

# SME OBSERVER

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## From The Editor's Desk

We have come around full circle! About a year and a half ago, during our weekly meeting we were debating initiating a publication that would look at various aspects of business, both at the macro level and enterprise level. What shall we call it? A long list of potential names was developed; each had uniqueness to it, but finally we settled for "SME Observer". Once the name was decided, we moved on to discuss the various aspects of the publication and finally developed content for the first issue. From thereon, there's been no looking back.

It now gives me great pleasure to share with you the first issue of the second volume of SME Observer. In this issue we take a look at the EU debt crisis and its effects, if any on Pakistan's economy.

Cont. Pg. 17

## MONEY, CREDIT & BANKING EU'S SOVEREIGN DEBT CRISIS AND PAKISTAN'S MONETARY POLICY

### *EU's Sovereign Debt Crisis A Synopsis*

As a consequence of European politicians' efforts to adopt a single currency, the Euro was established in Maastricht by the European Union (EU) in 1992. In order to qualify for joining the currency, member states were required to meet the terms of the treaty regarding budget deficits, inflation, interest rates and other monetary requirements. Although the countries using the single currency have been through booms and busts with regards to their economic journey, the recent Eurozone crisis appears to be the major center of attention among the world leaders.

In 2009, ratings agencies started to downgrade Greek bank and government debt after Greece's debt rose to 113% of GDP against the Eurozone limit of 60%. Greece's budget deficit in 2009 was revised upwards from 3.7% to 12.7% which is



more than four times the maximum limit allowed by EU rules. Consequently, Greece had to adopt a series of austerity measures so as to rein in its budget deficit. Moreover, it alarmed other heavily indebted countries in Europe such as Portugal, Ireland and Spain. On the basis of new figures provided by Greece, Eurostat felt the need of revising Greek deficit from 12.7% to 13.6% of GDP leading towards nervousness among investors with regards to lending money to Greece.

(Cont. Pg.2)

## SME TRADE OUTLOOK EXPLORING TRADE OPPORTUNITIES BETWEEN PAKISTAN AND INDIA

Pakistan and India apart from sharing a common border, share a distinct history, culture and traditions. Despite political and religious conflicts, people of both countries feel close to each other. In fact, products of both countries are very much popular across the lines. A huge bulk of Indian products and garments are available in the markets of Pakistan and almost same is the case with India.

(Cont. Pg. 3)

# EU'S SOVEREIGN DEBT CRISIS AND PAKISTAN'S MONETARY POLICY

(CONT. FROM PG.1)



In the wake of this crisis, the Eurozone members and IMF agreed a 110 billion euro bailout package to support Greece in May 2010 followed by a bailout package worth 85 billion euro to the Irish Republic in November 2010. In February 2011, Eurozone finance ministers set up a permanent bailout, called the European Stability Mechanism, of 500 billion euro, and later in May 2011, the Eurozone and the IMF approved a 78 billion euro bailout for Portugal. To avert the crisis in other European economies, Eurozone agreed a second bailout package for Greece totaling 109 billion euro. In an attempt to control increasing debts, Spain passed a constitutional amendment to incorporate a golden rule to put a ceiling on future budget deficits and Italy's upper house of parliament approved an austerity package cutting its deficit by 54 billion euro.

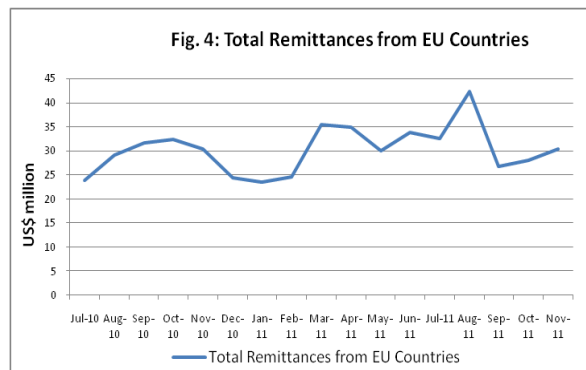
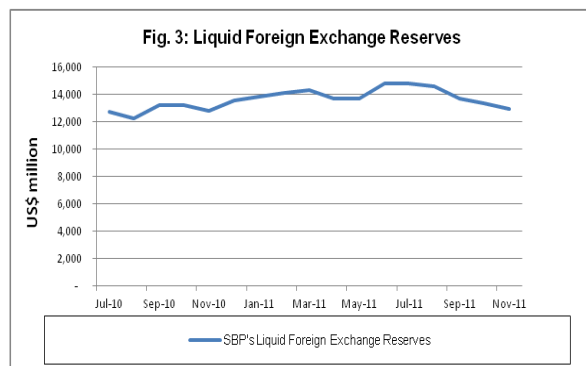
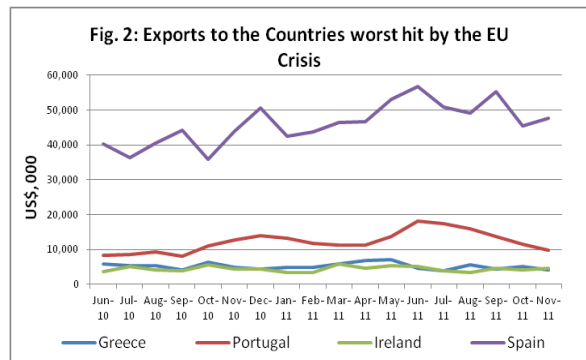
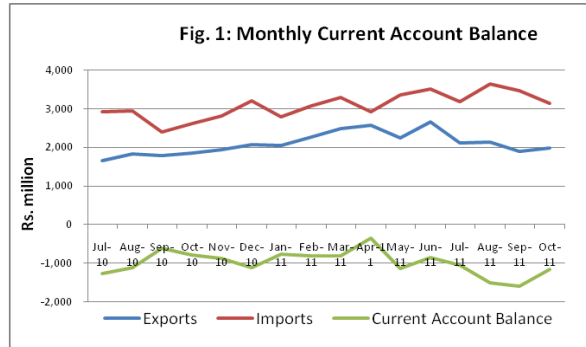
### Impact on Pakistan's Monetary Policy

The deepening debt crisis in Europe is not only troublesome for the EU but also making waves offshore. Contrary to earlier positive external current account position for FY12 on which basis SBP lowered its policy rate, the actual external current account deficit for the first four months of FY12 amounts to \$1.6 billion and is higher than previously projected deficit.

Increased trade deficit appears to be the key factor behind this larger than expected decline in the current account balance. The deteriorating trade indicators of Pakistan are predominantly attributed to the debt crisis in Europe which is Pakistan's largest trading partner.

According to figures released by the Federal Bureau of Statistics (FBS) in December 2011, country's export bill fell by \$173 million to \$1.6 billion whereas import bill increased by \$604 million to \$3.7 billion in November 2011 against the corresponding period last year. FBS reported a trade deficit of \$2.2 billion that has widened by 55.5% compared with the trade deficit in the same month last year. The declining trend in trade balance has also affected country's financial inflows as evident in SBP's tumbling liquid foreign exchange reserves.

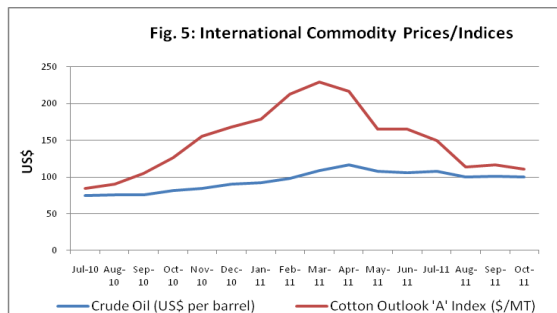
In addition to relatively larger external current account deficit, the amount of total remittances from EU countries has fallen considerably which has also contributed to the declining foreign exchange reserves.



Moreover, abnormally high cotton prices in FY11 have dropped considerably, leading towards lower export receipts. On the other hand, increasing oil prices and non-oil imports have contributed to higher import growth.

As a result of mounting external current account deficit and dwindling financial inflows, Net Foreign Assets (NFA) of SBP's balance sheet fell by Rs 115 billion during first five months of FY12. Therefore, in order to meet economy's prevailing demand for money, SBP has to provide significant liquidity to the system so that it can at least offset the falling NFA. In this regard, SBP has injected Rs 340 billion through its Open Market Operations (OMOs) as of 28 November 2011.

In a nutshell, the EU's sovereign debt crisis has led to an international financial contagion as it has affected both developed and developing economies. Similarly, it has added to Pakistan's deteriorating financial inflows in the shape of increasing trade deficit and shrinking remittances from EU countries. As the subsequent liquidity injection is not consistent with SBP's objective of achieving and maintaining price stability and carries inflationary risk, SBP has kept the policy rate unchanged at 12 percent in its recent monetary policy decision.



Albeit last few months witnessed a 200 bps reduction in the policy rate, the double-digit interest rates are high enough to restrict SMEs' access to finance. Tightened monetary policy results in lower business investment not only because of higher cost of capital but also due to the reduced supply of bank loans mostly to SMEs. In the periods of tightened monetary policy, banks make relatively more secure loans and reallocate their loan supply toward government and large firms and away from small firms. In the presence of information frictions in financial markets, SMEs tend to rely more on bank loans for external finance than issuing securities in the open market. In addition, increased emphasis on SMEs in Pakistan outweighs the gradually developing capital market and reinforces SMEs' dependence on bank finance.

## SME TRADE OUTLOOK EXPLORING TRADE OPPORTUNITIES BETWEEN PAKISTAN AND INDIA

(CONT. FROM PG. 1)

However, formal economic collaboration and trade is very limited between both countries due to political and social barriers. Despite the fact that India had granted MFN status to Pakistan in 1996 while Pakistan did not reciprocate; access of Pakistani exporters to Indian market is still very limited. This is mainly due to the fact that, a number of non-tariff barriers and religious constraints have been applied to restrict imports from Pakistan. Interestingly, trade between the two countries is unnaturally small, given their close proximity and the scope for gains from increased trade correspondingly large. The official trade in 2009-10 between the two countries was about \$2 billion per year, up from a paltry \$300 million a year in 2003-04. But still Pakistan accounts for less than 1 percent of India's trade and India accounts for under 5 percent of Pakistan's trade compared with the very large trade shares following independence of the two countries in 1947: In 1948-49, 70 percent of Pakistan's trading transactions were with India, while 63 percent of Indian exports came to Pakistan.



The estimates from gravity models suggest that trade between the two countries could be 5 to 10 times larger than the present \$2 billion per year, thereby raising GDP and household incomes in both countries. Informal trade, via third countries (such as the United Arab Emirates, specifically Dubai), is estimated at some \$2 billion to \$3 billion per year, and this trade could obviously be undertaken bilaterally at significantly lower cost. Constraints on economic integration include high tariff and non-tariff barriers, inadequate infrastructure, bureaucratic inertia, excessive red tape, and direct political opposition. At the same time, India's tariff rates remain high, especially for goods of particular interest to Pakistan, such as textiles, leather, and onyx, while nontariff barriers are substantial. Poor transportation linkages make trade costly, with railway and road connections inadequate and sea shipments constrained by both limited port facilities and bureaucratic regulations and restrictions. Moreover, constraints on visas and cumbersome payments and customs procedures further limit scope for trade. Table: 1 gives the detail of tariff and non-tariff barriers to trade between Pakistan and India.

**Table:1 Barrier to Trade between India and Pakistan**

Barriers to trade	India	Pakistan
<b>Tariff barriers</b>		
Most favored nation (MFN) status	Has granted MFN to Pakistan	Not granted MFN to India, imports from India restricted to positive list (786 items), most of the permissible items are chemicals, minerals and metal products, finished products are not part of the list, no special restrictions on exports to India
Unweighted average custom duty	22.2 percent	14.9 percent
Non-agriculture	19.7 percent	13.8 percent
Agriculture	40.1 percent	20.5 percent
General maximum customs duty	30 percent (20 percent, excluding agriculture)	25 percent
Special higher duties	For 18.5 percent of tariff lines: rate of 35 to 18.2 percent (agriculture, automobiles, textiles, and garments) India has extended tariff concessions to Pakistan on 393 items.	Pakistan has extended tariff concessions to India on 248 items, until recently 78 of these items could not be imported because they were on the banned list but these items have since been added to the positive list.
<b>Nontariff barriers</b>		
Import licensing	Dismantled; no registration, licensing fees, and quotas	Dismantled: no registration licensing fees and quotas
Subsidies	India provides significant subsidies to producers and consumers (mainly in agriculture).	Few subsidies except urea fertilizer and electricity to households, but subsidies through support prices (wheat and cotton)
Visa regimes	Very restrictive; visas take a long time to process and for a particular city, Pakistan nationals are required to register themselves upon entry into India and also have to report their arrival to and intended departure from each place of stay as permitted on the visa within 24 hours at the nearest police station	Very restrictive for Indians, police reporting required, but recently, some relaxation has occurred with multiple entry visas being granted to Indian businessmen when arranged through the Chambers of Commerce
Land transportation	Few border crossings, very limited rail traffic across borders, and requirement that rail wagons carrying goods across the border should return empty.	Few border crossings, very limited rail traffic across borders, and requirement that rail wagons carrying goods across the border should return empty.
Air travel	Still limited but some improvement in recent years.	Still limited but some improvement in recent years.
Sea transportation	Ships must first touch a third- country port to import from Pakistan (i.e Dubai or Singapore), limited ports and inland customs post at which the import of "sensitive" products can be cleared.	Ships must first touch a third- country port to import from India (i.e Dubai or Singapore). Pakistan has only one major port in operation (Karachi).
Payment systems	No branches of Indian banks in Pakistan, payments for exports/ imports have to be made through third-country banks.	No branches of Pakistan banks in India payments for exports/ imports have to be made through third- country banks.
Energy trade	No energy trade with Pakistan	No energy trade with India
Services/ information technology (IT)	Trade with Pakistan in services and IT is heavily restricted.	Trade with India in services and IT is heavily restricted.

Keeping in view the current trade status between the two countries, the following section highlights some potential areas for trade and economic collaboration. Economic cooperation between the two countries will not only play an important role in industrial development of both countries but also open the doors for new markets in other countries. Both India and Pakistan are located at the mouths of important trade routes and markets. Table:2 provides comprehensive analysis for trade and economic ties.

Table:2 Sectoral Analysis of India and Pakistan

Status	Comparative Advantage		Avenues for Cooperation
	India	Pakistan	
Significantly Different	<ul style="list-style-type: none"> <li>· Textile Machinery Spare Parts</li> <li>· Organic Fertilizers</li> <li>· Transport Equipments</li> <li>· Energy</li> <li>· Railway track material and equipment</li> </ul>		<ul style="list-style-type: none"> <li>· Cross country investment opportunities.</li> <li>· Market Access</li> <li>· Production Sharing Arrangement</li> <li>· Human Resource Skill Development.</li> </ul>
Identical Sectors at Relatively Different Levels of Development	<p><b>Textile</b></p> <ul style="list-style-type: none"> <li>· Man-made Filament (MMF) Yarn</li> <li>· MMF Fabric</li> <li>· Short staple cotton</li> <li>· Textile design</li> <li>· Automobile Industry</li> <li>· Auto spare parts</li> <li>· Telecommunications</li> <li>· Metals</li> <li>· Steel and Iron</li> <li>· Chemicals</li> <li>· Organic and inorganic chemicals</li> <li>· Dyes and dyestuffs</li> </ul> <p><b>Pharmaceuticals</b></p> <ul style="list-style-type: none"> <li>· Electrical goods</li> <li>· Food and food processing</li> <li>· Wood, processed wood</li> <li>· Fisheries</li> </ul>	<p><b>Textile</b></p> <ul style="list-style-type: none"> <li>· Long staple yarn</li> <li>· Cotton Fabric</li> <li>· Grey Fabric</li> <li>· Cotton Yarn</li> </ul> <p><b>Knitwear</b></p> <ul style="list-style-type: none"> <li>· Denim Jeans</li> <li>· Garments (cotton)</li> <li>· Hosiery (cotton)</li> </ul> <p><b>Home textile</b></p> <ul style="list-style-type: none"> <li>· Bed Linen</li> <li>· Table ware</li> <li>· Carpets and Rugs</li> <li>· Leather and leather goods</li> </ul> <p><b>Food and agriculture</b></p> <ul style="list-style-type: none"> <li>· Fruits, nuts, fresh and dried, sugar, spices, processed fruit, manufactured tobacco</li> </ul> <p><b>Metals and Minerals</b></p> <ul style="list-style-type: none"> <li>· Limestone, rock salt,</li> <li>· marble</li> <li>· Precious and semi-precious stones</li> <li>· Furniture</li> <li>· Gems and Jewelry</li> <li>· Hand made and machine made Carpets</li> <li>· Sports goods</li> <li>· Surgical Instruments</li> </ul>	<ul style="list-style-type: none"> <li>· Joint Ventures</li> <li>· Packaging</li> <li>· Co-branding</li> <li>· Production Sharing Arrangement</li> <li>· Franchises</li> <li>· Licensing</li> <li>· Designing</li> <li>· Technology transfer</li> <li>· Mutual Capacity Building</li> <li>· Packaging</li> <li>· Technology Transfer</li> <li>· Human Resource Management</li> <li>· Seminars and Workshops</li> </ul>

### Enhancing Trade for SME Development

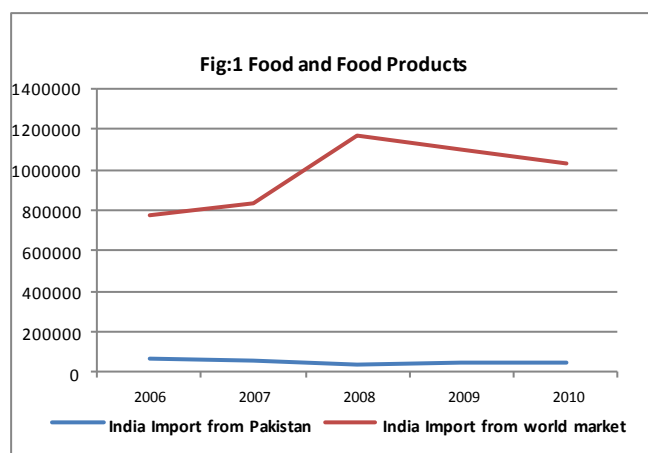
Both India and Pakistan are SME dominant economies. The density of SMEs in each country accedes 90% of total business population. The significant role of Small Scale Industries (SSIs) in the Indian economy is reflected by fact that presently these account for 95 percent of all industrial units in the country and contribute 40 percent of the total output. About 7,500 products are manufactured in the small-scale sector with export share to the extent of 35 percent. According to an analysis by the State Bank of Pakistan, SME sector of India is comparatively stronger than SMEs located in Pakistan. However, some Pakistani SMEs in sectors such as, sports goods, surgical instruments, garments, gems and jewelry are recognized worldwide and enjoy a distinction position in Pakistan's economy. Economic collaboration between these sectors may be beneficial for both countries.

#### 1. Food and Food Processing

India's import of food and food related articles from world markets has increased significantly over the last five years. Although there has been a slight decline after 2008, however, still this market has immense potential. It is, however, interesting to note that Pakistan's export to Indian markets has decreased since 2008. One of the major reason of limited export of food and food related products are the high tariff rates applied by India to restrict the import of these commodities from Pakistan. There is need to have open discussion with the trade promotion authorities of India to rationalize the tariff lines for Pakistan.

On average around 25% to 30% tariff is applied on the imports of this sector from Pakistan .(see table:1)

Table:1 Tariff Applied by India on the Import of Foods Related Items from Pakistan 2010

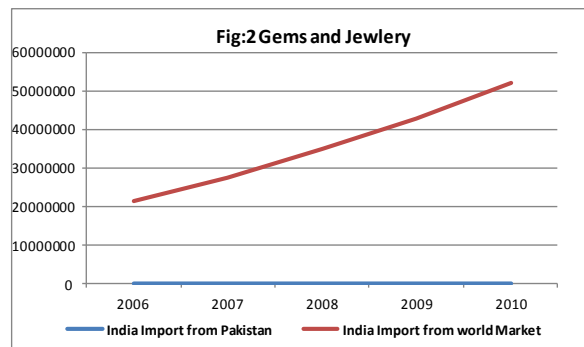


<u>Selected product codes</u>	<u>Product description</u>	<u>Number of tariff lines</u>	<u>Total ad valorem equivalent tariff (estimated)</u>
01	Live animals	34	20.00%
02	Meat and edible meat offal	61	29.28%
03	Fish and crustaceans, molluscs and other aquatic invertebrates	142	21.06%
04	Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included	43	23.24%
06	Live trees and other plants; bulbs, roots and the like; cut flowers and ornamental foliage	24	12.57%
07	Edible vegetables and certain roots and tubers	81	30.04%
08	Edible fruit and nuts; peel of citrus fruits or melons	87	29.54%
12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants; straw and fodder	98	24.84%
17	Sugars and sugar confectionery	38	38.47%
19	Preparations of cereals, flour, starch or milk; pastrycooks' products	33	21.60%
20	Preparations of vegetables, fruit, nuts or other parts of plants	70	21.66%
22	Beverages, spirits and vinegar	64	119.31%

Source: www.trademap.org

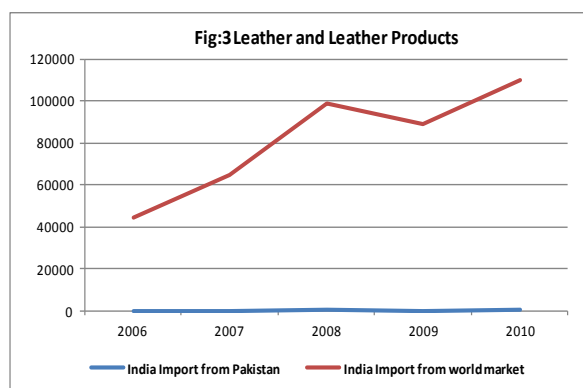
### 2. Gems and Jewelry Sector:

Pakistan's gems export constitute 0.07% of world exports and is ranked 61st in world exports. India is a leading importer and exporter of gems and imitation jewelry in the world market. Indian imports of gems and jewelry from world markets stands at US\$ 54 billion. Fig: 2 shows that Indian import of jewelry and precious stones has increased sharply within last five years. However, Pakistan, being the exporter of world class emerald and ruby, consists a negligible share in the Indian market. There is ample opportunity for Pakistani exporters to take advantage from the growing demand of gems and jewelry in their neighbouring country. On average around 10% tariff is applied by India on the imports of these gems and jewellery originating from Pakistan.



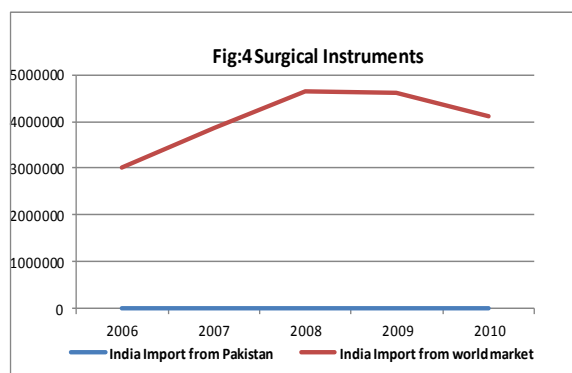
### 3. Leather and Leather Products

Pakistan is a manufacturer and exporter of genuine leather products such as footwear, suitcases, handbags, belts, wallets, and so on. One percent of total world export of leather and related items comes from Pakistan. Fig:3 shows that, Indian import of leather and related articles has increased significantly from 2006 to 2008 and then experienced slight decline till 2009. In 2010, leather product import of India stood at US \$ 110.0 million. Contrary to this, Pakistan's export to India is very trivial. On average 10% tariff rate is applied on the import of these commodities originating from Pakistan. According to an analysis of the State Bank of Pakistan, India is a potential market for leather and related items. Local producers should concentrate on this opportunity in order to enhance foreign earnings.



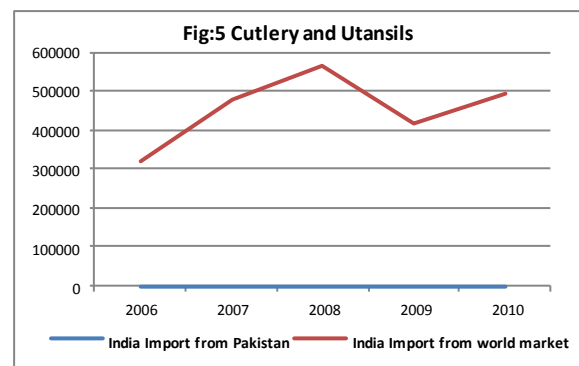
### 4. Surgical Instruments

Pakistan is the producers and exporter of world-class surgical instruments. The major importers of surgical instruments are USA, UK, Germany and EU. Indian import of surgical instruments from world market has increased from 2006 to 2008 and then decreased till 2010. India imported surgical instruments worth US \$ 4.1 billion in 2010 (see fig: 4), whereas, Pakistan's export to India were worth only US \$ 2 million. The average tariff rate applied by Indian government on the import of surgical instruments from Pakistan is only 6.5% which allows free and easy access of Pakistani producers to Indian market. Pakistani exporters of surgical instruments should explore the Indian market in order to enhance their exports from the sector.



### 5. Cutlery and Utensils

Pakistan's cutlery exports constitute 0.12% of total world exports. Major importers of cutlery from Pakistan are USA, UAE, Brazil, Germany and France. Fig:5 shows that Pakistan's export of cutlery is very limited even non-existent. During last five years, Indian market of cutlery items is expanding. Though it experienced fluctuations but the overall market of cutlery goods is increasing. Whereas, Pakistan's share in Indian market is constant over the years. The average tariff rate applied on products under this sector is 10%.



**6. Footwear and Related Articles**

Pakistan ranks 48<sup>th</sup> in Footwear exports, representing 0.15% of world exports. Major importers of Pakistan’s Footwear are Saudi Arabia, UAE, Germany, France and Yemen. Fig:5 depicts Indian import of footwear and related items from the world market. Like other SME specific commodities, Pakistan’s export of footwear to Indian market is very limited, despite the fact that the consumer preferences across the two nations is similar. In fact, Pakistani products such as, shoes, bags and dresses are very popular in India. Therefore, Pakistani producers of footwear and related items may explore Indian market and can take advantage of the growing demand of footwear in India.



**7. Sports Goods**

Pakistan's exports of sports goods represent 0.23% of world exports of this product; its ranking in world exports is 28th. Major importers of Pakistan sports goods are Germany, USA, Netherlands, United Kingdom and Spain. India also imports sports items from world market which are worth around US \$ 243 million. Pakistan’s export to India is very limited. Pakistan should take initiatives to enhance its exports of sports goods to India. The average tariff rate applied by India on sports goods imported from Pakistan is 9.76%.



## RAW MATERIAL IN FOCUS

### FERTILIZER

Agriculture is the second largest sector in Pakistan's economy, accounting for over 21 percent of GDP, and remains by far the largest employer, absorbing 45 percent of the country's total labour force. Nearly 62 percent of the country's population resides in rural areas, and is directly or indirectly linked with agriculture for their livelihood. As a result the agriculture sector is not only a primary supplier of raw materials to downstream industry, it also acts as a large market for industrial products and raw materials such as fertilizer.

Fertilizer is the most important input / raw material in enhancing agricultural productivity. According to the National Fertilizer Development Centre (NFDC), all of our soils are deficient in nitrogen (N), 80-90 percent are deficient in phosphorus (P) and 30 percent in potassium (K). This widespread nutrient deficiency affects agricultural yields adversely, and can be overcome by the balanced and adequate use of fertilizers. Contribution of balanced fertilization towards increased yield ranges 30 to 60 percent in different crop production regions of the country. One kg of fertilizer nutrient produces about 8 kg of cereals (wheat, maize and rice), 2.5 kg of cotton and 114 kg of stripped sugarcane. The importance of fertilizers to Pakistan's agriculture sector can also be gauged by the crop usage of fertilizer in Pakistan. Table 1 shows that all the major crops use large quantities of fertilizer.

Despite a clear lack of nutrient deficiency and a dependence of major crops on fertilizer, Pakistan's per hectare consumption of fertilizer (see Table 2) is not very high compared to some other countries like the Netherlands and Egypt. This can be attributed as one of the reasons for a low yield of 1.44 ton per hectare of cultivated land. However, fertilizer consumption is likely to increase in future as economic conditions improve, and government invests more in this sector. Already there are signs of growth with per hectare consumption increasing from 161kg in 2005-06 to 183kg in 2009-10.



Crop usage of Fertilizer in Pakistan							(000 nutrient tones)	
YEAR	Wheat	Rice	Maize	Cotton	Sugarcane	Others	Total	
2000-01	1344.02	159.41	66.37	684.45	314.37	394.38	2963	
2001-02	1328.59	157.58	64.61	676.6	340.77	389.85	2929	
2002-03	1369.87	162.48	67.65	697.62	320.42	401.96	3020	
2003-04	1461.5	173.34	72.17	744.28	341.85	428.85	3222	
2004-05	1847	221.64	55.41	923.5	295.52	184.7	3694	
2005-06	1902.1	228.25	57.06	951.05	304.43	361.4	3804	
2006-07	1835.8	220.29	55.07	917.9	293.72	348.8	3672	
2007-08	1790.5	214.86	53.72	895.25	286.48	340.2	3581	
2008-09	1855.5	222.66	55.67	927.75	296.88	352.55	3711	
2009-10	2180	261.6	65.4	1090	348.8	414.21	4360	

(source: NFDC)

*Nearly 62 percent of the country's population resides in rural areas, and is directly or indirectly linked with agriculture for their livelihood*

FERTILIZER CONSUMPTION IN SELECTED COUNTRIES										
										(Kg/ha)
Year	Netherlands	Germany	Japan	France	Egypt	Italy	USA	Russia	India	Pakistan
2000-01	470	232	-	225	-	211	106	-	103	138
2001-02	546	217	282	213	436	-	-	-	88	133
2002-03	354	216	270	203	373	-	-	-	100	137
2003-04	438	220	293	216	472	-	122	-	105	148
2004-05	510	216	365	210	548	-	113	14	106	161
2005-06	601	209	251	191	625	-	109	16	121	169
2006-07	419	190	344	178	381	-	143	12	114	159
2007-08	1188	191	321	196	450	136	168	14	133	157
2008-09	261	158	259	138	566	114	101	16	143	157

Source: NFDC

#### Production:

For the last 20 years, fertilizer industry in Pakistan has experienced a situation of excess demand. According to figures published by the NFDC in 2006-07, the total supply / production of fertilizer stood at 5.8 mntpa ( million tons per annum) compared to a total demand of 6.8 mntpa. This situation was arrived at through an average industrial capacity growth of 5.5% from CY 1990 to CY 2006. Correspondingly, demand for fertilizer grew at an average of 5.25% during this period, which means that supply of fertilizer has grown more rapidly than the demand in Pakistan. According to these estimates, supply of fertilizer in Pakistan would have overcome the situation of excess demand by 2010, when supply would have reached 7.8 mntpa. This has indeed happened due to industry capacity expansion undertaken by the major players in the industry such as FFC, ENGRO and FFBL (see Table 3). This fact is corroborated by the Economic Survey of Pakistan which shows a major decline in the imports of fertilizer due to higher domestic production as quantity of fertilizer import declined by 52 percent during July-April 2010-11 over the corresponding period last year.

CAPACITY EXPANSIONS (000 tn)					
Urea	Existing Capacity	Increase	Final Capacity	Due date	Type
FFC	1890	158	2048	May, 08	BMRE
ENGRO	1135	1300	2435	July, 10	Expansion
FFBL	446	223	669	Mar, 08	BMRE

Source: NFDC

#### Major Producers:

Fertilizer industry of Pakistan has an oligopolistic structure. The product is differentiated and there are 9 firms operating in the industry. The entry and exit of a single player in this structure can have an impact on the pricing. The industry holds no single dominant leader, yet the 4 largest firms are deemed to be price setters. However, government regulations and subsidies to farmers largely prevent these large firms from exploiting the market through price setting arrangements. Some of the major fertilizer producers and their products are listed below:

#### Fauji Fertilizer Company (FFC)

FFC was incorporated in 1978. The initial capital of the company was 813.9 Million Rupees. The present share capital of the company stands at Rs. 3.0 Billion. FFC has Rs. 1.0 Billion stakes in the subsidiary Fauji Fertilizer Bin Qasim Limited (formerly FFC-Jordan Fertilizer Company Limited). It has a total of 3 plants, of which 2 are located in Goth Machhi and 1 in Mirpur Mathelo. Sona Urea (most widely used fertilizer in the company) and Sona DAP are two of its main products.

*Pakistan's per hectare consumption of fertilizer is not very high compared to some other countries like the Netherlands and Egypt*



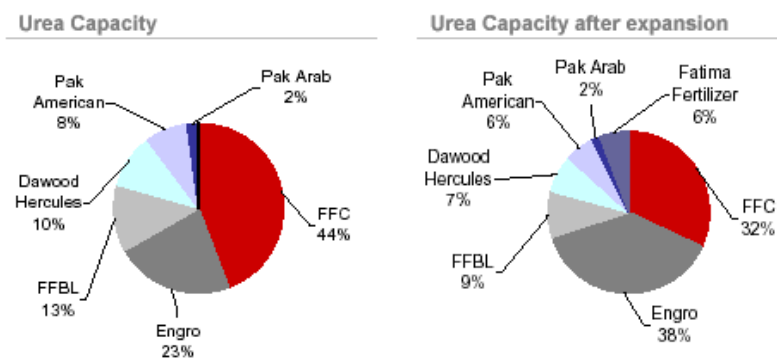
**Engro Chemicals Pakistan Ltd.**

Engro Chemical Pakistan Limited is the second largest producer of Urea fertilizer in Pakistan. The company was incorporated in 1965 and was formerly Exxon Chemical Pakistan Limited until 1991. Engro factories are located in Dharki and Bin Qasim, Karachi. It offers a range of products such as Engro Urea, Engro DAP, Engro Zorawar, Engro Phosphate etc.

**Dawood Hercules Chemicals Ltd.**

Dawood Hercules Chemicals Limited was incorporated as a public limited company in April 1968, as a joint venture between Dawood Group of Industries and Hercules Inc. USA. It was the first private sector venture in Pakistan to receive a loan from the World Bank and was the largest ammonia/urea plant in the country at that time. Its plant is located in Chicoki Malia, Sheikhpura and its main product offered in the market is known as Bubber Sher. Dawood Hercules was the first fertilizer manufacturing company in Pakistan to have received the ISO 9000:2000 certification.

The figure below shows the position of the major players in the fertilizer industry of Pakistan.



**Prices**

Fertilizer prices in Pakistan are impacted by 2 major issues. The first is the industry’s dependence on natural gas, whose supply has been intermittent in recent years and whose costs have been rising as well due to the severe energy crisis being witnessed in the country. An example of this is the rise in urea prices by 25.8 percent during the first nine months of the current fiscal year. DAP was also found to be more expensive by 46.5 percent during this time (see Table 4).

Dumping of foreign fertilizer has hindered the growth of the local industry and resulted in decline in its net margins and profitability. However, Dumping is seen as a problem for fertilizer industry worldwide. It arises due to excess supply and over producing countries inability to sell their produce. As a result they resort to dumping their products in other markets at substantially lower rates. Countries such China, India and other European Countries have tackled this problem by imposing anti-dumping laws and high tariff duties. Pakistan’s industry will also gain if the government can replicate some of these measures.

Year	Fertilizer Market Prices (USD/ metric ton)				Fertilizer
	Pakistan	US GULF	Middle East	Morroco	
2009-10	181.1236	-	275.1	-	Urea
2009-10	509.4382	384.2	-	-	DAP
2009-10	532.5843	704.2	-	-	SOP
2009-10	372.809	-	-	296	TSP

*Dumping of foreign fertilizer has hindered the growth of the local industry and resulted in decline in its net margins and profitability*



## FISCAL DEVELOPMENTS FOR SMES

### REVAMPED GST ON FIVE EXPORT ORIENTED SECTORS

Escalating government borrowing, attributable to growing budget deficits, and falling financial inflows have brought about liquidity injection by the central bank leading towards inflationary risks and crowding out of private sector. Considering SBP faces a dilemma while simultaneously maintaining financial and price stability, monetary and fiscal policy coordination seems inevitable.

In order to kick off such coordination, there is a dire need of reforming country's fiscal policy. Various attempts have been made in this regard such as 'imposition of lower rates of sales tax on domestic sale of five major export oriented sectors including textile (as well as jute), leather, carpets, sports goods and surgical instruments' which were earlier enjoying zero rated tax on both domestic sale and exports.

In an attempt to utilize the real potential of five major export oriented sectors including textile (including jute), leather, carpets, sports goods and surgical instruments and to reduce the intricacies involved in the commercial exporters' status, the Federal Board of Revenue (FBR) has revamped its GST zero rating scheme in December 2011. The revamped regime stipulates only two rates i.e. zero and 5%. For 128 items of raw materials and inputs specified under this scheme, sales tax will be charged at a zero rate if goods are supplied to registered persons engaged in the mentioned sectors and 5% if supplied to any other person including retailers.

This scheme shall be applicable from:

- ginning onwards in case of textile sector;
- production of PTA or MEG for synthetic sector;
- regular manufacturing in case of carpets and jute products;
- tannery in case of leather sector; and
- organized manufacturing in case of surgical and sports goods

The details including the incidence at import stage are illustrated in the table.

This scheme was originally introduced in April 2011 in which four different rates of tax were prescribed. FBR, through this scheme, had only collected Rs 570 million from April 2011 to June 2011 and Rs 974 million during the first five months of FY12. Although FBR experienced 27% growth in revenue collection from December 2010

to December 2011, the scheme could not achieve the results as desired. However, the benefits of the regime introduced in December 2011 shall be available to the registered persons appearing on Active Taxpayers' List (APL) on FBR's website.

Along with facilitating a swift revenue collection by the government, the newly introduced regime is expected to encourage documentation and registration of SMEs with an incentive of zero rated GST.

Well documented and registered export oriented SMEs will not only help the government expand its tax bracket and increase revenue but, as a result of reduced prices of raw materials and lower cost of production, will also become more competitive exporters.

Persons operating in Export oriented Sectors	STAGES			
	Import	Local supply other than retail sales	Local supply being retail sales	Processing for manufacturer
Manufacturer	0%	0% [to registered person] 5% ad valorem [to others]	5% ad valorem	0% [for registered person] 5% on processing charges [for others]
Commercial Importer	3% [for industrial input] 6% [for finished goods] Note: 1% rate included in above represents sales tax on value addition	0% [to registered person of these sectors] 5% ad valorem [to others]	5% ad valorem	N/A
Wholesaler / Distributor	N/A	0% [industrial input supplied to registered person of these sectors]  5% ad valorem [other supplies]	5% ad valorem	N/A
Retailer	N/A	N/A	5% ad valorem Note: Turnover tax under special procedure will not apply on turnover of goods covered in SRO 1125	N/A



## PRICE TRENDS

### WHOLESALE PRICE INDEX (WPI)

The Wholesale Price Index (WPI) also known as the Producer Price Index traces the relative changes in the price of an individual good (or a market basket of goods) over time. In some economies, at times, it is also substituted for the annual average inflation. The WPI gives an idea of the fluctuations in the prices of all the traded commodities in the country as a whole on a periodic basis. The WPI is a valid indicator for determining inflation for business enterprises as it provides fluctuations in the input prices to any business.

The Federal Bureau of Statistics compiles data on Wholesale prices trends. In this regard, a WPI by Group of Commodities is developed with a base year of 2007-08. The table below describes the commodity groups, their respective weights or proportion in the WPI and the changes over a period of one year starting November 2010:

#### Wholesale Price Index by Group of Commodities – % Change in Nov, 2011 over Nov, 2011

No.	Major Group	Share in WPI	% Change
	<b>General</b>	<b>100</b>	<b>11.96</b>
1.	Agriculture, Forestry & Fishery Products	25.77	3.24
2.	Ores & Minerals, Electricity, Gas & Water	12.04	9.24
3.	Food Products, Beverages & Tobacco, Textiles, Apparel & Leather Products	31.11	7.76
	Food Products, Bev. & Tobacco	20.07	14.68
	Textiles and Apparel	10.33	-3.96
	Leather Products	0.71	5.11
4.	Other Transportable Goods except Metal Products, Machinery & Equipment	22.37	28.93
5.	Metal Products, Machinery & Equipments	8.72	21.82

In terms of composition of the WPI, (Food Products, Beverages & Tobacco, Textile, Leather & Apparel) has the maximum weight of 31.11%, although Food Products, Beverages & Tobacco carries 20.07% share within this commodity group. This commodity group is closely followed by (Agriculture, Forestry and Fishery Products) at 25.77%. The third largest contributor to the WPI is (Other Transportable Goods except Metal Products, Machinery & Equipments) with 22.37% share. The two relatively smaller contributors to the WPI are (Ores & Minerals, Electricity, Gas & Water) and (Metal Products, Machinery & Equipments) with contributions of 12.04% and 8.72% shares respectively.

The WPI over the period of Nov 2010 to Nov 2011 recorded an overall inflation of 11.96%. While all the five commodity groups experienced inflationary pressure, the sub-category of (Textiles and Apparel) was the only one that saw a minimal decrease in inflation at -3.96%. Among the rest of the commodity groups, (Other Transportable Goods except Metal Products, Machinery & Equipments) saw the highest inflation at 28.93% followed by (Metal Products, Machinery & Equipment), (Food Products, Beverages and Tobacco), (Ores & Minerals, Electricity, Gas & Water) at 21.82%, 14.68% and 9.24% respectively. Inflationary pressure on all the above commodity groups directly add to cost of inputs at each stage of value addition and thus higher final prices for goods available for purchase.

A further breakdown of the (5) commodity groups comprising the WPI gives out the price trend over the past year for the component commodities.

#### 1. (Food Products, Beverages & Tobacco, Textile, Leather & Apparel)

This Group is made up of three sub-categories i) Food Products, Beverages & Tobacco ii) Textile and Apparel and iii) Leather & Apparel, whereas there are 40 commodities altogether in the whole group and it has the largest share of 31.11% in the WPI.

**Food Products, Beverages & Tobacco:** There are 22 commodities in this sub-group and it contributes 20.07% to the WPI. This sub-group saw inflation of 14.68% in the last 12 months up to Nov, 2011. The largest commodity within the group was 'Processed Liquid Milk' with a 22.14% share in the sub-group and inflation in this product category was recorded at 18.80% in the said period. The second commodity with significant share in the WPI i.e. 17.22% was 'Meat of Animals' that recorded a high inflation level of 25.36%. The third most significant commodity in the group was 'Wheat Flour' with a share of 11.47% in WPI; however, inflation in this important segment was recorded at a low level of only 2.41%. The highest inflation within the sub-group was recorded in 'Spices' at 128.50%, though it has a small share of 0.72% in the WPI. The two other groups having significant shares in the WPI and with high inflation rates were 'Vegetable Oils Refined', 9.58% share and 30.11% inflation and 'Vegetable Ghee' 7.78% share and inflation at 35.41%.

**Textiles & Apparels:** There are 15 commodities in this sub-group and it contributes 10.32% to the WPI. This is the only sub-group that saw declining price trends @ -3.96% in one year. Cotton Yarn has the main share within this group with 50.82% share, prices of which declined by 16.89%.

**Leather Products:** This sub-group has three commodities and has the smallest share in WPI i.e. 0.71% and saw inflation of 5.11%.

## 2. Agriculture, Forestry and Fishery Products

This is the second largest contributor in terms of share in the WPI with 25.76% share. There are 27 commodities in this group and it saw a low level of inflation of 3.24% over the said period. The three major commodities in this group are 'Raw Milk from Bovine Animals', 'Fiber Crops' and 'Rice' with shares of 7.02%, 5.31% and 2.44% respectively. Although overall inflation for the whole group was only 3.24%, inflation in the aforementioned commodities except Fiber Crops for the period was 23.31% and 29.35%. Significantly, Fiber Crops saw declining prices @ -27.49%. Other significant commodities that saw declining prices include 'Fish Live Fresh or Chilled' -2.34% and 'Sugar Crops' -1.53%. Over the same period, prices for 'Vegetables' having share of 1.244% increased by 39.98%, 'Fresh Fruits' with share of 1.51% increased by 20.36% and 'Cotton Seed' having share of 1.15% increased by 22.52%.

## 3. Other Transportable Goods Except Metal Products Machinery and Equipment

This is the third largest contributor in terms of share in the WPI with 22.36% share. There are 25 commodities in this group and it saw an overall inflation of 28.93%, which is highest among the five major commodity groups. This group comprises key products in terms of economic cost of doing business. Among these are 'Diesel' with the highest share of 5.26%, 'Furnace Oil' having share of 3.26% and 'Fertilizers' with a share of 2.86%. Inflation for these three products was 21.78%, 39.51% and 68.39% respectively. 'Cement' with a contribution of 1.81% in the WPI also saw an increasing price trend of 12.23% over the said period.

## 4. Ores and Minerals, Electricity, Gas and Water

This is the 4<sup>th</sup> contributor in terms of share in the WPI with 12.03% share. There are four commodities in this group and it saw an overall inflation of 9.24%. There are two important products in this group 'Natural Gas Liquefied' that has a share of 5.73% and 'Electrical Energy' with a share of 5.49%, where inflation over the period was recorded at 15.42% and 2.70% respectively.

## 5. Metal Products, Machinery and Equipment

This commodity group comprises 19 commodities and products and has the smallest share of 8.71% in the overall WPI. Inflation in the group was recorded at 21.82%. The most significant products in this group are 'Steel Bars and Sheets' having share of 1.40%, 'Lighting Equipment' with a share of 1.44% and 'Fridge, Washing Machine, Sewing Machine, etc.' with a share of 1.16%; price escalation in the three product

categories was recorded at 17.95%, 28.40% and 24.30% respectively. The largest share within the whole group was that of 'Bicycles' having 3.34% share and in terms of prices it rose to 23.88%.

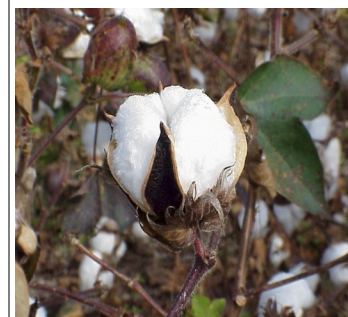
**Price fluctuation of top ten commodities within the commodity groups over the previous year i.e. November 2010 are as follows:**

### Price Increase:

Spices (128.50%), Fertilizers (68.39%), Plastic Products (45.59%), Vegetables (39.98%), Furnace Oil (39.51%), Mineral Water (36.35%), Hard board (36.00%), Other Food Products (35.56%), Vegetable Ghee (35.41%) and Dairy Products (not elsewhere classified) (34.94%).

### Price Decrease:

Fibre Crops (27.49%), Edible Roots/Potatoes (25.42%), Cotton Yarn (16.89%), Stimulant and Spice Crops (15.94%), Milk and Cream in Solid Form (11.06%), Sugar Refined (10.38%), Sorghum/Jowar (3.68%), Fish Live Fresh or Chilled(2.34%), Medicines(1.84%) and Sugar Confectionary(1.84%).



## LAHORE ON RAILS OPEN SOURCE TECHNOLOGIES— SMAP

This section of SME observer has specially been developed to:

- Motivate SMEs in Pakistan to use open source technologies
- Educate Pakistani SMEs in the use of free and open source technologies at minimal cost
- Present rich features of open source tools and to provide technical assistance to SMEs regarding its implementation

In this Issue, we look at SMAP (SMEDA Accounting Package) that holds great benefit for SMEs.

### SMEDA Accounting Package—SMAP

#### Introduction:

Finance and accounting software is generally used by small and medium-sized enterprises (SMEs) to save time by automating recurring processes and simplifying financial reporting. However, as an increasing number of suppliers target smaller businesses, deciding which package to choose is becoming more complex. Recently, software suppliers have been adding more inventive features to their accounting packages, such as web interfaces and better integration with supply chain and other applications, and have also modified products to make them more convenient for non-accountants. Large software suppliers, such as Microsoft, SAP and Oracle have customized financial software products for SMEs. There are also many specialist suppliers and web-centric service providers; but most of them are expensive.

Looking for the perfect software for your business can be distressing. This issue of SME Observer can help you follow a logical process to choose the right software for your enterprise. Does any of this sound familiar?

- Have you gone through this process earlier? Perhaps you tried choosing accounting software because it worked well for another SME, only to find that it was wrong for your business.
- Or did you let your IT expert choose the appropriate software, and then find that the accounting team refused to use the software when it was installed as the supported features do not exactly fit in Paki-

stani context such as prices, taxes and receipts etc.

- Are you just setting up your SME and haven't yet decided on which accounting software to go with and are actually confused by the choices, and concerned by the horror stories you've heard?

Cognizant of the aforementioned issues, in September 2004 SMEDA started offering a software based accounting package through its website, which was developed keeping in view business documentation requirements of Pakistani SMEs. Since then, this software is available for download free of cost. SMEDA has also provided training on software usage at various locations. Eleven thousand (11,000) SMEs across 153 cities have downloaded this software and approximately 5,000 are using it for their bookkeeping requirements.

#### Why should SMEs use SMAP?

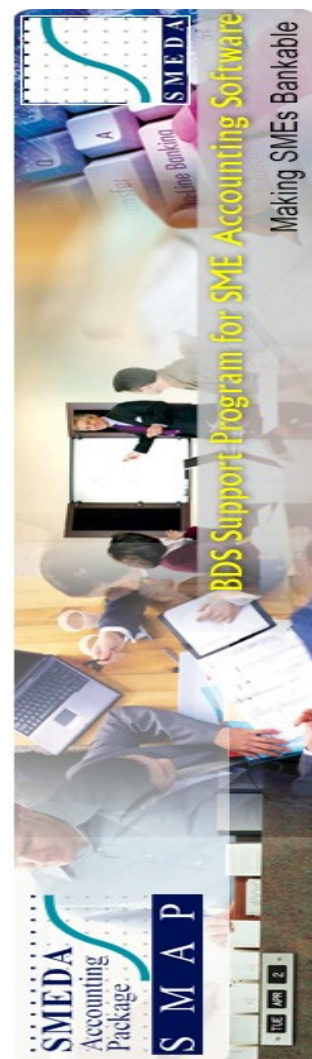
SMAP is specially designed for small and medium tier Trade, Services and Manufacturing companies, keeping in view the dynamics of local markets. It is an integrated business application which is developed on customer experience & accounting standards, successfully running in hundreds of companies.

SMEDA ensures quality assured SMAP services regarding installation, implementation, training and operational issues to SMEs through;

- SMAP Service Providers' Network s
- SMAP Implementation Manual, available through SMEDA offices and website [http://smap.smeda.org/Software/SMAP\\_User\\_Guide.pdf](http://smap.smeda.org/Software/SMAP_User_Guide.pdf)
- SMAP Technical Assistance

Small and Medium Enterprises, being end users of SMAP services, form an integral part of the network. Being an SME, you can benefit from:

- Gaining access to certified business development service providers of SMAP
- Receiving cost effective technical assistance on implantation of software
- Access to trained technical personnel on tackling software maintenance issues



*“Lahore on Rails” is basically inspired from “Madrid on Rails”, also stirred by famous open source web application framework “Ruby on Rails”; a project initiated by the city council of Madrid to motivate SMEs to use open source technologies.*

## SMEDA Accounting Package (SMAP)

*Software based accounting system supported  
by Service & Technology*

- Receiving professionally designed and administered training of software yourself
- Primary information on accounting practices, book keeping procedures
- Networking with Banks and accounting professionals to expand and better manage your business

### SMAP Accounting Package - Features

Salient features of SMAP accounting software which are quite useful for SMEs include:

- **Inventory Control:** Keeps track of stock movement, provides product details and offers supplier management
- **Receivables & Sales:** Defines customer information, summarizes customers analysis, payments details and manages product-wise cash and credit sales
- **Payables & Purchases:** Prepares supplier analysis, compiles supplier ageing charts and manages product-wise purchase history
- **Production Management:** Maintains production operations by auto inventory updating and batch-wise finished goods reports
- **Financial Accounting:** Automatically consolidates business information and generates all year end reports which provide an instant overview of business performance
- **Cash / Bank Management:** Manages cash / bank accounts by adding / modifying / deleting accounts, receiving and making payments
- **Electronic Point of Sales:** Records sales by scanning bar codes, automatically updates stock lists and provides a printout of sales invoice, it also creates & prints bar codes for products
- **Data Backup & Security:** SMAP software ensures the security of your critical financial data by offering you backup & restore data modules. You can secure your business information through login and password options.

We believe that accounting software should be powerful as well as easy to use. Hence, SMAP is the right solution that will definitely make your business more efficient. It will save your time to either work less or profit more.

*Open Source Technologies  
provide SMEs an  
opportunity to grow and  
expand their business.*



Developer's Site: <http://smap.smeda.org>

Download Link: [http://smap.smeda.org/software\\_download.php#smap](http://smap.smeda.org/software_download.php#smap)

Help Files: [http://smap.smeda.org/Software/SMAP\\_User\\_Guide.pdf](http://smap.smeda.org/Software/SMAP_User_Guide.pdf)

For more information regarding aforesaid Open Source Tool, please contact:

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Or e-mail at [farhan.tanveer@smeda.org.pk](mailto:farhan.tanveer@smeda.org.pk)



*Turn Potential Into Profits*

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## **Small & Medium Enterprises Development Authority (SMEIDA)**

### **Vision**

*“Growth of globally competitive SME sector, through a conducive environment and support services, serving as an engine of sustainable growth for national economy”*

### **SMEIDA Mandate**

- *Facilitate Policy-making and provide overall planning relating to SMEs in Pakistan*
- *Advise Federal Government for allocation of funds*
- *Act as resource base for providing expertise, information, data and statistics*
- *Provide, arrange and facilitate support services*
- *Initiate activities for growth and development of SMEs*

## **FROM THE EDITOR'S DESK**

The fiscal policy section covers the revamped GST regime for key SME sectors. In the Trade Outlook section we look at the potential opportunities of trade with India. We do not claim the analysis to be exhaustive. It is only a first step towards developing greater insight into trade related aspects with India and identifying potential opportunities for expansion. Productivity of agriculture is largely dependent upon agriculture inputs. Fertilizer being one of the major inputs is therefore covered under the Raw material section. In the section on Price trends, we have, in this issue discussed the Wholesale Price Index. While by and large businesses may be aware of the fluctuations in consumer prices, a look at the Wholesale Price Index speaks of the health of the economy, tracing the relative changes in the price of an individual good (or a market basket of goods) over time. In fact in some economies, at times, it is also substituted for the annual average inflation.

In the previous issues of SME Observer we initiated a section on educating and informing SMEs of the importance and effectiveness of employing ICT in their businesses. In this issue we introduce our SMEs to SMAP (SMEIDA Accounting Package) that is easy to use and is available for download and installation, free of cost.

As always, we are eager to hear from our readers. So we hope that you find this issue of the SME Observer insightful and informative and spare sometime to provide us with your feedback, so that we can make SME Observer, an even better and more useful publication.

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