifying critical policy gaps.

The key action areas identified in Phase I include a) market access b) cluster development c) skills, d) energy and f) trade policies and custom procedures. Phase II tracked progress along these dimensions and found it to be uneven. In terms of *market access*, attainment of GSP+ was a major step forward and in many ways the most important factor in sustaining growth in Pakistan's garments industry since 2014. This can be a major attraction to Chinese manufacturers looking to relocate some of their production outside their country, further reinforced by planning Special Economic Zones and introducing incentives to Chinese investors under CPEC.

The second area that has seen progress is *cluster development*. As discussed, Quaid-e-Azam Apparel Park (QAAP) is an ambitious initiative on which considerable progress is being made and it seems probable that by 2018 a large part of the project would be operational. This, together with GSP+ status and incentives under CPEC, can be a game changer not only for the garment industry but possibly for the entire textile chain. If a few large Chinese garment exporters successfully set up manufacturing facilities in QAAP, it will change the perception that Chinese businesses have about Pakistan. As a result other garment manufacturers, currently relocating to Vietnam, Cambodia, Myanmar, etc., will consider Pakistan as a viable option. Once this process starts it is likely to spillover to the rest of the textiles sector, resulting in growth in Chinese investment particularly in areas where there is considerable existing demand, such as synthetic fibres, or where Pakistan is already a major player, such as denim fabric and home textiles.

In two of the remaining three other areas, Skills and Energy, there has been some progress and it seems likely that in the next two to three years more concrete steps would have been taken to address the shortfall. In *Skills*, PSDF is well positioned to rapidly expand programs to meet the needs of the garment industry. As the PSDF model facilitates provision of skills training through providers in the private and public sector, it results in the development of a skills training sector that is both sustainable and able to respond effectively to evolving needs of the garment industry. In the area of *Energy*, while there has not been a substantive improvement in the current situation, huge investments are being made in power generation, transmission as well as in imported LNG infrastructure. These investments are like to start having a significant impact by end of 2017. The energy crisis, which began almost a decade ago, could be more or less over in a few years. This would imply that the textile industry would no longer be subject to significant power and gas load shedding. However, the price of gas may be substantially higher than in the past.

Unfortunately, the area *Trade Policies and Custom procedures* saw little progress. Despite best efforts of the Punjab Government, import of raw materials remains just as heavily regulated as before with no improvement in the workings of the customs department and the ANF. This anti-export bias seems to be compounded by government's exchange rate policy of maintaining a soft peg with dollar and resulting appreciation of the currency. The recently announced government incentive package to boost exports only treats the symptoms and does not address the underlying problems identified in Phase I. The proposed special economic zones under CPEC may provide a partial solution by providing garment exporters with easy access to raw materials at world prices and a business friendly custom procedures environment. Going forward policy reforms in this area should be the main focus of efforts (by the government and private sector) to promote Pakistan's garment industry.

4 Annexure A

Garments Phase II Questionnaire

Date: **Filled by:**

1. **<u>General</u>**

i. Name
Address
Phone
Email

ii. What is the date of establishment?

iii. Type of products manufactured?

iv. Please provide a little history of your firm.

v. What is your organizational structure? Is it a joint venture, family owned, public limited etc.?

Who makes all the major decisions? Owners or management?

vi. How would you classify yourself? Large, medium, small (according to scale of production, number of employees, number of machines)?

vii. Has the scale of production increased over the years? What are the problems you have faced in increasing the scale (capacity constraints vs. demand constraints)?

viii. Do you export? Which countries do you export to? (Products and countries % share of the 2 to 3 most important in each case) Has your market shifted/ expanded after GSP+ status was granted?

ix. What was the revenue generated by your firm last year?

x. Export value for last year in units and monetary terms.

xi. Who are your competitors? (Exporting countries)

xii. How would you describe your value chain? (Specify Knit or Woven)

(Yarn -> knit -> dye -> cutting -> embroidery -> printing -> stitching -> finishing -> packaging -> export?)

What is the value created at each stage:
What is the cost at each stage:
What is the most binding constraint in the value chain?

xiii. Which stages are labor-intensive and which are capital intensive?
xiv. Are you vertically integrated?

If vertically integrated, why so? Is it helpful in meeting international compliance standards?

Is growth constrained in the absence of vertical integration?

xv. Is demand a constraint to your growth?

xvi. Do you outsource? Yes/No.

a. Why?

b. Problems with Outsourcing.

2. Inputs

Raw Materials:

i. What are your major raw materials?

ii. What are your major trimmings?

iii. Do you use imported or local trimmings and raw materials?
Why import? Where do you import from?
What are the problems faced in importing? Are they easily available?

iv. How do you choose which firms to buy from?

v. What are the major constraints that you face? (Quality issues/ price issues/ time delays?)

vi. Do you use better cotton or organic cotton?

Machinery:

i. Number of Machines

ii. What are the major machines? Knitting, dying, stitching, finishing etc.?

iii. What is their value?

iv. Are the machines local or imported? If imported, then where are they imported from?

v. Where does repairing of your machines take place?

vi. Is it possible to import these machines from India, China? What are their repair problems?

vii. Financing arrangements?

viii. How many workers do you have per machine per shift?

ix. Do machine related issues prevent multiple shifts?

x. What are the major constraints that you face in the production system?

Employment:

i. What is the total number of employees?

ii. What is the average level of education of the workers?
a. Less than 5^{th} Grade
b. Less than Matric
c. Matric_Intermediate
d. Intermediate_Bachelors

iii. Which method of payment do you use? (Piece rate?)

iv. Is the piece rate a hindrance in maintaining quality? Does it lead to high turnover?

v. What is the proportion of male/female workers?

vi. Any particular advantages/disadvantages of hiring females?

vii. How many shifts do you have? Reasons for having only a single shift?

viii. Do you provide transportation service to your workers?

ix. Do you face any particular problems in finding the right skill set? Which category of worker is the hardest to get (along the value chain)?

a. Supervisory labor (HR and quality side)
b. Labor supervision system
c. Female workers

x. Do you conduct on the job training sessions? If yes, please tell us about the kind of training being offered.

xi. What are the major constraints that you face? (Demand, labor, energy, other infrastructure, financing, etc.)

Skills development:

i. If the government had a program for skills development, which skills have the highest demand?

ii. Would you be willing to pay for the training? What proportion?

iii. Have you hired any PSDF/ TEVTA trained employees?

iv. What kind of international expertise would be helpful? How could this be funded?

Finance/Investment:

i. What is your biggest expense?

ii. How do you manage your working capital?

iii. What are the government incentive schemes/mechanisms that apply to you? Do they aid or hamper the performance?

a. Research and Development rebate

b. Export refinance

c. Duty drawback

d. Withholding taxes

e. Other

iv. Which of these if provided will help improve your ability to compete the most?

Infrastructure/Energy:

i. Do you use/ prefer water or road transport

ii. What is the major source of energy you use?

iii. Do you produce own electricity? Gas? Diesel? Petrol?

iv. Please provide a cost comparison of WAPDA versus self generated electricity.

3. Role of buying houses/outsourcing

i. Do you deal with the customers directly or do you go via buying houses?

ii. What is your view of buying houses?

iii. What role can buying houses play to make your production more efficient? Can and do they act as consultants?

iv. What, if any, is the role in facilitating sub contracting?

v. What is their role in creating demand for your products (linking you with the international market)?

4. Export performance:

i. What are your reasons for success/failure/stagnation?

ii. Is ‘innovation vs. replication’ one of the factors?

iii. What do you think are the factors due to which the garment industry in China and Bangladesh is doing better than Pakistan's?

Impact of security crisis:

a. Internal law and order situation/militancy on

   i. Foreign buyers

   ii. others

5. Role of government

i. Is the government helpful or a nuisance in terms of the following:

   a. Customs/ Import policy?

   b. Shipping? (Both on import and export products)

   c. Labor inspection?

   d. Taxation?

   e. Provision of Services?

ii. What can the government do for you w.r.t. the following:

   a) Energy

   b) Human Resource

   c) Production system: raw-material and machinery

   d) Roads/Infrastructure (Will Lahore to Karachi motorway be beneficial? Have you used Punjab Highway Patrol 1124 services?)

   e) Negotiations

   f) Skills Development

   g) Negotiating market access

6. Textile Conference

i. Did you attend the International Textile and Clothing Conference held on 7th-9th December 2013 arranged in Lahore?

ii. Was it useful?

7. Quaid I Azam Apparel Park

i. What are your views on setting up a "garments city"?
ii. Will you be willing to shift your location in the future?

Note on Punjab Skills Development Fund (PSDF)

What is PSDF?

PSDF is a not-for-profit company established under the Companies Ordinance 1984 as a joint venture by the Government of the Punjab (GoPb and Department for International Development (DfID), UK. It started in 2010 and is a GBP 50 million training fund set up with the objective of financing 135,000 individuals, by motivating a market for training services. PSDF has 12 Board members, 7 are non-government, 4 departmental secretaries, and a CEO.

What is the model?

PSDF itself does not conduct or arrange skills training neither does it set up vocational training facilities. It merely funds proposals of vocational trainings that have existing infrastructure and facilities. PSDF has initiated various schemes under which it encourages partnerships of private firms and businesses to bid for the provision of vocational trainings. Moreover, PSDF also supports business models that generate profits for private skills providers, engaging in skills development for the poor.

Under PSDF schemes, training providers propose vocational trainings in skills that are in demand by the industry and the labour market. These skills aim to improve employability prospects for vulnerable communities in their hometowns as well as nationally and internationally.

The Fund now has an approach inclined more towards sector-oriented skills development. In view of this methodology, multiple schemes of skills development have been inducted to ensure that the key industrial sectors of the Punjab are equipped with the provision of skilled labour force. The schemes are introduced after thorough research to identify skills insufficiencies in a particular sector. Since these interventions are evidence-based, they enhance the effectiveness of the trainings whilst bridging the gap between TVET and the industry at large.

What does it attempt to achieve and how?

The Fund attempts to create impact in 5 areas:

1. Creation of skills training market
2. Industrial partners
3. Income generation
4. Schemes for females
5. Geographical reach

The PSDF program primarily focuses four districts in Southern Punjab, including Bahawalpur, Bahawalnagar, Lodhran and Muzaffargarh. These four districts are least developed in terms of poverty, education, health indicators, for example. The target beneficiaries of the program include the vulnerable in the selected four districts, such as the poor, women, and those living on less than $2/month. PSDF aims to cover 60% males and 40% females and has an overall objective to train 80,000 vulnerable people over a period of five years. Achieving this goal requires solving two related problems in the districts: increasing usage of training by the target and right population ("uptake") and providing training that positively impacts outcomes (the "value-addition" of training).

What has it achieved so far?

The Fund has expanded enormously since it was launched. It started off by targeting 4 districts in Punjab and trained 80,000 individuals between 2011-2013. The number of districts covered rose to 14 and the number of trainees augmented to 135,000 between 2013-2015.

The impact the program intended to make in creating a skills training market has grown dramatically by 638% between 2011-2016. The overall income generation has also gone up as a result of increased employability. In the 4 districts PSDF initially targeted, 67% of males from a pool of 1900 trainees have been employed and 28.32% of females from a total of 834 targeted trainees. The efforts initiating schemes for females have also been fruitful, which is evident by 1153% growth in the impact of these schemes between 2011-2016. In addition, the geographical reach of the Fund has expanded over time. The impact of engaging training locations has increased by 728% between 2011-2016. This has been achieved by setting up mobile training institutes, conducting trainings at industrial units and rural areas, incentivizing high performing institutes, and capacitating and attracting NGOs.

Way forward

The PSDF envisions to stretch its coverage to all 36 districts of the Punjab between 2016-2021 and aims to train 380,000 individuals. The Fund has formulated a strategy for the period 2016-2021 and the key features of the strategy include:

1. Employer leadership in selection of trades & trainings
2. Quality trainings of highest standard
3. Local and international placement of PSDF trainees
4. Entrepreneurial trainings and business support for self-employment
5. Customized programs to boost employment & self-employment of women

Note on Punjab Industrial Estates Development and Management Company

Punjab Industrial Estates Development and Management Company (PIEDMC) was established in 2003 as a move to encourage public-private partnership in the manufacturing sector. It aims to facilitate rapid industrialization through a network of modern and innovative industrial estates, which provide one-window facilities to entrepreneurs. PIEDMC is a section 42 company, incorporated under Companies Ordinance 1984. The Company is owned by the Government of Punjab and is run by a Board of Directors (BOD) comprising of 16 directors. Majority of them are private sector industrialists and the rest are ex-officio members.

The key objectives of PIEDMC are:

- To provide quality infrastructure for the manufacturing sector in order to facilitate its growth.
- To ensure efficient, cost effective and sustainable management of industrial estates.
- To enact “One Window Operation” by providing utilities and services at industrial estates.

PIEDMC was provided Rs. 1 Billion as a soft loan, to initiate development of new industrial estates. The following industrial estates have been developed or are in the process of being developed:

- *Quaid-e-Azam Industrial Estate (QIE):* QIE formerly known as Kot Lakhpat Industrial Estate is the oldest planned industrial estate in Punjab. Spread over 565 acres in township, Lahore, the project started in 1960s. It has 477 industrial plots varying in size from 1 kanal to 100 kanals. The estate was previously managed by Housing & Physical Planning, Government of the Punjab (GoPb) and later by Lahore Development Authority (LDA). In April 2004, the ownership and management of the estate was transferred to Punjab Industrial Estates Development & Management Company and was renamed as Quaid-e-Azam Industrial Estate.
- *Sundar Industrial Estate (SIE):* SIE comprises of 1750 acres of land and was inaugurated in 2007. It was the first project assigned to PEIDMC for construction. It is located on the Sundar Raiwind Road.
- *Multan Industrial Estate (MIE):* In 1960’s approval was obtained by the Provincial Government to establish an Industrial Estate in the south of Punjab and 1410 acres of land was acquired for this purpose. However, due to lack of funds, GoPb decided to develop it in two phases. In 2004, the GoPb formally handed over MIE to Punjab Industrial Estates in order to revive industrial activity. GoPb allocated an amount of Rs. 100 million for up gradation of the estate infrastructure and the same amount was contributed by PIEDMC. Encouraged by the response of up gradation work in Phase-I, PIEDMC was assigned the task of development of

infrastructure work for Phase-II in September 2006. It is located adjacent to Phase-I, at a distance of approximately 17 km south west of Multan city. Phase-II is spread over an area of 667 acres.

- *Bhalwal Industrial Estate:* It comprises of 441 acres of land and is located at approximately 19 km, Bhalwal-Bhera Road, Bhalwal. It is presently under development.
- *Rahim Yar Khan Industrial Estate (RIE):* It comprises of 456 acres of land and was initiated in 2012. RIE is ideally located at approximately 20 km from Rahim Yar Khan City, towards Sadiqabad on main National Highway. Development is in progress.
- *Vehari Industrial Estate (VIE)*: It comprises of 277 acres and is located 6 km from Vehari City, towards Pakpattan Canal on Khanewal Vehari Road. Development is in progress.
- *Quaid-e-Azam Apparel Park (QAAP)*: The development of QAAP is a work in progress. The land purchased and being developed for QAAP is 1500 acres near Sheikhupura, 40 km from Lahore. The aim of building the QAAP is that the entire garments value chain, which is fragmented in different locations, will be integrated in one industrial estate.

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