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Pakistan

Transport Competitiveness in Pakistan

Analytical Underpinning for National Trade Corridor Improvement Program

July 18, 2006

Energy and Infrastructure Operations Unit
South Asia Region

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Abbreviations and Acronyms

3PL	Third party logistics
4PL	Forth party logistics
APL	American President Lines
ATTA	Afghan Transit Trade Agreement
C&F	Cost & Freight
CARE	Customs Administration Reform
CBR	Central Board of Revenue
CBU	Completely Built Unit
CEO	Chief Executive Officer
CKD	Completely Knocked Down
CMA CGM	CMA CGM Group
CONCOR	Container Corporation of India Ltd.
DHL	Dalsey, Hillblom, Lynn
DLB	Dock Labor Board
DWT	Deadweight Tonnage
EPIC	Europe Pakistan India Consortium
EU	European Union
FCL	Full Container Load
f.o.b.	Free on Board
FY	Fiscal Year
GD	(Pakistan) Goods Declaration
GDP	Gross Domestic Product
GE	General Electric
GOP	Government of Pakistan
GRT	Gross Registered Tons
IAS	International Accounting Standards
ILO	International Labour Organization
IMO	International Maritime Organization
IR	Indian Railways
JICA	Japan International Cooperation Agency
KDLB	Karachi Dock Labor Board
KICT	Karachi International Container Terminal
KPT	Karachi Port Trust
LPG	Liquefied Petroleum Gas
LCL	Less Than Container Load
MOR	Ministry of Railways
MSC	Mediterranean Shipping Company
MTDF	Medium Term Development Framework
NHA	National Highway Authority
NLC	National Logistic Cell
NMT	Non-motorized transport
NSICT	Nhava Sheva International Container Terminal
NTC	National Trade Corridor
NTCIP	National Trade Corridor Improvement Program

NTTFC	National Trade and Transport Facilitation Committee
OECD	Organization for Economic Co-operation and Development
PACCS	Pakistan Customs Computerized System
PIFFA	Pakistan International Freight Forwarders Association
PIFFC	Pakistan International Freight Forwarders Council
PIL	Pacific International Lines
PNSC	Pakistan National Shipping Company
NTCIP	National Trade Corridor Improvement Program
NYK	Nippon Yusen Kaisha
PONL	PONL Royal P&O Nedlloyd N.V.
PQA	Qasim Port Authority
PR	Pakistan Railways
PRCAS	Pakistan Railways Advisory and Consultancy Services
PRAL	Pakistan Revenue Administration Limited
PRC	Pakistan Railways Corporation
PSO	Public Service Obligation
QICT	Qasim International Container Terminal
SME	Small and Medium Enterprise
TARP	Tax Administration Reform Project
TEU	Twenty Foot Equivalent Unit
THC	Terminal Handling Charge
TIR	Transport Internationaux Routiers (French acronym)
TRRL	Transport and Road Research Laboratory
TTFP	Trade and Transport Facilitation Project
UNCTAD	United Nations Conference on Trade and Development
VSS	Voluntary Separation Scheme
VTMS	Vessel Traffic Management System
WTO	World Trade Organization

CURRENCY AND EQUIVALENTS

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EXECUTIVE SUMMARY

1. The report is neither a transport master plan nor an encompassing policy framework for the transport sector. Rather, it examines the performance of Pakistan's terrestrial links with the global market place, identifying their strengths and weaknesses, providing policy suggestions and, in some cases, broad investment priorities to ensure that the fulfillment of Pakistan's economic potential is not constrained by its trade and transport systems¹. In many respects, the theme of this report mirrors the National Trade Corridor Improvement Program (NTCIP). The analysis and recommendations formed the basis for the World Bank support and advice to Government of Pakistan (GOP) on the strategic framework for the NTCIP.

2. The strategic framework for the NTCIP was initiated by the Prime Minister of Pakistan on August 18, 2005. The National Trade Corridor (NTC) links the Afghan border, close to Peshawar, through Lahore to Karachi and Port Qasim and includes the link to Khunjrab; the corridor handles the major part of Pakistan's external and internal trade. The concept of the NTC takes a holistic and integrated approach to reducing the costs of doing business by raising the trade and transport logistics chains in Pakistan to international service levels. Under this Government driven framework, recommendations of the report provided analytical underpinning for targets set and achieved under NTCIP.

3. At the request of the Prime Minister, a Task Force was set up under the Deputy Chairman of the Planning Commission, with dedicated representatives from the Ministry of Commerce, Ministry of Communications, National Highway Authority, Ministry of Railways, Ministry of Ports & Shipping, Central Board of Revenue, Ministry of Petroleum, Ministry of Defense and the World Bank. The conclusions and recommendations provided in this report have been incorporated into the Government's NTCIP interventions (please see the Government's matrix indicating proposed targets for the NTC program in Box 1). This report thus largely summarizes what might be termed analytical underpinning for the Government's National Trade Corridor Program. As the NTCIP proceeds further, the World Bank will continue its support and partner with the various stakeholders as indicated by the Government of Pakistan.

4. The studies were initiated in response to the increasing recognition that the pace of Pakistan's economic growth and development will be strongly influenced by its competitiveness in world markets. This was the central theme of the recent World Bank Report "Pakistan: Growth and Export Competitiveness Report" (Box 2). As competition for global market share intensifies, it is essential for Pakistan to develop a carefully managed strategy for increased competitiveness and enhanced global integration aimed at accelerating industrialization and growth. Identifying and analyzing the elements that significantly impact the competitiveness of actual and potential export industries should facilitate the design of sector policies to improve export performance and ultimately overall economic growth.

5. Overall, determinants of export performance can be split into external and internal factors. External factors are mainly related to market access conditions. Internal factors refer to supply side conditions. Supply capacity is affected by transport costs and service quality (including speed and reliability of delivery), entrepreneurship, capital and labor costs, and product quality as well as the role/performance of the export promoting institutions. These supply capacity elements have a significant and positive impact on export performance and thus, in turn, on the competitiveness of export products.

6. The cost and service level provided by the internal and external transport systems is just one element of a country's competitiveness. As tariff levels fall, the economic distance to market

¹ The transport sector in this report covers roads, road transport, railways, ports and shipping.

(defined as the sum of all time and cost expenditures for moving a consignment to a market, including freight rates, handling costs, transit times, delivery predictability, loss and damage, insurance costs, etc.) plays a more and more critical role in determining competitiveness. While freight rates are still important in the final price of the product, the other elements of generalized costs, such as predictability and reliability, become increasingly important in the composition of total distribution costs.

7. An efficient, low cost trade and transport system, offering high levels of reliability and service standard, will not guarantee export success and the attraction of large scale inward direct investment. But, the obverse is likely to ensure that participation in modern high value, time-sensitive manufacturing will either be deterred entirely or confined to enclaves around international airports, dependent on air transport for export delivery, if not also the supply of imported inputs. Transport at internationally competitive levels may not be sufficient for the success of the development strategy adopted by Pakistan, but it is a pre-requisite for Pakistan to become globally competitive, as outlined in the Medium Term Development Framework (MTDF), 2005-2010.

8. In many respects, Pakistan's external transport and trade facilitation systems provide an adequate level of connection with the global economy:

- Sea freight rates for both container and bulk cargoes are in line with regional and international levels, taking into account the size of the container flows;
- Sea transit times are slightly better to some major markets than for its competitors and worse for others, but this is largely a feature of geography and distance;
- There is an adequate supply of road transport which, for break bulk and bulk cargo, offers some of the lowest road freight rates in the world, but with very low service levels;
- Where service quality is important, Pakistan's exporters have improvised relatively effective (if rather ad-hoc) arrangements with the road transport industry to monitor the flow of exports and ensure delivery times at port, though at significantly higher freight rates than are normal;
- While Customs was traditionally a major constraint, with very cumbersome and time-consuming manual systems, it is beginning to achieve significant improvements in clearance times and is in the process of further major streamlining of procedures. It is however still perceived as a problem by port users.

9. Clearly, the state of Pakistan's transport systems has not deterred rapid growth in the export oriented manufacturing sectors, particularly in textile and clothing. However, while the systems may have been adequate, they are often far from international standards and could provide lower costs and further improved levels of service to Pakistan's external sector, thus enhancing its competitiveness and growth prospects. Pakistan has also to adapt to the changing structure of the global transport system to ensure that it does not become a relative economic backwater, served only by feeder shipping. International levels of efficiency and service will increasingly be needed if Pakistan is to sustain its growth rates and become a truly major player in world markets.

10. The main weaknesses of the present transport system in relation to what might be termed "international norms" can be summarized as follows:

- High port costs and high port profits, resulting in higher charges to users than might be considered as desirable in terms of overall economic policy, increasing openness to the world economy and stimulating trade;
- Long dwell times for inbound containers, resulting in congested terminals and the need to construct additional facilities;

- Ports with relatively shallow draft, which will increasingly limit shipping connections as the size of container vessels on direct services increase;
- A weak, fragmented and relatively under-developed freight forwarding/logistics sector, which has yet to provide the breadth of services and levels of vertical integration which are increasingly found elsewhere;
- A fragmented approach towards trade facilitation with improvements to be made in the public private forum on trade facilitation issues, the National Trade and Transport Facilitation Committee (NTTFC);
- A main road infrastructure which requires major investment to provide the capacity and quality required for rapid and reliable road services;
- A trucking sector, operating old and technologically outdated trucks, which offers low freight rates but long transit times and unreliable service quality unless shippers are prepared to introduce additional and costly measures;
- Import regulations and tariff structures that inhibit the modernization of the trucking fleet;
- A trucking sector which has low private costs but high external costs in terms of vehicle overloading, leading to road damage and high accident rates, and congestion;
- A rail system with the haul distances and engineering standards which should provide the potential for rail to take a substantial share of the long distance freight market but carries insignificant levels of freight traffic and has been largely abandoned by the private sector.

11. Some of these shortcomings can only be removed by investment, others (for example, the revitalization of the railways) by both investment and policy change, while others require mainly policy change and the freedom for the private sector to make their own decisions and investment. Investments are relatively uncontroversial, given that they only require funding and funding sources. On the other hand, many of the policy changes, necessary to streamline systems, may be more difficult to agree and implement as they may adversely impact entrenched interests in maintaining existing systems. Investments alone are, however, unlikely to bring the level of change required where policy change is essential to achieve the full potential.

Box 1: Government's Targets for National Trade Corridor Program

Rationale & Approach			
Gain competitive advantage in the fast globalizing world and enhance efficiencies through, (i) provision of world class infrastructure, (ii) efficient logistics chain, and (iii) smooth interface between the public and private sectors			
Holistic and integrated approach to reduce the cost of doing business by improving trade logistics to international standards			
Focus			
Overhauling complete logistics system, including			
<ul style="list-style-type: none"> • Procedures (legislation, regulation, administration and documentation) • Services (shipping and port services, trucking, railways, handling, warehousing, customs, insurance, banking, freight forwarding) • Infrastructure (ports, roads, rail, aviation/air transport, warehouses, dry ports and pipelines) 			
Working arrangements			
Prime Minister's Inter-agency NTC Task Force chaired by Deputy Chairman, Planning Commission (PC)			
Task Force operating through six committees, each chaired by the Federal Secretary concerned (Ports & Shipping, Trade Facilitation, Highways Modernization, Trucking Modernization, Railways Restructuring and Modernization, and Aviation and Air Transport Modernization)			
NTC Secretariat established in PC for inter-sectoral coordination, analytical work, performance assessment and impact evaluation			
Trade Facilitation	Ports and Shipping	Railways	Trucking
<p>Modernize and streamline trade and transport logistics practices</p> <p>Develop trade facilitation strategy</p> <p>Expedite implementation of CARE</p> <p>Develop Freight Forwarding, Insurance, Banking to support trade logistics</p> <p>Strengthen NTIFC</p> <p>Modernize other trade organizations (such as FPCCI)</p> <p>Publicize Trade Facilitation (WTO, SAFTA, ECO)</p>	<p>Ports to reduce costs, improve logistics, and upgrade the existing infrastructure to enhance Pakistan trade competitiveness</p> <p>Professional port management</p> <p>New ports sector master plan and business plan</p> <p>Deepen berth draft of Karachi Port and Port Qasim</p> <p>Reduce free cargo dwell time to ¼ days</p> <p>Establish IT port community network</p> <p>Reduce vessel charges to international norms</p>	<p>Create PR Freight Business Unit with dedicated locos and rolling stock</p> <p>Create a commercial rail environment eliminating cross subsidies</p> <p>Introduce private sector management and financing in rail freight sector</p> <p>Ensure Fast Track Access for PR' freight business to reduce travel time for Karachi-Lahore container services to 28 hours against present 56 hours</p> <p>Door to Door service through involvement of private road transport haulers from Railway Stations</p>	<p>Make Pakistan regional hub for international trade/ facilitate expanding trade volume</p> <p>Effectively control overloading, environmental externalities and fuels quality</p> <p>Reduce operating costs, achieve fuel efficiency and save road assets</p> <p>Replace obsolete 2-axle and 3-axle rigid trucks</p> <p>Encourage introduction of modern prime movers/ multi-axle, euro standard trucks by rationalizing import tariffs</p> <p>Incentivize fleet operations, declare trucking as an industry</p> <p>Replace ineffective MVE system</p> <p>Revise National Truck Specifications and mainstream roadside assembly/ modification accordingly</p>
Estimated savings: USD 1.3 billion per annum	Estimated savings: USD 450 million per annum	Estimated savings: USD 1 billion per annum	Estimated savings: USD 2 billion per annum
<p>Source: Pakistan Development Forum, Presentation on National Trade Corridor by Dr. Asad Shah, Member Infrastructure, Planning Commission, 11 May 2006.</p> <p>Note: This matrix does not include the aviation and air transport modernization committee's objectives and work program as this is currently under development.</p>			

Box 1: Summary of World Bank Report on “Pakistan: Growth and Competitiveness” (2006)

Pakistan could see real per capita GDP growth average more than 5 percent over the next decade, but such progress is far from automatic. It will require not only sound macro-economic policies but also the investment and business environment that will develop and nurture new competitive strength. To achieve and sustain such growth, national savings will need to increase from the present 17 percent of GDP to, at least, 21 – 23 percent but perhaps as much as 27 – 29 percent if capital and factor productivity continue at present levels.

The Growth and Competitiveness Report, prepared by the World Bank during 2005, provides a comprehensive assessment of both the macro and micro-economic policies that the Government of Pakistan (GOP) should consider in developing its framework for accelerating economic growth. The Report combines the analysis in recent macro-economic studies with firm survey data from comparator countries, a cross-country quantitative framework (including 78 countries) to analyze the impacts of investment, governance and stabilization policies, and value chain analyses of five products which are either major export items or potential export items to identify those factors which do greatest harm to competitiveness and the priority remedial actions required.

The Report stresses the macro-economic foundations for growth and competitiveness: low fiscal deficits, price stability, positive interest rates and an appropriate exchange rate policy. But, the principal focus is overcoming the weaknesses in the business and investment environments. The remedial measures that it identifies aim at: reducing the cost of doing business and increasing market competition; increasing factor productivity; and strengthening export competitiveness and the export base through reducing costs throughout the supply chains. Success in achieving these objectives, and thus helping to accelerate growth and employment, will depend on the consistency of government actions. Steady improvements in the business environment would encourage increased domestic and foreign private investment.

Some of the proposed reform agenda may have a significant gestation period, such as reform of the labor and land factor markets, but there are high priority areas for early action. In particular:

- Addressing the pricing and structural issues of the power sector
- Improving the access of small and medium sized enterprises to financing
- Developing human capital and increasing the supply of skilled manpower
- Improving the efficiency of the duty drawback and sales tax rebate systems
- Streamlining trade/transport logistics and enhancing the administration of food quality and safety standards.

CONCLUSIONS AND RECOMMENDATIONS

12. In some elements of the external transport and trade system, change is already taking place and the momentum of change needs to be maintained and possibly increased and extended to cover the entire system. In other areas, Government has made announcements of its intention to introduce major changes but has yet to implement them. There are also aspects where changes have yet to be agreed, let alone implemented.

TRADE FACILITATION AND TRADE LOGISTICS

13. Efforts to increase Pakistan's competitiveness, especially of its exports, require a systematic approach that takes into account both common and trade specific impediments to efficient trade and transport logistics. Such efforts must look beyond improvements in transport infrastructure towards a general strengthening of the entire supply chain while incorporating three elements of trade facilitation, namely harmonization, simplification and standardization of trade procedures, and improvements in logistics. The efficient functioning and market structure of the ports, railways and road system as well as improvements in trade procedures and logistics services are at the heart of increasing competitiveness of exports, thus improving the general trading environment. Proposed actions include:

- *Reducing port dwell time and charges* by (i) rolling out Pakistan Customs Computerized System, (ii) completing the study identifying pre- and post-customs delay in cargo clearance, (iii) improving Afghan trade and transit procedures, and (iv) clearing full container loads (FCL) at their destinations;
- *Strengthening the public-private partnership on trade facilitation*, the National Trade and Transport Facilitation Committee (NTTFC), by enhancing its current institutional setup, structure and source of funding;
- *Enhancing services in the logistics sector*, mainly by (i) changing customs procedures with respect to bonded warehouses and movements of goods in bond and (ii) enhancing cargo consolidation, cross-docking, and inventory monitoring services;
- *Enhancing trade facilitation* by (i) developing and finalizing a trade facilitation strategy (discussed at the Trade Facilitation Conference in March 2006), and (ii) simplifying transit procedures for cargo destined for Afghanistan by renegotiating the Afghan Transit Trade Agreement (ATTA);
- *Increasing efficiency at dry ports* through (i) the formulation of standard operating procedures, (ii) the roll out of customs reform and implementation, (iii) customs examination of FCL cargo on customer premises, and (iv) the fast-track loading of exports cleared by customs at Karachi port;
- *Establishing performance monitoring indicators and benchmark.*

PORTS AND SHIPPING

14. The basic policy decision to make the port authorities landlords rather than service operators has already been taken and extensively introduced. But, the port authorities (particularly the Karachi Port Trust) are still overstaffed and unnecessary labor regulations (the Karachi Dock Labor Board) still persist, raising the cost of services to the users. While cargo handling charges are comparable with international ports, shipping charges are high and the port authorities are very profitable. Government needs to assess whether such financial transfers from users to the ports are really in the best interest of development or whether lower charges and lower port profits would have a more

positive impact on trade and economic development. Ports & shipping reform should include such actions as:

- *Improving port management* by (i) reducing port charges by 15 percent², (ii) appointing port management specialists, (iii) reducing port staff by 25-40 percent, (iv) phasing out ‘double charging’ to streamline container handling charges, (v) outsourcing of port services to the private sector, and (vi) making navigation available on a 24 hours 7 days a week basis;
- *Updating the National Ports Master Plan* to re-evaluate the appropriate roles of the Karachi Port Trust (KPT), the Port Qasim Authority (PQA) and Port of Gwadar³;
- *Closing the Karachi Dock Labor Board (KDLB)* by using a mutually agreed separation scheme;
- *Improving port infrastructure* to modernize and meet international standards by investing in both cargo handling capacity and draft depth to cater for larger vessels;
- *Completing the transformation of the KPT* to landlord status. In the longer term, GOP may also wish to consider whether a restructuring of the KPT to provide greater focus to both port and property activities would increase the effectiveness of both;
- *Raise the level of port and commercial/marketing professionalism at both ports;*
- *Establishing performance monitoring indicators and benchmarks.*

15. Sea freight rates are determined in a competitive market and Pakistan can do little to affect them, other than ensuring that the ports charge appropriate rates, provide the draft necessary to maintain/encourage direct calls, and ensure rapid turnaround. At the present time, international shipping provides Pakistan with comparable service times and rates to its main competitors. The role of Pakistani-owned vessels is strictly limited to the Pakistan National Shipping Corporation (PNSC), which enjoys a privileged and profitable position through its monopoly over the import of bulk petroleum oils. Increased participation of Pakistan-owned vessels might be encouraged by the privatization of PNSC, removal of cargo reservation, and the maintenance of the existing tax incentives. However, the commercial benefits to the external sector would be limited as Pakistani-owned shipping would follow world market rates. The economic benefits would also be rather limited as the foreign exchange component for shipping services (capital cost, fuel, spares, etc.) is high.

RAILWAYS

16. Pakistan Railways (PR) is a reasonably large passenger railway which carries some, largely public sector, freight. The quality of its mainline infrastructure and the geographical configuration of economic development and freight demand (large, long distance flows concentrated on very few origin/destination points) should mean that rail has the potential to be a substantial player in the freight market which it has largely ceded to road transport. Infrastructure investment in communications and signaling is required but the primary investment priorities for a substantially

² A 15 percent reduction of port charges is a first stage in making external transport costs and thus Pakistan trade more competitive. On April 27, 2006, the KPT Board of Trustees approved a 15 percent reduction in KPT Port charges effective from July 1, 2006. The KPT earlier reduced 15 percent of its charges in FY04, which was first reduction in its history. The cumulative 30 percent reduction in KPT’s wet charges should benefit traders at large and make port more cost-effective. This incentive should also result in more trade through the Karachi Port which is premier port of Pakistan, handling almost 70 percent of external trade.

³ A corporate plan was prepared for a proposed ports project in 1999/2000. This needs to be updated with a revised master plan for the sector.

increased freight presence are some additional motive power and the replacement of the four-wheeler wagon fleet.

17. Investment will, however, have a limited impact unless the underlying business and management environment within the railway sector is fundamentally transformed. PR is a government department with operating priorities set by passenger traffic, a large network of lines and services operated for social or strategic reasons or sheer institutional inertia, and a management outlook dominated by public sector constraints. If PR is to compete effectively and the railways to regain its role as a primary transport mode for long distance freight, substantial changes will be required in its governance, finances and operation management/priorities:

- *Establishing a reform team and preparing a restructuring plan* by (i) appointing a CEO and railways reform team (and transitional support consultants), (ii) preparing a rail restructuring plan and advising on the new structure of autonomous board, and (iii) completing a human resource audit;
- *Developing a Business Plan and Marketing Strategy;*
- *Transforming its present departmental structure and governance* to meet commercial management and priorities. State Corporation status may be necessary, but other measures will also be needed to provide the required commercial management;
- *Separating core and non core services* by establishing separate holding companies for freight, passenger and non-core activities and land assets with an increased operational and management priority to freight (freight should have its own accounts, dedicated motive power and train paths);
- *Treating infrastructure cost recovery on an equal basis for road and rail.* While commercial rail services should fund their above rail costs and track maintenance, major track rehabilitation and new investment should be funded by GOP. PR should also be relieved of its past sunk costs (debt servicing and existing pension obligations) as rates should be based on long-term future avoidable costs;
- *Introducing modern financial management and accounting* through IAS accounting designed on a business lines approach;
- *Resolving the social and strategic cost* of keeping loss-making lines/service open for business.

18. Structural changes in the organization, management and governance of the railways should be accompanied by efforts to ensure that the right labor and skill levels are available for efficient present and future operations. The present productivity levels and past restrictions on recruitment make it very possible that present overstaffing may co-exist with impending staff shortages in critical areas.

TRUCKING

19. Present trucking services are largely low cost and low quality, provided by the informal sector. Such services are unlikely to sustain the growth and development of an increasingly complex externally-oriented manufacturing sector operating to international standards, competing in international markets and required to meet international delivery times and reliability. A competitive trucking sector will normally attempt to accommodate changing customer requirements and preferences, but such adaptation can be greatly facilitated by the appropriate policy framework and enabling highway infrastructure.

20. Policies should be established which encourage the growth of a modern trucking sector, enhance service speed and reliability and reduce the high external costs of the present trucking sector.

Reforms should include:

- *Rationalizing truck import tariffs and removing the deletion policy* to encourage the re-equipping of the fleet with larger, modern vehicles appropriate to providing high service levels;
- *Allowing import of second hand equipment* to allow small operators to re-equip their fleets at reasonable cost. Second hand trucks are the traditional route for small operators in almost all countries;
- *Improving trucking regulations* by (i) agreeing on TIR implementation modalities, (ii) rationalizing MVT, registration and inspection systems administered by the provinces, (iii) enforcing axle load control plan, and (iv) increasing numbers of formal truck operators which will reduce high external costs of the sector (in terms of both road damage and safety);
- *Initiating and implementing truck modernization* to achieve EU compliance, de-link and corporatize National Logistics Cell's Trucking Unit, revise national truck specifications for 2, 3, and multi-axle prime movers, and propose a diesel quality plan.

OVERALL ASSESSMENT

21. Although major investment in Pakistan's main transport infrastructure is still required, especially in the highway sector, much of the essential capital assets for an efficient, competitive transport sector already exist. The port infrastructure is adequate for present demand and the main line rail track infrastructure would support a much higher level of freight operations. Policy and institutional changes in the way that the transport sector is organized and managed would result in substantial gains in productivity and cost reductions as well as establishing the basis for increased private sector investment in the sector. Introducing such changes may not be easy as some may be at variance with entrenched interests, but they are needed to provide the transport industry necessary to support a rapidly growing economy competing in the global market.

22. The presented package of changes represents the basis for the World Bank's involvement in the NTCIP, which relates proposed changes to envisaged outcomes and develops potential savings related to improving the business environment in Pakistan.

1. A TRADE FACILITATION AGENDA

1.1. INTRODUCTION

23. The importance of trade facilitation⁴ to Pakistan's competitiveness forms the background of this chapter. Over the past decade, the Government of Pakistan (GOP) has done much to improve the country's trade procedures (particularly Customs clearance) and logistics services. GOP has also been a main proponent of addressing trade facilitation under the auspices of the ongoing WTO negotiations, playing an important role in helping to bring trade facilitation negotiations back on track after Cancun, and by building consensus on the establishment of a Negotiating Group on Trade Facilitation.

24. While Pakistan supports the general trade facilitation agenda within WTO negotiations, as it believes trade facilitation can improve trading principles⁵, it underlines that there must be an adequate linkage between any new obligation and the implementation capacity of developing countries. The real challenge of trade facilitation is to minimize transaction costs and the complexity of international trade for local businesses, without compromising efficient and effective levels of collection of customs revenues and other border controls.

25. More than ever, the sustained economic growth and trade competitiveness of Pakistan heavily depend on improvements to its trade environment through harmonization, simplification and standardization of trade procedures, and improvements of logistics services. The GOP has significantly liberalized the country's trade regime since 1998, through tariff cuts and rationalization, and exports have increased substantially and the export basket has shifted from primary exports to manufacturing and non-traditional exports.

26. The pattern of demand for trade related procedures and logistics services are, in turn, changing as trade moves from low value and time insensitive primary products to higher value products. Increasingly, attention is shifting to more effective supply chains and more efficient order cycle times as the means of increasing competitiveness. Lead times have always been critical for high-value goods and perishables, which form a small but rapidly growing part of Pakistan's export. They are becoming increasingly critical for medium and low value goods where large wholesalers and retailers want to minimize inventory and the risk of overstocking, while still ensuring product availability.

27. The bulk of Pakistan's international trade, about 40 million tons per annum of dry and liquid cargo, is transported by road along the main corridor, Peshawar-Lahore-Karachi, called the National Trade Corridor (NTC). Almost all of this trade (95 percent) is handled by the two seaports of Karachi and Port Qasim, located about 50 km from each other. Pakistan's trade is characterized by a concentration of movements within the country (mainly along the NTC), small numbers of export destinations and import origins (mainly three regions) and a simple supply chain structure⁶. This should provide ideal conditions for improving trade procedures and logistics services.

⁴ Although there is no agreed single definition of trade facilitation, in this chapter trade facilitation is seen as creating an efficient environment for trade and transport. This is done through simplification, harmonization and standardization of international trade procedures and improvements in trade logistics services (such as warehousing, consolidation, etc.).

⁵ Pakistan has put forward two proposals in the Trade Facilitation Negotiation Working Group, namely TN/TF/20 and TN/TF63.

⁶ The supply chain most often involves direct movement between the factory and port or via an inland container depot.

1.2. EVOLUTION OF IMPROVEMENTS IN TRADE AND TRANSPORT LOGISTICS

1.2.1. Pakistan's Export Characteristics

28. Pakistan's economic reforms have done much to boost its share of total trade as percentage of GDP (rising to 30 percent in 2004-05) and underscore the growing importance of merchandise trade for its economy. Pakistan's exports have strongly performed in recent years, rising to about US\$ 14.4 billion in 2004/05 (Table 1). Imports have also increased rapidly, reflecting higher oil prices and strong demand, in particular for machinery.

Commodities	2004-2005	% of total exports	% growth (previous year)
Textile and Garments	8.926	62%	8%
Raw Cotton	0.110	1%	131%
All others	1.087	8%	-6%
Cotton manufactures	7.729	54%	10%
Other core categories	3.190	22%	32%
Rice	0.932	6%	47%
Leather and leather products	0.938	7%	26%
Petroleum and Petroleum Products	0.476	3%	62%
All others	0.842	6%	39%
Developmental Categories	1.098	8%	32%
Chemical & Pharmaceuticals	0.453	3%	72%
Fish and fish preparations	0.139	1%	-9%
Fruits and vegetables	0.126	1%	-6%
All others	0.380	3%	35%
Others	1.178	8%	44%
Footwear (excl. leather)	0.029	0%	174%
Furniture and mattress	0.176	1%	270%
All others	0.972	7%	28%
Total Exports	14.391	100%	17%

Source: Pakistan Exports Statistics, 2006, Export Promotion Bureau.

29. Pakistan's exports, in terms of value, are highly concentrated in a few items, namely textiles and clothing, cotton, rice, other textile and garments, and leather/leather products. Exports of textile manufactures (62 percent) are undergoing a structural transformation from low to higher value added items with the shares of knitwear (12 percent), readymade garments (13 percent) and, to some extent, bed wear (10 percent) showing significant increases compared to 2003-04. Other export commodities with high growth rates to the previous year include furniture and mattresses (270 percent), footwear (174 percent), and chemicals and pharmaceuticals (72 percent).

30. The export growth of Pakistan's manufacturing sector is characterized by two main features: the manufacturing sector is mainly driven by SMEs⁷, and the main exports, such as textiles and clothing as well as other core categories (leather/leather products, etc.), are characterized by a buyer driven supply chain. In such chains, production is organized and controlled by the final, mainly large buyers who do not directly organize production themselves, but have key first tier suppliers⁸.

31. In terms of geographic location, production of knitted and woven garments is concentrated in Karachi and Lahore, whereas firms in Faisalabad cater mainly for home products (i.e. bed linen, towels, and other textile made-ups). In Karachi, the factories are specialized in producing fabric, dyeing or manufacturing garments. Other core categories (i.e. sports goods, surgical instruments which represent 2 and 1 percent of total exports, respectively) and part of the leather garment industry and development categories, such as cutlery, are located in the city of Sialkot.

32. Although Pakistan trades with a large number of countries, its exports and imports are nevertheless highly concentrated with a few countries. About one-half of Pakistan's exports went to seven countries, namely, the USA, Germany, Japan, the UK, Hong Kong, Dubai and Saudi Arabia, and one-half of imports originate from just seven nations, namely, the USA, Japan, Kuwait, Saudi Arabia, Germany, the UK and Malaysia.

33. Pakistan has achieved considerable progress in simplifying its tariff structure and reducing its tariff levels, and the share of trade in GDP has increased from 24 percent in the late 1990s to close to 30 percent by the end of FY2005⁹. Generally, Pakistan's applied tariffs are below WTO-bound commitments, and the weighted average applied tariff is currently 16 percent down from 56 percent in 1994. The tariff on most consumer goods has been reduced to 25 percent, on most intermediate goods to 10 percent and on raw materials to 5 percent.

34. The relatively low tariffs on imports of raw materials (i.e. cotton) are mainly based on the dependency of Pakistan on these imports as inputs for its export products (textile and clothing). In Pakistan, as in other countries, there are a number of schemes to put the exporters on a duty/tax free basis in order to compete on a level-playing field in international markets. These include (i) the duty drawback mechanism, which facilitates the rebate of customs duties collected on import inputs; (ii) a program to refund sales tax collected; and (iii) the duty and tax remission for exports scheme. Major inefficiencies in these systems, particularly with respect to SMEs, still remain¹⁰.

1.2.2. Trade Facilitation and Logistics requirements of Pakistan's major exporters

35. The larger exporters (mainly multinational companies) have established relatively simple and efficient supply chains, both inbound and outbound, and have direct contracts with the buyers. The SMEs exporters, including those producing garments, surgical suppliers and sports equipments, leather goods and other non-traditional exports, do not have these advantages. In general, their supply chains are more complex; they have more difficulty with custom facilities for importing required raw materials as input for export products and lack direct access to markets.

36. Services provided by the logistics sector in Pakistan, in particular freight forwarders, are fairly simple. These services involve direct movement from the factory and port or via an inland

⁷ There are approximately 3.2 million private business enterprises. These enterprises (mainly SMEs employing up to 99 persons) constitute nearly 78 percent of the non-agricultural labor force.

⁸ In garments such buyers include department stores like Debenhams in the UK or JC Penney in the US, speciality stores such as Gap, brand names without production or major retail outlets of their own such as Liz Claiborn, discount stores such as Walmart, supermarkets like Tesco, and mail order houses.

⁹ Pakistan's share in global trade has inched up from 0.15 percent to close to 0.2 percent.

¹⁰ Remedial actions include: (i) to continue simplifying duty drawback rules and documents, (ii) to provide importers/exporters with easy to use information on procedures, (iii) to intensify efforts to shorten the processing of submissions by new export firms and SMEs, which are facing particular large delays.

container. Although 100 percent of shipment consolidation is handled by freight forwarders, the constraints on establishing bonded storage and the limitations on who can operate such facilities has halted further development in the industry.

37. In general, it is difficult to generalize about the impact of the costs for logistics services on the competitiveness of exports goods because of the wide range of exported goods and the differences in their sensitivity to delivered cost and time. An attempt to estimate and apportion the costs of logistics was made in a 1996 study; the results show the relatively low proportion of costs for customs' clearance but a high percentage for the total logistics' service, especially the land and ocean transport. The intervening years have seen a reduction in their importance as a result of increasing value of exports and improvements in the transport infrastructure/services. In order to understand the relative contribution of different logistics services, the costs for a sample container shipment from Sialkot to Europe were estimated and are shown in Table 2.

Size	Costs (US\$ thousand)		Time (days)	Costs as % of total		Time as % of total
	20'	40'		20'	40'	
Contents (tons)	12	20				
Value (approx.)	\$30,000	\$50,000				
Sea Freight	\$1,150	\$2,100	19	58%	61%	73%
Trucking	\$300	\$400	3	15%	12%	12%
Port Charges	\$135	\$250	3	7%	7%	12%
Consolidation	\$250	\$450	1	13%	13%	4%
Clearance	\$150	\$250		8%	7%	
Total	\$1,985	\$3,450	26	100%	100%	100%
Per TEU	\$1,985	\$1,725				
% of Value ^(a)	6.6%	6.9%				

Consultant's estimates.
Note: Not included are taxes and duties.

1.2.3. Trade Facilitation and Logistics at the core of NTCIP

38. Reflecting the high priority assigned to supporting sustained growth and competitiveness of Pakistan's economy, the Government has launched an integrated corridor management program, called the National Trade Corridor Improvement Program (NTCIP). The NTCIP focuses on the corridor linking Pakistan's major ports in the south with its major cities in the North, namely, the Peshawar-Lahore-Karachi corridor.

39. The vision for trade and transport logistics under the NTCIP is the establishment of an efficient and integrated system that will facilitate the transformation of the present levels of services to international standards while ensuring safety in mobility. The objective of the program is to develop an integrated approach to planning, investing and managing the NTC logistics system with the strategic thrust for the optimal utilization of the existing capacity, improvement management of maintenance and operations, and the coordinated use of the available modes of transport.

40. It is widely recognized that an integrated corridor management program in Pakistan must look beyond improvements in transport infrastructure to the general strengthening of the entire supply chain, including trade logistics. The focus of these efforts is on the effectiveness and cost of procedures and services available to international trade. The efficient functioning and market structure of the ports, railways and transport system and their ancillary services is, in turn, critical for efficiency of trade movement.

41. Key outcomes will be significant reductions in the time and cost of moving goods along the corridor. Under the NTCIP, the Prime Minister has indicated a desire for the reduction in customs clearance time to two days, a reduction of ports free storage period and a decrease in port dwell time by June 2006. In view of the importance of the program and its direct correlation with the economic growth strategy devised by the government, implementation is being personally monitored by the Prime Minister. A list of indicators on trade facilitation and logistics to be monitored under the NTCIP and their respective targets is presented in Table 3.

Box 2: Measuring NTCIP Performance and Targets on Trade Facilitation and Logistics

The average customs processing time should only measure the duration of Customs processing from the lodging of the Customs declaration until its release (including the duration of the physical examination performance). The customs clearance time differs from the overall port processing time measure which includes the time from the moment of the arrival of the goods until the moment when the goods have been cleared by customs (i.e. customs processing is completed) and the importers are allowed to pick them up and proceed to the domestic market. In many cases, pre- and post-customs delays are largely due to long grace periods granted to importers at ports or border crossing. Such is the case for ports' free storage period at Karachi Port. The measurement of performance targets set by NTCIP in terms of customs clearance time (and ports' free storage period) will be undertaken according to this methodology.

Table 3: NTCIP: Performance measures/targets for Trade Facilitation/Logistics

Measure	To date	June 2006
Average Customs clearance time	4 days (1)	2 days(2)
Ports' Free Storage Period	7-9 days	4-5 days

Source: Presentation to the PM by the Taskforce, January 2006.

Note: (1) This is based on a survey undertaken by a consultant hired by the World Bank (see Box 2 for details on methodology).

(2) This is in line with the Bank funded Tax Administration Reform Project (TARP). TARP has set negotiated targets for Customs performance in terms of trade facilitation. These consist of a reduction of the average customs clearance time to less than one day by end of 2006, and to less than 4 hours by end of the project, at designated sites.

1.3. DIAGNOSTIC OF TRADE LOGISTICS IN PAKISTAN

42. The Government of Pakistan has made significant progress in the facilitation of international trade. These improvements include measures taken to simplify and modernize customs procedures, and to increase the quality of logistics services. It has also focused on the infrastructure side of the supply chain by upgrading roads and ports facilities, in particular along the Peshawar-Lahore-Karachi corridor.

43. Transport services, with the exception of rail, have benefited from a reduction in public sector participation and an increase in competition (see subsequent chapters for details). The logistics services industry, in particular freight forwarding, has to some extent increased the range of services offered and improved the quality of these services through interaction and cooperation with international service providers.

1.3.1. Customs Modernization: Simplified Procedures

44. The simplification, modernization and harmonization of procedures and documents are at the heart of the trade facilitation agenda with customs clearance being the main focus. There are several areas where interventions and reforms have been implemented and/or initiated in Pakistan: (i) the introduction of a SAD as the standard for the Pakistan Goods Declaration (GD) and (ii) computerized reorganization of clearance.

45. The GD is based on the United Nations Layout Key prescribing a standard layout for all international trade documents. The GD is the equivalent of the single administrative document (SAD) used internationally and was gradually introduced to replace various forms for goods clearance such as the bills of entry, shipping bills, baggage declarations, transshipment permits etc. The introduction of the GD¹¹ has brought Pakistan at par with international standards, reducing the costs of transaction and logistics.

46. In parallel with the development of the GD, a major effort was made to improve areas of customs and collection of duties. As previously detailed, the Government has been reducing customs duties and simplifying their structure over the last few years¹². At the heart of the Customs Administration Reform (CARE) was the development of a comprehensive single window for all clearance operations (Pakistan Customs Computer System, PACCS), which took place between February 2002 and March 2005. PACCS was launched in Pakistan as a pilot project starting at Karachi International Container Terminal (KICT) in March 2005 to set up electronic filing of the GD from the premises of the authorized consignors, consignees and the customs agents.

47. If/when fully implemented, the system will allow the clearance procedures to be moved away from the border while, at the same time, reducing opportunities for informal payments and providing incentives for importers and exporters to obey existing regulations. PACCS replaced the former manual clearance system (still in place in other customs stations around the country), which was characterized by multiple windows, numerous official signatures and verifications (up to 36 signatures and 62 control steps) and an environment with limited accountability and transparency¹³. The system is currently being implemented in the pilot project at KICT for all types of declarations including imports, exports and transshipment.

48. The estimated processing for Customs at KICT in 2005 is reported to be around 3 days, according to consultant estimates. A pilot survey¹⁴ undertaken by a consultant in 2004 indicated that average processing time for customs at KICT was about 4 days, 53 percent of total dwell time (see

11 The GD was launched at Port Qasim Collectorates of Customs as a pilot project for imports. After successful implementation of the pilot project for imports at the Port Qasim the use of the GD has been extended to Export Collectorates and has now been successfully implemented throughout the country.

12 In 1995, the Pakistan Revenue Administration Limited (PRAL) system was first introduced and followed by a broader effort aimed at reforming collection of duties and taxes, the Customs Administration Reform (CARE).

13 For example, all documents were previously hand carried by clearing agents from one desk to another, and the entire processing chain encouraged discreet interface between customs officials and importers. PACCS offers a virtual single window environment.

14 This is time reported by the private sector which tends to count additional delays aside from the actual customs processing time, such as those due to the port authority or the customs brokers. The estimated processing for customs at KICT in 2005 is five hours, according to figures provided by the CBR CARE team.

Box 2 for methodology of measurement). The time between clearance and exit from port, which was on average seven and a half days has, with the introduction of PACCS, been cut to one day or less, because importers no longer have the incentive to use the port as a convenient storage area. In addition, the time between the landing of the containers to declaration lodging has come down from two days to none (declarations can be lodged in advance), and the time between declaration lodging and release of goods is now, on average, under five hours. This makes the progressive rollout of PACCS, to the rest of Pakistan a very high short-term priority.

49. Though Customs is beginning to achieve improvements in clearance times and the further streamlining of procedures, port users at both Karachi and Qasim still perceive customs processing as a problem. This perception is due to the long dwell times for containers in ports, which are well above international norms. Post-customs delays are on average 4.3 days which include the time containers spend in the terminals after the completion of customs formalities.

50. Since the average time for customs processing was established to be about 4 days, it would be fair to conclude that customs processing at KICT generally exceeds 24 hours. Yet, according to the survey, the shortest clearance time was about 3 hours and shortest pre-Customs delay was less than an hour; these times provide sufficient grounds to conclude that it is theoretically possible for overall customs processing to be completed in less than 24 hours.

51. The long customs processing time is related to the fact that at the time of survey, all shipments were inspected. Best practice in risk management used by Customs suggests that selectivity and targeting of inspections have yielded noticeable successes. In addition, once trade intensifies it may not be physically possible for Customs staff to examine all shipments as they did at the time of the survey.

52. Post-customs delays represent major impediments and include excessive free storage periods¹⁵. While this is certainly a welcome advantage for importers and a desirable feature in many ways, it is however an obstacle to efficient port operations and utilization. Other delays are attributable to the shortages of road transport; lack of rail services and logistical facilities to take containers out of the port; a weak business sector; uncollected cargoes due for auction remaining in port for long periods; government interference; and fumigation procedures.

53. The long dwell times effectively reduce the capacity of the container terminals to less than half their potential. Ship-shore container handlings speeds are up to international levels, but on-shore container processing times are more than twice as long as at efficient international ports. The consequences are clear during visual inspections of the terminals. At both the KICT and the QICT, the berth occupancies are low while the stacking areas are full, even with 4 high stacking. The Indian Nhava Sheva International Container Terminal (NSICT) handles about three times as many containers as the KICT and the QICT, with a berth of similar length. Failure to solve the dwell time problem will entail unnecessary duplication of investment in container terminals.

1.3.2. Ancillary Logistics Providers

54. There are a number of logistics services, like consolidation, freight management, warehousing, etc., needed to facilitate trade inbound and outbound movements. Critical among these are logistics services providers such as freight forwarders and clearance agents. While the logistics industry in Pakistan has experienced significant improvements over the last decade, most of the effort has been to improve the efficiency of the existing activities. In order to improve Pakistan's trade

¹⁵ The free storage period of 7 days (effectively 9 days), including weekends, should probably be reduced to about 4 days soon after the customs bring in a comprehensive set of reforms scheduled for 2005. Most of the terminals in the Gulf have free dwell times of 10 days, but much of the traffic is transshipment, which is not the case in Pakistani ports.

competitiveness, it is necessary to focus on adding value by increasing the quality of the services provided. The services currently provided by the industry depend mainly on the existing market structure and its functioning.

55. The logistics industry in Pakistan includes a large number of freight forwarders and clearance agents offering individual services and a combination of services through subcontracting. Most forwarders coordinate less than container load (LCL) shipments, for both imports and exports by negotiating for the services of the consolidators and clearance agents. To a lesser extent, freight forwarders also handle full container load (FCL) shipments, about 20 percent of all FCL shipments.

56. In general, the services provided are simple because of the simple structure of the supply chain (direct movement between the factory and port or via an inland container depot). While the forwarding industry in Pakistan has a significant role in providing logistics services to importers, much of their growth has come from handling exports, especially for the growing clothing and textile industry.

57. The common arrangement is for exporters or local forwarders to deliver shipment to either the port of Karachi or Port Qasim (rarely to airports) where foreign buyers take receipt of f.o.b. shipments and complete their movement using nominated forwarders. Some buyers use nominated logistics providers to extend their involvement backwards through the supply chain and provide consolidation services, i.e. distribution centers or buy ex-factory. Meanwhile, some exporters sell on C&F basis services with the delivery to the foreign port being managed by local forwarders operating through joint ventures or partnerships with foreign forwarders or by acting as agents for international logistics companies.

58. Generally speaking, the freight forwarding industry is highly competitive (with downward pressure on profits). There are an estimated 456 (mainly small) ¹⁶ freight forwarders operating in Pakistan (see Table 4). But, 11 percent of all freight forwarders (exclusively the larger ones) offer integrated logistics services (4PL) and have captured almost half of the market. Many of these are local offices or representatives of large international companies (e.g. DHL/Danzas, Bax Global). Others are part of joint ventures or have established associations with forwarders in other countries so as to offer international logistics services.

Table 4: Size Distribution and Profitability of Logistics Providers, 2004

	Firms (% of total)	Market share (% of total)	Net Profit Margin (%)
Brokers	55%	18%	1.0%
3PL services	34%	36%	2.5%
4PL services	11%	47%	4.0%

Source: Pakistan's International Freight Forwarding Sector, 2005.

Note: 4PL services are fully integrated logistics services which include coordination of other logistics and transportation providers. 3PL services include transportation, warehousing, order management and other logistics activities including light assembly.

59. The situation in the local freight forwarding industry is improving, albeit slowly. Only recently has the government recognized forwarding and logistics as an industry, allowing forwarders to engage in foreign exchange transactions¹⁷. This followed the transformation of the industry's representative body, which represents about 80 percent of the freight forwarding companies, from a council under the Federation of Pakistan Chambers of Commerce and Industry to an independent

¹⁶ The majority of Pakistan's freight forwarders have fewer than 15 employees and over half are sole proprietorships or partnerships. Despite their size, most have at least 10 clients and about half have 30 or more.

¹⁷ Ministry of Commerce, Trade Policy 2005-06, Speech by Humanyan Akhtar Khan, Minister of Commerce, July 21st, 2005.

association (PIFFC to PIFFA). The industry is now positioned to introduce a well-defined trading environment and push for effective government support.

60. Because of the simple structure of the supply chain in Pakistan, there has been little incentive for the development of integrated logistics services or the introduction of services other than transport and storage. Clearance agents and freight forwarders have always offered trucking and storage services, usually through subcontracting, but only now are attempting to integrate these services. The use of subcontracting is one approach, given that the core business of 4PLs is to coordinate the various activities of the supply chain. The local industry has however failed to provide the development and promotion of the value-added services that have become the hallmarks of modern logistics, e.g. tracking and tracing, cross-docking, vendor managed inventory, global door-to-door delivery and embedded enterprise software.

61. The consolidation business has also been slow to evolve largely because forwarders are not allowed to move the container out of the port except to the nearby container freight stations or the dry ports and then only after customs clearance. Inland movements to the dry ports are primarily FCL shipments. The current constraints on establishing bonded storage facilities and the limitation on who can operate them has placed serious limitations on the development of the logistics services' suppliers.

62. The role of the industry and trade associations, which hold consultative sessions with regulators on a periodic basis, is also important as an avenue to influence the GOP's policy on trade facilitation and logistics issues. A platform of interaction between the public and private sector on trade logistics issues has been established under the auspices of a collaborative framework, the National Trade and Transport Facilitation Committee (NTTFC).

63. The NTTFC and its secretariat, established as part of a World Bank project (Trade and Transport Facilitation Project, TTFP), has been recognized by the industry for its achievements in establishing professional standards for freight forwarders, and contracts of affreightment. While responsibilities for implementing improvements in the logistics sector remains with the relevant Government agencies and the private sector, the NTTFC's role is to facilitate the dialogue and, most importantly, provide the technical support for proposed innovations. The introduction of the GD was mainly promoted by Customs, with training support from the TTFP.

1.3.3. Opportunities with respect to Supply Chain Security

64. One of the most significant developments in the international transportation of goods in the last few years has been the proliferation of security initiatives affecting the modern supply chain, most of which have been introduced for trade with the United States. Pakistan has reached an agreement with US Customs and Border Protection authority on the container security initiative (CSI). This represents an important incentive to both consolidate and integrate the logistics industry, and seek further partnerships between the trade and Customs, enabling the introduction of the concept of approved importers/exporter.

1.4. THE WAY FORWARD: A TRADE FACILITATION AGENDA

65. A trade facilitation agenda for Pakistan needs to recognize that (i) competitiveness in Pakistan is a function of export price and, equally important, the trade environment, of which trade facilitation and logistics is a part, and (ii) the need to be flexible and ready to respond to changing priorities as new problems replace older ones. The lessons of trade facilitation initiatives aimed at reducing time delays, costs and potentials for alterations in the trade logistics chain in other parts of the world can be summarized as follows:

- Excessive regulation by the public sector holds back private sector participation and competition, thereby overwhelming entrepreneurship and private investment;
- Streamlining and upgrading information technology, while simplifying customs and other regulatory procedures is at the heart of trade facilitation (developing electronic linkages between various stakeholders);
- Care should be taken to avoid overly optimistic goals and to develop realistic timetables for implementing trade facilitation measures;
- Detailed indicators, such as increasing outputs, government revenues, cost savings, consumer satisfaction, productivity gains, job creation and more efficient public institutions, should be used to monitor performance;
- Improving the enabling environment through infrastructure modernization and regulatory reforms, particularly in the transport sector, increases the ability of a country to improve efficiency, and to attract and retain appropriate private investors;
- Capacity building efforts are critical in particular for logistics services providers for timely and effective implementation of trade facilitation and reform measures;
- Ownership and political commitment are key to ensuring strong local leadership, availability of funds, and clear delineation of ministerial responsibilities.

66. Efforts to increase Pakistan's export competitiveness require a systematic approach that takes into account both common and trade specific impediments to efficient trade facilitation and transport logistics. Constraints related to the public sector require coordination between government agencies and often between public and private sector while private sector initiatives need further development through incentive-creation.

1.4.1. Develop national trade facilitation strategy

67. Formulating a national trade facilitation strategy is at the forefront of trade facilitation initiatives. This represents also one of the objectives under the NTCIP. The strategy should be developed as an integral part of Pakistan's trade policy, optimizing the use of trade infrastructure and complementing trade promotion efforts.

68. To be effective, such a trade facilitation strategy needs to address the following issues:

- Identification of trade facilitation priorities as part of the national development strategy and NTCIP program
- Application of WTO disciplines in trade facilitation with focus on costs and benefits for Pakistan
- Provision of a reasonable schedule of implementation of trade facilitation priorities
- Projection of financial support for priority areas, including but not limited to WTO provisions

1.4.2 Establish effective public-private partnership

69. A public-private partnership between the three main players involved in trade facilitation, namely the Government agencies, private sector logistics service providers and traders has been established, and its contribution to the trade facilitation agenda has widely been recognized. But, NTTFC's role needs to be further strengthened as *the* focal point on trade facilitation in Pakistan; presently, its institutional setup, structure and source of funding are weak.

70. To make NTTFC a more effective forum with the aims of raising trade facilitation issues, proposing solutions and supporting the implementation of these solutions, further ownership, commitment and financial contributions from both the industry and the Government are needed. The level of contribution to the Secretariat should be sufficient to support at least three professional staff and provide funding to support seminars, training and prepare technical reports.

71. Given the high priority for sustained growth and competitiveness and the Government's launch of the NTCIP, NTTFC needs to expand its role as coordinator of technical assistance and research on trade facilitation to become a real service center in support of the development of the National Trade Corridor (NTC).

72. A follow up project on Trade and Transport Facilitation, prepared by the Ministry of Commerce in cooperation with the Planning Commission and approved by Central Development Working Party of the Planning Commission proposes, amongst other activities, to upgrade the staffing, and broaden the mandate of the NTTFC Secretariat. An increasingly important ongoing role for NTTFC and its Secretariat will be to establish itself as a reference point for NTCIP, regional chambers of commerce and other business associations on trade facilitation issues, in general, and, in particular, as they are negotiated within the WTO. The proposed follow up project also includes additional technical assistance to underpin NTCIP with analytical work.

1.4.3. Rapid roll out of CARE approach and refinement

73. Improvements in customs clearance procedures create the potential for substantial gains in trade facilitation. While Pakistan has started customs modernization under the CARE system, it is important that the efforts now underway to introduce computerization and specialization be continued through a rapid roll out of PACCS, together with modifications to make it more effective. For speedy implementation of the plan, the Central Bureau of Revenue (CBR) has issued instructions to all Collectors of Customs. According to the CBR, it is imperative that the collectorates undertake a thorough analysis of their existing clearance procedures and devise a strategy to identify and remove hurdles to the swift clearance of goods.

74. Serious efforts are undergoing at KICT with the introduction of a modern approach to customs clearance, but customs clearance procedures are fragmented throughout the country. Both transit and clearance at up-country locations is slow and inefficient for reasons that are related to the current manual customs procedures in addition to non-factor services, poor physical logistics, and overall transport costs. These procedures also represent major impediments to transit to Afghanistan which is currently covered by the ATTA¹⁸.

75. As renegotiation of the ATTA cannot be undertaken by Customs, given its status as an international agreement, negotiations between Customs of the two countries are underway in order to change the current Afghan Transit Trade Invoice (ATTI) to a single transit document, the Customs Transit Declaration, accepted by both Pakistan and Afghanistan Customs. The Goods Declaration could then be used as the Unified form of Goods Declaration in order to avoid the double capture of similar information requested for Customs transit procedures. This would mean that the Afghanistan Customs Clearance Document (ACCD) would be aligned with the Goods Declaration. In this respect, the CARE approach, notably through PACCS, is an opportunity to develop the entire trade corridor. Such plans already exist in customs, where the Afghan transit document will be replaced by electronic interface between the Pakistan and Afghan Customs administrations. An adequate integration of the customs modernization plan into the integrated trade corridor management approach, suggested by NTCIP is therefore necessary.

¹⁸ The ATTA required that freight be moved by the railways between the port of Karachi (this was the only port in operation at the time of signature of the Treaty) and the railheads at Chaman and Peshawar. At these railway terminals, cargo in transit to Afghanistan are to be loaded on trucks for delivery into Afghanistan.

76. While PACCS is well developed, and provides for streamlined operations, it may need further refinement in two areas, namely risk management and post release checks. A team working on the Tax Administration and Reform Project identified the following issues: (i) the on-line updating of PACCS may result in possible changes in duties or regulatory requirements during the interval between lodging and assessment of declarations; (ii) the direct entry of rules and rates by other, non Customs users can pose a threat in terms of data integrity, (iii) the payment of duty when declaration lodging, as early as ten days before the arrival of goods, can have an impact on revenue collections due to fluctuations in the exchange rate, and (iv) post-release audit functions, an indispensable counterpart to expedited release, do not appear to have been addressed. The following steps are suggested to refine PACCS: (i) update the entire files of PACCS only once a day, (ii) validation by Customs of all entries and changes before becoming effective, and (iii) a simulation on recent transactions, showing the impact of this measure on financial statistics.

1.4.4. Improve range and quality of logistics services

77. GOP needs to recognize that without a strong freight forwarding industry, export targets are unlikely to be achieved. The freight forwarding industry in Pakistan still operates under major constraints, like establishing bonded storage facilities. Various efforts are underway to upgrade the skills of the logistics services suppliers mainly through training in basic skills. This has, however, not impacted the quality of services and created the value additions required for further trade competitiveness. There is a need to create incentives for the industry to develop additional value-added services.

78. The interface functions offered by PACCS such as online connectivity between traders, electronic documentation filing, no requirement for the export manifest, and advance cargo handling instructions represent steps towards a more integrated supply chain management and further integration of customs functions with logistics services. The potential role of Government and NTTFC in promoting added-value to freight forwarding industry services should be the key to the future growth of the industry.

79. This will require changes in customs procedures regarding bonded warehouses and movement of goods under bond. The limited shipment consolidation services provided by small freight forwarders in Pakistan are still prevalent due to limitations of bonded storage facilities and issues of ownership of these facilities. Until this issue is resolved, the development of the freight forwarding industry and the flexibility of merchandize exporting will continue to be constrained. It will also require better cargo consolidation, cross-docking, and inventory monitoring services, and more efficient data interchange between shippers and logistics providers.

80. Under international practice, bonded warehouses are usually categorized as (i) publicly owned warehouses, usually owned by a Chamber of Commerce or a port authority, where all operators can store goods (subject to specific conditions), and (ii) private warehouses, which can be used either for the sole purpose of the owner, or can be rented out to other operators. This practice has enabled consolidators and freight forwarders to use their warehouses for freight consolidation purposes. It is unclear why this is not possible in Pakistan.

1.4.5. Increase efficiency at dry ports

81. At present, only about 10 to 15 percent of the import and export cargo are being handled by the 12 dry ports of the country, whereas the volume of work should be more than half according to international standards. This consideration leads to the further development of the existing dry ports, shuttling goods between Port Qasim or Karachi Port and dry ports as efficiently as possible. This, however, presupposes appropriate regulatory arrangements, in particular with customs, to allow for quick removal of imported goods from the port grounds, final clearance taking place at the dry port,

or even later at the final destination. The formulation of standard operating procedures for dry ports and the roll out of CARE initiative to dry ports as well as the introduction of customs examination of FCL export cargo at factory premises would help increase efficiency of dry ports.

1.4.6. Establish systematic performance monitoring system

82. The sustainability of NTCIP and continued financial support by the Government and international donors will largely depend on positive outcomes. The establishment of performance indicators to monitor and measure the progress in the work program endorsed each year is critical to provide the basis for continuing support. GOP may wish to identify the outcomes that the country expect from the major initiatives and suggest qualitative and quantitative indicators that can capture the achievement of desired outcomes. For trade facilitation, the indicators should measure and assess the efficiency, accuracy and speed with which various steps in an international trade transaction is carried out.

83. Reliable performance indicators for Customs activity should cover two areas: (i) performance at selected locations, considered as representative of border or inland clearance office activity, and (ii) national values used to assess the overall performance of the Customs administration, compared to international or regional benchmarks. Local performance indicators include (i) overall time between arrival and release of goods, (ii) rate of physical examination, and (iii) rate of detection of irregularities. Under the Tax Administration Reform Project, the following pilot locations for local performance monitoring were discussed: (i) KICT, where a first survey was carried out in summer 2004, and where on-going monitoring is possible, using PACCS functions, (ii) Lahore inland clearance terminal, where paper procedures are still in operation, (iii) Towr Kham (main border crossing with Afghanistan), which is paired with the corresponding border station in Afghanistan, and (iv) Sost (main border crossing with China).

2. PAKISTAN PORTS POLICY

2.1. INTERNATIONAL PORT REFORM

84. Thirty years ago, ports were major barriers to trade in many countries, and this led to pressure for radical reforms. These reforms have been very successful in increasing efficiency and reducing costs. The current consensus favors the abolition of government monopolies and the introduction of competition wherever possible. This generally entails the promotion of private sector operation; deregulation of entry, investment and tariffs; and also government measures to tackle labor problems, especially those of over manning and restrictive practices. There is general agreement on the desirability of the withdrawal of port authorities to a landlord role, with most/all operations carried out by private companies in a competitive environment.

2.2. PROGRESS IN PAKISTAN'S PORT REFORM

85. Pakistan has been making steady progress in port reform and improving port performance. Since it opened in 1980, Port Qasim has operated as a landlord port, serving the steel, petroleum, chemical and other industries. The majority of the cargo is handled at independent terminals. It also has a privately operated container terminal. Karachi is also making progress towards converting itself into a landlord port. Although most of the cargo is still handled at government berths, the Karachi Port Trust (KPT) has now privatized most of the container operations and is planning further privatizations. There is now strong competition between the two ports' four container terminals which handle the majority of Pakistan's international seaborne trade, in terms of value. As a result, Pakistan's ports now rate quite highly on the two most important performance indicators: handling speeds are generally up to international standards and *tariffs* are only slightly high by international standards

(a) Handling speeds

86. The ship-shore handling speeds at Karachi are in line with those at efficient international ports for all categories of cargo – especially containers, but also bulk cargoes and general cargo. Containers are handled at over 25 moves per crane/berth hour¹⁹, bulk cargoes are handled at approximately 3,000-9,000 tons per ship day, depending on the commodity handled, and general cargo at 2,500 tons per ship day. These high handling speeds reflect the fact that the operations are already run mainly by the private sector. The Karachi Dock Labor Board (KDLB) does not detract significantly from ship-shore handling efficiency, simply because its workers do not participate in the actual cargo handling work.

87. The operations at Port Qasim are also generally up to international standards. Handling speeds for containers are around 22-24 moves per crane/berth hour; and handling speeds for non-container cargoes are in line with standards at efficient ports elsewhere.

¹⁹ Productivity per *ship*-hour, however, is not quite as impressive as productivity per *crane*-hour. A major international shipping line reports about 55 moves per ship hour for the large direct-call ships, and this is slightly below the international standards expected. Internationally, ship-hour productivity can reach 125 moves/hour, but these levels are only reached on very big vessels with large numbers of box exchanges.

(b) Tariffs

88. Total container handling charges at port Karachi's specialized terminals are on rather the high side by international standards. They are estimated at US\$113 per twenty foot equivalent unit, TEU (US\$122 per 20 foot container and US\$210 per 40 foot container)²⁰. There are two main reasons for the relatively high charges. Firstly, the shipping lines impose several additional charges including, in some cases, a shipping surcharge whose justification is now no longer clear. Secondly, a "terminal handling charge" (THC) is effectively charged twice: (i) by the shipping line and (ii) by the container terminals. If the THC were charged only once, the cost would be around US\$88 per TEU, which is more in line with international charges, including those in Indian ports.

89. Charges for handling bulk cargoes and the residual general cargo, however, are relatively low by international standards. They are negotiated at levels of around US\$4-6 per ton, which often include additional services such as bagging on the quay or re-handling. Container handling charges at Port Qasim are slightly below the KPT levels, averaging about US\$105 per TEU compared with US\$113 per TEU at Karachi.

(c) Comparison with Other Countries in the Region

90. Pakistan's port reforms compare relatively well with those of the other Indian Sub Continent countries. India's reforms have been generally limited to container terminals, and the government has failed to develop capacity in line with rapidly growing demand. Also, the port authorities have failed to tackle the staffing problem at existing ports, and are now saddled with large numbers of surplus employees. In Sri Lanka, reforms have been limited to the privatization of one container terminal; and the Colombo port authority has the burden of a vast labor force (13,000 employees). Bangladesh has made very little progress in port reform. However, Pakistan's main exports are trading in an increasingly competitive market and Pakistan needs to ensure that its ports fully support its external trade position with the highest efficiency at the lowest cost. Table 5 summarizes port efficiency at KPT with comparable international benchmarks (PQA's performance is similar to that of KPT as seen in the table).

Table 5: Pakistan's Port Efficiency compared with comparable benchmarks

	KPT	QICT	Sri Lanka (SAGT)	Hong Kong	India (Nhava Sheva)
Containers handled per crane hour	25	24	25	30	25
Containers handled per ship hour (a)	55	60	70	100	65
TEU per metre of quay p.a.	400	680	1000	1800	2000
TEU per terminal hectare p.a.	18,000			40,000	43,000
Container Dwell Times (days in the terminal)	10	10	5	4	6
% of containers examined physically	100%	100%	<5%?	<5%	High
Waiting times for berths, hours per ship	0	0	0	0	24
Waiting to service time ratio	0	0	0	0	0.5
Handling charges per TEU, or tonne	113	105	35/150(c)	140	80
Ships dues/ship call, 2800 TEU ship	\$30,000	\$28,000	\$5,500	\$6,000	\$25,000
TEU or tonnes per staff member p.a.	900		1200	1600	3000
Water Depth (m)	10.5	11.5	13	14	12
TEU handled p.a. (million)	1.4		2.2	14	2.2

Source: Consultant's estimates

²⁰ Tariffs at the non-specialized KPT berths are about US\$30 per TEU lower.

2.3. NEED FOR FURTHER REFORM

91. Despite the recent progress in the reform of Pakistan's ports, further reform is still desirable in two main areas: (i) the port authorities; and (ii) the KDLB.

2.3.1 Port Authorities

(a) Staff Numbers

92. Both ports are overstaffed. The KPT has made bold progress, reducing staff numbers from 14,000 in the late 1990s to 5,000 in 2004, but still needs further streamlining to bring staffing levels in line with KPT's new role. Port Qasim seems to also be overstaffed (with 1,600 employees), although not to the same extent as the KPT, and it may actually require additional staff in some areas. But even the largest landlord ports in the world generally employ fewer staff than the PQA. Rotterdam has 1300, Antwerp has 1600.

(b) Type of Staff

93. The main need within the port authorities' management and operations is for a more commercial approach. The ports have made progress in modernizing management procedures, including computerization of financial transactions and automatic security systems, but need to strengthen contacts with port users. The emergence of competition between Karachi and Port Qasim (and in the future from Gwadar) makes the introduction of active marketing departments even more necessary than before, when the only non-captive traffic was transit traffic. Such departments will need to be staffed with the necessary commercial management skills.

(c) Port Finances

94. The ports make excessive profits. The KPT's budgeted revenues of US\$150 million for 2004-5 are more than twice as high as its budgeted costs. A surplus of this level is unusual in the port industry, as is the very high level of income from investments (43 percent)²¹. The Port Qasim Authority (PQA) also makes a large profit, with operating revenues of US\$32.1 million compared with operating costs of US\$21.2 million in fiscal year 2003 (see Table 6). This shows that about 40 percent of the net surplus comes from income from investment, property and storage while about 60 percent comes from operations.

Table 6: Income and Expenditures: Port Qasim Authority (fiscal year 2003)

	Pakistani Rupee million	US \$ million
Revenues (Total)	1,924	32.1
Operating Expenditure (Total)	1,274	21.2
Operating Surplus	660	11.0
Income from investment, property, storage	429	7.2
Net Surplus	1,089	18.2

Source: Port Qasim Authority.

²¹The KPT has extensive landholdings in Karachi City and makes large non-port property investments as, for example, the Port Tower (Pakistan Economic Survey 2004-5). It might be desirable to separate port and non-port land and activities into separate enterprises to allow a completely port focused authority to manage the port.

95. High port profits are not a “good thing” per se. They reflect port charges that are higher than necessary; these are additional costs which are passed on to importers and exporters. This is not necessarily a “zero sum” game from the viewpoint of the economy as a whole; lower port charges and increased incentives for trade may have a much more positive impact on the overall economy than high port profits. A substantial reduction in port revenues and surpluses would be desirable, particularly if this was achieved via port tariff reductions (see next paragraph), which are passed on to the wider economy.

(d) Tariffs

96. Port entry charges are high at both Karachi and Qasim. The combined KPT charges on ships for port entry, tugs, pilotage and berth hire amount to about US\$0.82 per GRT. This would be equivalent to US\$26 per TEU on the assumption of a 35,000 GRT ship handling 1000 TEU. Although these charges are well above international benchmarks, they are not significantly higher than at the main Indian ports. But they are over five times higher than those at the dominant container transshipment ports of the region - Colombo, Dubai and Shalala. The KPT is aware that their charges are high, and has reduced the average port entry cost from over US\$1 per GRT to US\$0.82 in the last year.

97. The PQA’s port entry charges are slightly lower than those of the KPT. The combined charges on ships for port entry, tugs, pilotage and berth hire at PQA amount to about US\$0.72 per GRT. These tariffs contribute to large financial surpluses for the KPT and the PQA. They deter lines from calling with large ships; and they are the main reason for the Pakistan Port Surcharge. The PQA has reduced port charges by 15 percent during May 2005.

(e) Promotion of Competition

98. Competition between the two port authorities so far has been limited. The ports are not permitted to discount tariffs to attract customers. The port authorities do not have marketing departments. Competition in the port sector occurs mainly at the terminal level. The terminals are free to negotiate tariffs, while the port authorities are not. In the crucial container sector, competition between Qasim International Container Terminal (QICT) and the three KPT container terminals is already intense. It resulted in QICT taking several customers away from Karachi in 2004. The container terminals at Qasim and Karachi have different cost advantages and disadvantages. The costs of container operations at Qasim are lower than they are at Karachi, because they do not have to pay for a dock labor board and they pass only 60 percent of the wharfage charges back to the PQA. (the PQA’s wharfage charges are also lower than those of the KPT).

99. These savings reduce costs by about US\$29 per TEU (US\$17 for the Dock Labor Board and US\$12 for the lower wharfage) compared with KPT. On the other hand, QICT has the additional costs of inland transport to/from Karachi and the cities to the north: the weighted average additional land transport cost of using Qasim rather than the KPT is about US\$31 per TEU. The net result is that Qasim suffers from a cost disadvantage of about US\$2 per TEU, which is trivial in relation to total costs and the importance of service quality.

(f) Acceleration of Reform

100. Until the late 1990s, the KPT lagged behind world trends in port reform. But, it has now completed the most important task in progressing towards a landlord role, by introducing competing private container terminals. Two thirds of Karachi’s dry cargo, in terms of tonnage (and a much higher percentage in terms of value), is shipped in containers.

101. There are now two private container terminals at Karachi and one at Port Qasim. In addition there is a low cost option for container handling at the KPT berths. Consequently competition is now

strong. Karachi has avoided the “second best” form of privatization, via utility style concessions with regulated tariffs and productivity levels. The KPT is committed to the continuation of reforms, and is planning further introduction of the private sector - in bulk handling, marine services and the engineering department.

102. The most important area under the KPT, which would benefit from further privatization, is the handling of geared container ships, mainly feeders. Almost all these ships are handled at the KPT berths, which still handle over 40 percent of Karachi’s containers. The services at KPT are reported to be about US\$30 per TEU less expensive than those at the KICT and QICT. Their productivity, however, is lower, at about 17 moves per crane hour compared with about 25 at the specialized terminals. The largest of the operators at the KCT berths has rented an area of 4 hectares, which reportedly handles 180,000 TEU per annum. The ship-shore charge is low, and is kept low by competition from other stevedoring companies. The shore handling is, however, still carried out by the KPT staff.

103. The compulsory shifting of the feeders to the KICT and QICT berths is being considered by the KPT. This is not recommended; the low cost alternative has demonstrated its commercial viability by attracting over 40 percent of the containers handled at Karachi. It is comparable with the low cost “midstream operations” at Hong Kong, which continue to handle about a quarter of the port’s containers. These low-cost, low-technology options are used particularly by small businesses/traders and may thus indirectly benefit lower income groups²².

104. The weak points of these low-cost operations are that (i) the stevedores do not have their own quays, and (ii) the KPT is still involved in shore handling. It is recommended that the stevedores should be allowed their own separate berths and that the KPT should withdraw from operations.

105. Port Qasim has not had to embark on a major reform program comparable with KPT’s because:

- Port Qasim has always been a landlord port. The operations are carried out efficiently by private sector companies or industrial plants;
- It has not been burdened with a dock labor board (see the next paragraph); and
- The staff surplus is far smaller than at the KPTs.

106. There is, therefore, no need for a privatization program at Port Qasim. The port has only one publicly owned terminal and the operations are carried out efficiently by 10-15 private stevedoring companies who have purchased their own equipment.

(g) Reduction in Container Dwell Times

As discussed in Chapter 1, one of the main problems at Pakistani ports is the dwell time for containers in port, which is well above efficient international norms. The long dwell times effectively reduce the capacity of the container terminals to less than half their potential. Ship-shore container handling speeds are up to international levels, but on-shore container processing times are more than twice as long as those at efficient international ports. At both KICT and QICT, the berth occupancies are low while the stacking areas are full. Failure to solve the dwell time problem will entail unnecessary duplication of investment in container terminals. Conversely faster dwell time tailored with customs reform shall help capacity increase of QICT. It is therefore imperative that customs reforms such as CARE and PACCS, tailored with increased automation, be invariably launched at the port to reduce dwell time at Port Qasim.

²² It has been suggested that these small traders serve the less formal sector and thus impact lower income groups in Pakistan.

2.3.2 Karachi Dock Labor Board

107. There are no significant problems with the terminal operators' own labor. The problems are caused by the KDLB, whose registered dockers the terminal operators are obliged to employ and subsidize. The original aims of the KDLB, when it was set up in 1973, were reasonable. Like similar schemes in other countries, the KDLB was established to provide regular work and income for dock workers who had previously been employed on a *casual* basis;

108. In practice, however, the scheme started badly and it has become more unsatisfactory over time. Its main deficiencies are:

- It was overstaffed from the start. When the KDLB opened in 1973, 8598 dockers reported for registration. This was more than had been expected, and almost twice the requirement;
- Dockers were guaranteed employment at a time when containerization and other forms of mechanical handling were reducing the need for manual workers;
- The reduction of the KDLB via natural wastage was slowed by the introduction, in 1987, of the hereditary right of a son to replace a retiring dock worker (phased out in 2000);
- The wages for the dock workers rose to levels several times higher than those for workers in comparable work elsewhere in Karachi; and the cost of medical and other benefits for relatives as well as the dockers have increased steadily;
- The KDLB staff receives further payments under an incentive scheme. These are based on very low, outdated "norms" for cargo handling, which result in the dock workers getting bonuses even if handling speeds are very low;
- The registered dock workers, however, do little work on the quays. In fact, they do not have the skills for modern cargo handling operations. They are trained mainly for outdated general cargo, break-bulk operations, while two thirds of Karachi's dry cargo is containerized. The port operators, however, are obliged to employ the KDLB gangs, and to pay for them essentially to watch the operations. The general consensus within the port is that the KLDB staff are neither needed nor wanted;
- Worse, the manning levels for the KLDB gangs are several times as high as would be necessary, even if they worked (e.g. KLDB container gangs consist of 24 men while only 4-6 are needed). They are based on outdated productivity norms.

109. The main effects of the KDLB on efficiency and costs at Karachi can be summarized as follows:

- The KLDB does not detract significantly from port productivity, because its members do not participate significantly in the work;
- The KLDB adds significantly to costs. Firstly, the cargo handling companies are obliged to employ the unnecessary KDLB gangs and, in most cases, pay unnecessary incentive payments. Secondly, the cargo handling companies have to pay a cess (i.e. a levy) to provide minimum salaries for KDLB staff when they are not "working", as well as medical and other benefits.
- The KLDB impairs the level playing field competition between Karachi and Port Qasim, as Port Qasim does not have a DLB.

110. The abolition of the KDLB has almost unanimous support amongst port users and there are many international precedents for such a move. Similar schemes have been closed in many other countries, as they are now regarded as obsolete. The DLBs were originally set up to provide guaranteed employment and incomes to the *casual* labor that used to predominate in ports. But, the trend is now towards *permanent* employment, especially in container terminals. A recent ILO study reported that two thirds of a large number of ports, replying to a questionnaire, stated that casual

workers accounted for less than 10 percent of their requirements. Wherever possible, permanent employment should be encouraged at Karachi.

111. The key to facilitate KDLB's abolition is the availability of funds for worker pay-offs. There appears to be a consensus that about Rs. 1 million per employee would be required, i.e. just over Rs. 4.2 billion, or US\$70 million. This would be equivalent to a minimum of seven years' salary. This would be extremely generous by international standards (for example, the UK dock workers got a maximum of about 15 months salary). It would have to be available as a lump sum, enabling those who wished to set up other businesses to do so.

112. There are three possible sources of finance for funding KLDB's closure:

- The continuation of the cess for, say, 3 years to repay a bank or other loan, e.g. from the KPT surpluses, which would be used to pay the lump sums *now*, with future cess payments as security. This would not be an unacceptable burden in practice, as the cess would have to be paid if the KLDB were retained;
- The sale of DLB property; and/or
- GOP funding or, alternatively, a World Bank loan or a commercial bank loan. The World Bank, as well as being a possible source of funds, has an extensive track record of assisting with sensitive labor reductions, e.g. in coal mining in Russia. The World Bank could also assist with a social audit of the likely consequences of closing the KLDB and make provision for worker counseling, retraining, and other social safety net measures.

2.4. INVESTMENT REQUIRED

113. The private sector has already taken over most of the responsibility for investment in the terminals. The container terminals at Karachi and Qasim are being expanded with private funding. There are also private sector plans to build new specialized facilities, an LPG terminal and an edible oil terminal at Qasim, financed mainly by Malaysian interests. There is, however, a need for investment in basic infrastructure, in particular for dredging²³.

114. At the KPT, capital dredging of at least 1.5 meters is necessary to accommodate direct calls by the container ships which will be introduced in the near future. Direct calls have already largely replaced feeder services at the top Indian ports as a result of: (i) the growth of traffic volumes, and (ii) the sharp rise in port efficiency following privatization. Pakistan is now starting to follow the same trend, but the current draft restriction at Karachi, 10.5 meters in practice, is too shallow to accommodate the ships which are now being phased in. Two top shipping lines have already moved from Karachi to Port Qasim because Karachi does not have sufficient draft. But, Port Qasim has only a minor advantage. Shipping lines confirm that they plan even larger ships on the routes.

115. At PQA, there are plans to dredge the entrance channel to 13.2 meters, with 17 meters at the entrance. The project includes work on the banks and areas for ships to pass. The objective is to accommodate 85,000 DWT vessels and stimulate direct calls from shipping lines. The costs are estimated at about US\$90 million; and the PQA has already approached the government for approval.

116. The consequences for the economy of Pakistan of being served only by feeder vessels in the medium to long term would be serious. They would include:

- Additional costs of feeder services to and from regional hub ports such as Salalah, Colombo or Singapore, to connect with trunk route services;

²³ A contract has been signed for the procurement of dredging at Port Qasim.

- Longer transit times and delays, which are very injurious to the export markets, especially for delivery sensitive commodities such as garments and textiles; and
- The loss of potential international investors who include frequent, direct shipping services on their check list of preconditions for locating in a country.

117. Other investment requirements listed by the PQA operational staff included buoys for night navigation all along the 43 km long channel, especially at sharp bends, to demarcate the bank limits; dry-docking facilities for tugs, which currently have to use the government owned and operated Karachi dry-dock, where naval vessels get priority; procurement of a dredger for regular maintenance of the long channel; replacement of floating craft, including tugs and pilot boats; and a Vessel Traffic Management System (VTMS)²⁴.

2.5. OTHER ACTIONS NEEDED

118. Other requirements include a Master plan, development of marketing capability, release of statistics, and consideration of the role of the Navy in the ports:

- A revised national ports master plan would seem advisable. The original master plan was carried out in 1994, while Port Quasim's master plan was updated during 2001²⁵. A revised master plan should examine Karachi, Port Qasim and the new port at Gwadar which will soon be open for commercial traffic. It should determine (i) the need for dredging at the separate ports; (ii) the effects of world shipping trends on port requirements, including the consolidation of shipping lines, larger vessels and the possible trend away from hub and spoke services to direct calls; and (iii) the potential of Pakistan's ports, particularly Gwadar, to act as gateways to/from the economies of Central Asia;
- The port authorities require marketing departments, with the ability to negotiate terms and discount tariffs, where necessary, to attract traffic. This is necessary for enhancing competition between Karachi and Port Qasim for the benefit of the overall national economy;
- The port should compile and publish regular statistical reports, covering cargo traffic, shipping traffic, cargo handling speeds, ship times at berth, waiting times, financial indicators, etc. They should be reported in a statistical yearbook. It is unusual for major ports not to prepare such documents;
- The dominance of the Navy in port management is unusually high by international standards. Many of the top positions are occupied by naval officers on short term assignments, from which they either return to the Navy or retire. While these officers may well be of high caliber, this practice may have two rather negative effects. Firstly, the officers may be less commercially minded than will become necessary for future port operations (modern ports are intensely competitive); secondly, the predominance of short term Navy assignments in high positions may well limit the incentives of the permanent port staff to perform well in order to advance their careers. The KPT is aware of these problems and has emphasized that the assignment of naval staff to senior positions is a short term solution - a consequence of expertise not being available within the KPT. The KPT's stated intention is to have KPT officers occupy all positions.

²⁴ The economic/financial feasibility of these proposed investments has not been assessed for this policy note.

²⁵ The Masterplan was prepared by Engineering Consultants International in collaboration with M/s Maunsell Consultancy Services and included (i) a review and analysis of existing facilities, (ii) transport access to Port Qasim, (iii) Port's institutional framework, (iv) Port's operations, and (v) land management issues. The Master Plan is currently being updated.

2.6. REGULATION

119. The Ministry of Communications is the effective regulator of the ports industry. Its main controls are over port authority tariff changes and investment, which have to be cleared by the Director General, Ports and Shipping. The Ministry has allowed the ports to build up unusually large financial surpluses. The long term aim should be to minimize regulation, relying wherever possible on competition to reduce tariffs and increase port efficiency and customer service.

2.7. SUMMARY OF MAIN RECOMMENDATIONS

- *Improving port management/operations* by (i) reducing port charges by 15 percent, (ii) appointing port specialists, (iii) reducing port staff by 25-40 percent, (iv) phasing out 'double charging' to streamline container handling charges, (v) outsourcing of port services to private sector, and (vi) making navigation available on a 24 hours 7 days a week basis;
- *Updating National Ports Master Plan* to re-evaluate the appropriate roles of the KPT, the PQA and Port of Gwadar;
- *Closing the KDLB* using the retrenchment option;
- *Improving port infrastructure* to modernize and meet international standards by investing in both cargo handling capacity and draft depth to cater for larger vessels;
- *Completing the transformation of the KPT* to landlord status and raise the level of port and commercial/marketing professionalism at both ports;
- *Establishing performance monitoring indicators and benchmarks.*

3. PAKISTAN SHIPPING POLICY

3.1. INTERNATIONAL SHIPPING TRENDS

120. Twenty five years ago, international general cargo shipping was dominated by self-protecting shipping 'conferences', which limited competition in the industry and fixed freight rates at high levels. These cartels often contained state-owned national shipping lines, which were allocated cargo under UNCTAD's 40/40/20²⁶ cargo sharing code of practice. Today, international general cargo shipping is much more competitive. Although the industry is dominated by a relatively small number of international shipping lines²⁷, the decline of the conferences and the increased level of competition have resulted in a fall in freight rates to levels well below those of the late 1980s. Almost all of the state run national shipping lines have dropped out, unable to survive in the competitive market.

3.2. OBJECTIVES OF SHIPPING POLICY

121. This report assumes that shipping policies in Pakistan have two main aims:

- To promote efficient, low-cost shipping services to support Pakistan's international trade; and
- To promote the national shipping industry in order to minimize the loss of foreign exchange on payments for international shipping services. The cost of international shipping services to Pakistan is probably over US\$2 billion. Moreover, in a volatile region, a national shipping industry may help provide security for strategic imports.

122. This report regards the first objective as being, by far, the most important.

3.3. PERFORMANCE OF EXISTING SHIPPING SERVICES

3.3.1. Container Shipping Services

123. The two most important dimensions for container shipping services are the tariffs and the service quality:

(a) Tariffs

124. Pakistan's freight rates are broadly in line with those of its international competitors for exports – in particular India, Sri Lanka and Bangladesh. There are, however, some differences, as shown in Table 7. Pakistan's freight rates are lower than China's freight rates on the routes to Europe and the US East coast – because of the shorter distances. But, Pakistan has slightly higher freight rates than the west coast of India. This is to some extent inevitable in a competitive market, because Indian container volumes are very much greater and thus containers handled/vessel call are higher.

²⁶ Cargo sharing: 40 percent to ships of exporting nation, 40 percent to ships of importing nation, and 20 percent to third party ships.

²⁷ At the beginning of 2004, the top 4 container shipping companies controlled 31 percent of the world market, and the top 25 companies controlled 79 percent of the market. Industry concentration has increased with the acquisition of P&O Nedlloyd by Maersk.

	US\$ per TEU, to Europe
Pakistan	1,350
India West Coast	1,250
India East Coast	1,300
Bangladesh	1,400
China	1,650
Colombo	900

125. All of the world's top eight container shipping lines provide services to Pakistan's ports. The lines calling are, in descending order of their share in Pakistan's export market, Maersk-Sealand, APL, MSC, PONL, Safmarine, PIL, Yang Ming Line, NYK, CMA CGM, Hanjin, United Arab Shipping Company, and Evergreen²⁸. No Pakistani shipping lines provide container services.

126. The services are highly competitive, reflecting recent developments in the international shipping industry: decline in "conference" power and disappearance of national cargo reservation. In addition, shipping services in the region have received a boost from the liberalization of the Indian ports and their increased efficiency. Previously, the ports were so inefficient that no major container lines would call. Overall, there has been a radical improvement in efficiency and a major reduction in container tariffs, during the last twenty years. Container rates reflect market conditions in the world economy and are thus subject to significant movements, Table 8:

	2000	2001	2002	2003	2004
Asia to Europe	1,600	1,296	1,208	1,672	1,826
Europe to Asia	800	688	694	795	735
Average, both directions	1,200	992	951	1,234	1,281
Asia to US (Pacific)	1,950	1,624	1,476	1,995	1,946
US to Asia (Pacific)	850	801	757	871	838
Average, both directions	1,400	1,213	1,117	1,433	1,392

Note: These rates include CAFs, BAFs and also THCs (unlike the previous table)
Source: Containerization International

127. The increased demand from the rapid expansion of Chinese manufactured exports has raised rates recently but a big expansion in the number of container vessels under order may result in downward pressures on rates in the near future.

128. The container shipping rates for Pakistan's exports are negotiated mainly by the large importers in the US and Europe (e.g. WalMart, Target, etc) who have formidable bargaining power. They arrange the sea transport because a high percentage of textile exports (70 percent of Pakistan's exports) are sold f.o.b.

²⁸ The container shipping industry is consolidating but, even with the purchase of PONL by Maersk, the top five shipping lines serving Pakistan still lift <50% of the export containers shipped.

(b) Service Quality

129. The transit times from Pakistan are satisfactory. The fastest times are 19 days to Europe and 22 days to the USA. Interestingly, the best transit time to Europe is achieved by a feeder operator rather than a direct call service. The Europe Pakistan India Consortium's (EPIC) direct service takes longer as it is rather a "milk run", calling at Jebel Ali, Qasim, Nhava Sheva, Mundra, Aqaba, Port Said, Cagliari, Tilbury, Antwerp and Hamburg. Exporters also point out that feeder services give greater frequency than direct calls. Maersk has two feeder services, both of which call at Qasim once a week, while the EPIC direct service to Europe calls only once a week

130. In comparison with its major competitors, Pakistan shipping time advantage/disadvantage depends critically on the destination:

- For European destinations, Pakistan's transit times are slightly faster than those from Hong Kong, and very slightly slower than those from India;
- For US East Coast destinations, Pakistan's transit times are faster than those from Hong Kong, and similar to those from India;
- For US West Coast destinations, Pakistan's transit times are much slower than those from Hong Kong, and similar to those from India²⁹.

131. The exporters express general satisfaction with the quality and level of services. Their complaints are limited to shut out times, etc. and the seemingly arbitrary additional charges applied by local agents.

132. There is, however, the danger that limited port drafts may leave Pakistan as the poor relation in regional shipping services, with larger and more economic ships calling at Indian ports but not at those of Pakistan.

3.3.2. Bulk Shipping Services

133. The bulk ships bringing cargoes to Pakistan are chartered on the open market. Their costs are therefore dependent on the charter rates and world economic conditions. The rates are normally low, but have been high for the last two years, as a result of the extraordinarily high demand for shipping to China. These costs cannot be much influenced much by the GOP, except insofar as it can promote a larger user-owned national fleet (see below).

134. The bulk ships do not face significant bottlenecks or inefficiencies in Pakistan's ports. Port handling speeds are adequate to turn the ships round quickly, and there is no significant queuing time for bulk berths. The available water depths limit the size of vessels. While this may not affect some traffic, importers of petroleum products, iron ore and coal report that they would use larger vessels, if they could.

3.3.3. Overall Assessment of Shipping Services

135. The costs, transit times and reliability of container services to/from Pakistan are satisfactory, despite the lack of participation by Pakistani lines.

136. The costs of bulk shipping services are dependent on international freight rates, which have been low for many years, but are high at present. Service quality is satisfactory

²⁹ However, exports to the East Coast are four times higher than those to the West Coast.

3.4. THE NEED FOR GOVERNMENT INTERVENTION

137. The scope for government policy to reduce freight rates or increase efficiency in shipping services is limited, other than by ending its protection of an inefficient public sector shipping corporation. As described previously, the container services calling at Pakistan's ports are efficient and their tariffs are in line with those to competing countries. Their efficiency and low tariff levels are a result of a high level of competition in the shipping sector; government intervention or regulation in this area is unnecessary.

138. Bulk freight rates are high at present. This is, however, the result of unusual conditions in the international charter market; and, again, there is little scope for government intervention to improve the situation.

139. The main measures that the government could take to reduce freight rates are, for both container and non-container cargoes, to:

- (i) Dredge entrance channels and berths to allow larger vessels and thus obtain the economies of vessel size. The current channel depths at both Karachi and Qasim are well below the Panamax depth which is now the standard at many major international ports³⁰. The diseconomies of limited ship size are a direct cost to the economy and will become increasingly serious as the size of container vessels rise.
- (ii) Reduce the high port entry charges although these high port dues are not a cost to the Pakistan economy, rather a transfer from importers to the port authorities.

140. In addition, as the next section will suggest, the dismantling of the protection enjoyed by the state owned Pakistan National Shipping Company (PNSC) and the promotion of private Pakistani shipping lines would be desirable. But it is emphasized that a large national fleet is not a *necessary* condition for efficient shipping services and reasonable tariffs, these are already provided by foreign shipping lines.

3.5. THE PROMOTION OF NATIONAL SHIPPING

3.5.1. The Role of the Pakistan National Shipping Corporation (PNSC)

141. The role of Pakistani entities in international shipping has become limited in recent years. The only significant company, with Pakistani registered ships, is the PNSC, which is state owned. It has 14 ships of which 4 are oil tankers and the remainder old, out-dated general cargo ships. It has no container ships. Twenty five years ago, PNSC had a fleet of 50 ships. By the late 1990's, PNSC had lost most of its liner cargo and was making regular losses.

142. Privatization of PNSC was seriously considered in the early 1990s, but was reportedly vetoed on the grounds that a national fleet, under state control, was necessary for "strategic control". This argument may seem less justified today, given the improvements in regional political relations. It might also be noted that the policy of attempting to maintain a strong national liner shipping industry, via state control, has effectively destroyed the rest of the national shipping industry.

143. In 2001, PNSC was given a new lease of life, when it was awarded a 10 year contract to carry all crude oil imports to the national oil refineries (about 8 million tons per annum), despite owning only one tanker. On the available evidence, the tariffs charged by PNSC are well above market rates

³⁰ Pakistani ports have depths of 10.5 m (KPT) and 11.5 m (PQA), well below those of China and the Red Sea (14 – 16 m) and even below those of the west coast of India (12 m) and Colombo (12.5 m). See also Chapter 1. Pakistan Ports Policy.

and these have allowed PNSC to make large profits in the last few years. They were sufficient, for example, to allow PNSC to buy new tankers from its accumulated financial reserves.

144. This monopoly has effectively prevented the growth of private shipping. There is now no effective shipping industry in Pakistan outside PNSC. This problem has persisted for many years, but this should not be a reason to allow it to continue. It has become more urgent as the aftermath of 9/11 has left three quarters of Pakistan's large seafaring community unemployed (see section 3.5.3).

145. It is emphasized again, however, that a national fleet is not essential for competitive shipping services.

3.5.2. Attempts to Promote Private Shipping

146. Shipping was nationalized in 1971, when the ships of several private companies were taken over by the PSNC. Since then, the role of Pakistani private shipping has been minimal.

147. There was an attempt to revive the sector in the 1990s, but the outcome was disappointing. Initially, three companies (Tristar, Ray and Milwala Shipping) bought ships. Two years later, the government announced retroactive import duties and other taxes, totaling 34 percent. Two of the new ships, which were located in Pakistan and unable to pay the taxes, were arrested. As a result, all the other ships were sold. The liability of imported ships to duty was later cancelled but the incident left a legacy of distrust regarding the stability of government shipping policies.

148. There was a second attempt to promote private shipping in 2001, when the government introduced several financial incentives. These included income tax, import duty and surcharge exemptions, an annual tonnage tax of one dollar per gross ton, and the easier movement of foreign exchange. But these financial incentives have had no effect. The private Pakistani shipping fleet is still more or less non-existent. This is partly attributable to distrust but also to (i) the reservation of government cargoes for PSNC (private operators have to obtain a "no objection certificate" from PNSC, which has the right of first refusal for government cargoes); and (ii) residual problems with the ability of lines to transfer foreign exchange.

3.5.3. Merchant Marine

(a) Seafarer Employment

149. According to the Ministry of Ports and Shipping, Pakistan has 20,000 trained seafarers and, in the past, their incomes were a major earner of foreign exchange. Little of this employment was on Pakistani ships, with almost all the Pakistani seafarers employed abroad on foreign ships. PNSC now employs only about 600 people.

150. Before 9/11, about 90 percent of Pakistani seafarers were in employment, now only 25 percent are employed. The main reasons are the problems in obtaining visas and the imposition by the US Homeland Security Department of the need for security guards at ports where Pakistani sailors land. The Director General of Ports and Shipping considers this very unfair, as there have been no cases of terrorism amongst sailors. The Ministry has taken up this issue with the IMO, who have duly raised it with the US authorities, but without any success, so far.

(b) Training of Seafarers

151. The Ministry of Communications is currently upgrading the Marine Academy, which annually trains 100 officers and 100 engineers. It requires funding to replace equipment, particularly simulators, which were originally purchased with assistance from JICA, 15 years ago. The equipment is now outdated, and it is difficult to get spare parts. Such investment would become particularly urgent if Pakistan's seafarers again become accepted internationally and if Pakistan's national fleet expanded.

3.5.4. Recommendations for the Promotion of Pakistan's Shipping Industry

152. The following measures might be introduced to promote a sustainable private sector shipping industry:

- Privatization of PNSC
- Continuation of the tax concessions which have been introduced in recent years
- Continued attempts to reassure prospective investors who have lost confidence in the government's commitment to a private shipping industry
- Permanent removal of all reservation of cargoes for PNSC, especially government cargoes; and all bulks, including those for government agencies (iron ore, coal, wheat, fertilizers, etc), and the final abolition of the waiver system.
- Lobby abroad to have visa problems for Pakistani sailors removed
- Free movement of foreign exchange

153. However, a successful Pakistani private shipping industry would not necessarily lower freight rates, except where the ships are owned by the importers (e.g., the oil or steel industries). Independent private Pakistani lines would almost certainly charge market rates, as do the shipping lines in other countries.

154. The main benefit would be reduced foreign exchange payments to foreign shipping lines, probably amounting to over US\$2 billion per annum. However, a large part of vessel costs (fuel, vessels, spare parts, etc) are incurred in foreign exchange, so the net foreign exchange saving would be much less.

4. THE RAIL SECTOR IN PAKISTAN: POLICY AGENDA

4.1. INTRODUCTION

155. Pakistan's population and geo-economic development is largely located within the influence area of the Indus. 80 percent of the population lives and 85 percent of its GDP is generated within the provinces of Sindh, primarily around Karachi, and Punjab. The economic centers of these two provinces are separated by ≈1,000 kms of relatively flat terrain and connected by both highway and rail. Large volumes of long distance passengers and freight move along this north-south axis. This spatial distribution of population and economic development should be ideal for rail transport:

- high potential levels of traffic
- long haul distances over flat terrain
- limited number of traffic centers

156. There should be great potential for regular point-to-point unit/block services with the minimum of interchange and intermediate marshalling – the operating configuration most suited to the provision of efficient and cost-effective rail services.

157. Pakistan's economy has, in the past few years, become much more outward looking and more open to private sector investment and initiative. Growth has shifted to a higher trajectory, and the economy is diversifying with a substantial export-oriented manufacturing sector. Exports have increased and shifted from primary products to manufactures; in the early 1980s, primary products accounted for a third of exports and manufactured goods for a half, the proportions are now ten percent and over seventy five percent, respectively.

158. The growth in incomes and higher value production is beginning to change the pattern of demand for transport, with increased emphasis to higher service (lower transit times, increased reliability and efficient door-to-door services) rather than simply low fares/tariffs.

4.2. EVOLUTION OF PAKISTAN RAILWAYS

159. The rail network was constructed when rail provided the only means of relatively high speed, high capacity inland transport. The railways were built to meet a range of objectives: administrative, security/strategic, social as well as economic and commercial. Until the advent of commercial long distance road transport, the authorities were able to maintain the network and services by exploiting rail's effective monopoly over longer distance transport. Non-commercial lines and services were financed from the earnings on the commercial lines and services.

160. The construction of a modern highway network, almost throughout Pakistan, and the growth of the road transport industry has fundamentally changed the transport sector. Demands which could previously only be met by rail can now be served more conveniently, at lower cost and higher service standards, by road. Over the last 30 years, road transport has progressively become the dominant means of motorized transport within Pakistan (Table 9), as it has in almost all developed and developing countries.

Table 9: Market Share in Pakistan's Transport Sector (% of total traffic)				
	Passengers		Freight	
	Rail	Road	Rail	Road
1955 -1960	41	59	73	27
1998 - 2003	9	91	4	96

161. The dominance of road transport has resulted from:
- Private sector ownership and management;
 - No effective regulation/control of axle-loads, vehicle weights or condition, or driver hours;
 - Flat terrain, on the main route, allowing trucks to carry very heavy loads at slow speeds;
 - Intense competition, resulting in among the lowest trucking rates in the world³¹;
 - Private transport agents coordinating contracts and arranging backhauls;
 - Simple vehicle technology, easily maintained, often with locally fabricated parts;
 - Customers, until recently, primarily interested in very low rates rather than high service.
162. Like most public sector railways, PR did little, until recently, to respond to the competition:
- It continued to operate the entire network, even though the rationale for many lines has effectively disappeared;
 - It continued to try and cross-subsidize passengers from freight and the non-core network from the core network;
 - It continued to offer the traditional pattern of supply-driven services;
 - It failed to downsize staff substantially, streamline operations and reduce costs/tariffs.
163. Total rail traffic declined, financial results deteriorated and PR has become dependent upon the Government (GOP) for:
- Investment;
 - Debt servicing and pension payments;
 - Operating losses (in many years).
164. While PR retained a significant share of long-distance passenger traffic, it effectively lost private freight traffic. Rail freight is now largely confined to segments where rail is protected by regulation (e.g., Afghan transit traffic, bonded containers, and public sector entities). Rail carries such a small proportion of freight that, objectively, closure would hardly matter to the national economy. Rail has commercial potential and could play a valuable transport role but it is not an economic necessity.
165. PR's problems developed gradually but eventually a major structural change was recognized as necessary. In the late 1990s, the policy was to privatize PR. Passenger and freight divisions were created and the private sector was invited to operate trains. Public investment was severely curtailed, on the expectation of future private sector investment, and locomotive and rolling stock fleets suffered. Then the government changed, policy was reversed and privatization was abandoned. The

³¹ The low rates are primarily for bulk/loose cargo. Nevertheless, rates for containers are significantly higher in the trucking than rail sector as the ability to overload trucks is effectively constrained. But container traffic is the market segment for which higher quality service is demanded.

privatization policies had little ownership within PR and they had little impact on the traditional priorities and management practices. Little was achieved other than to deepen the equipment crisis and intensify distrust of reform and restructuring.

4.3. PRESENT CHARACTERISTICS OF PAKISTAN RAILWAYS

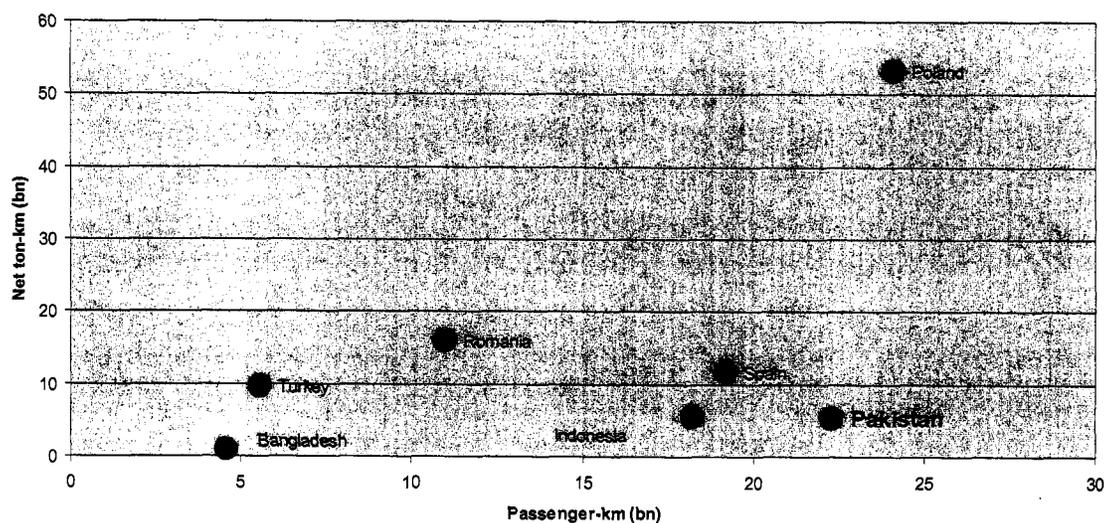
4.3.1. Passenger/freight

166. Over the last 30 years, passenger numbers have fallen but passenger-kms have increased and are now at record levels (Table 10). Freight levels have fallen almost continuously, in terms of both tons and ton-km (though there has been a slight increase during the last few years³²).

	Passengers		Freight	
	No.	Pass-kms	Tons	Ton-kms
1980-5	113.5	17,400	11.2	7,380
1985-0	82.3	18,500	11.0	7,940
1990-5	69.1	17,800	7.7	5,890
1995-0	68.0	18,800	5.9	4,370
2000-5	72.8	22,990	6.1	4,744

167. In international terms, PR is a medium sized passenger railway which also carries some freight. In fact, few European railways carry as many passengers as PR (Figure 1).

Figure 1: Rail Traffic: International Comparison



168. Passenger services receive total priority within PR: train paths, locomotives, management, etc. An entire class of GE locomotives (the Blue Tigers), with high levels of reliability, are reserved for the express passenger services. Freight services get the less reliable locomotives and lose their

³² The recent growth has been reversed in FY06 with a decline of 15 percent in the number of loaded wagons during the first six months, mainly the result of oil traffic dropping by almost 50 percent.

locomotives, if passenger locomotives fail³³. While PR acknowledges that more freight would improve its financial results, the priorities have still been to improve the passenger service.

169. The scale and quality of PR's freight services are constrained by: (i) its low track priority, only the parcel and the container services are timetabled; (ii) its low priority for motive power; and (iii) the antiquated rolling stock, mainly four-wheeler wagons with high tare/load ratios, low running speeds (40 km/h) and poor reliability. PR has very few high-speed, high capacity modern wagons, hardly more than to run a daily Karachi – Lahore container service.

170. Passenger traffic accounts for over 80 percent of PR's operations but only 56 percent of total revenue. Unit passenger revenue is much lower than average freight revenue. PR's pricing policies are much closer to Indian Railways than China Railways (Table 11).

Railway Network	Yield Pass-km/Yield ton-km
China	2.23
India	0.38
Pakistan	0.40

171. Indian Railways (IR) and PR have continued to charge relatively high freight rates in order to keep passenger fares low. China railways, on the other hand, has rebalanced its pricing structure and shifted to much higher passenger fares, which now cover passenger costs.

4.3.2. Two Railway Networks

172. PR has a network of 7,791 route-km, including 1,040 km of multiple-track, effectively combining two rail systems:

- *The core railway*: primarily the main north-south route³⁴, 45-50kg/m rail, 23 ton axle-loads, maximum speeds of 100-110 km/h, good track condition and very few temporary speed restrictions; and
- *The non-commercial railway*: a collection of little used strategic and branch lines, 37kg/m rail, track often in poor condition (about a third of the network under temporary speed restriction), maximum speeds of 40-70 km/h and axle-loads restricted to 17 tons.

173. In very broad terms, the core railway encompasses about a third of the total network but carries three-quarters of the total trains, and over 85 percent of freight traffic (see Table 12).

	Percentage of Network		Percentage of Trains per day		
	Route-km	Track-km	Passenger	Freight	Total
Core	33	41	73	86	76
Non-commercial	67	59	27	14	24

The revenue generated on a small core commercial network is use to try and support a non-commercial network, twice its length.

³³ PR staff estimate that locomotive failures on passenger trains occur about three times per day.

³⁴ Not quite the core commercial railway as it also includes the strategic link to Quetta.

4.4. FINANCIAL POSITION OF PAKISTAN RAILWAYS

174. PR is not profitable and might be considered technically insolvent, unable to service its debts and often unable to fund fully its operating costs and pension payments. There was, however, a marked improvement in PR's financial results during FY05 (see Table 13)³⁵.

Revenue	2003-2004	2004-2005	% change
Passenger	7,939	9,002	+13
Freight	4,343	5059	+16
Coaching & Military	1,363	1419	+4
Sundry	923	2790	+202
Total	14,568	18270	+25
<i>Operating Expenditure</i>	16,857	17991	+7
<i>Surplus/Deficit</i>	-2,289	279	

175. Freight and passenger revenues grew significantly but the major revenue increase was in Sundry Incomes, primarily a major rise in property income. The improvement in PR's operating position helped reduce GOP subsidy from the Rs. 8 billion in FY2004 and a sanctioned level of Rs. 9.1 billion in FY2005 to Rs. 3.9 billion.

176. Despite this improvement, PR remains dependent on GOP for debt servicing, asset replacement and new investment³⁶. PR also faces major unfunded pension liabilities.

4.5. CORE AND NON-CORE RAILWAYS IN PAKISTAN

177. The core railway analyzed is detailed in Table 14. The network includes the Quetta line though, under a PSO regime, the Quetta line would undoubtedly be a candidate³⁷. The passenger services on the core network include a number of services which only use the network for part of their journey (e.g., the Khushhal Khan, Karachi-Peshawar, travels from Multan to Peshawar via Kundian). 44 pairs of trains (64 percent of passenger train-km) use the core network exclusively, these include 17 of the 20 mail and express services and generate 81 percent of passenger revenue. The core network carries 86 percent of freight train-km and 92 percent of wagon-km³⁸, but these include wagons which also use the non-core network for part of the trip. If freight traffic is restricted to the core network exclusively, freight would be reduced by about 24 percent.

³⁵ Passenger revenues have been increasing at 11-19 percent during the 2000s. Freight revenues were adversely affected by the loss of petroleum with the opening of pipelines.

³⁶ Passenger railways, in general, receive significant subsidies from government.

³⁷ Costs on the Quetta line are high because of the steep gradients and need to split trains.

³⁸ No detailed origin-destination data are available and some approximations have had to be used.

From	To	Class*	Distance (km)		Trains/day		
			Route	Track	Pax	Freight	Total
Karachi	Lodhran	Primary A	841	1,682	34	11	45
Lodhran	Khanewal	Primary A	135	150	20	4	24
Lodhran	Khanewal (chord)	Primary A	91	91	13	7	20
Khanewal	Lahore	Primary A	287	327	16	8	23
Lahore	Rawalpindi	Primary A	287	302	21	3	24
Rawalpindi	Peshawar	Primary B	175	189	8	4	12
Khanewal	Lahore via Faisalabad	Primary A	304	304	30	3	33
Sangla Hill	Wazirabad	Primary A	109	109	8	2	9
Rohri Jc	Quetta	Primary B	383	421	10	2	12
Total			2,612	3,575	22	6	28
% of total network			33	41	73	86	76

Note: * PR track classification

4.5.1. Above-rail train costs and revenues on the core and non-core networks

178. The financial positions of the core and non-core railway networks were estimated on the basis of a cost model using the FY2004 PR Accounts. The analysis breaks down costs between passenger and freight services, core and non-core networks, and above rail train costs and those costs associated with the provision, maintenance and management of the infrastructure³⁹. Depreciation on passenger and freight services use accepted international provisions, rather than the low depreciation provisions included in the PR Accounts. The results of financial analysis are outlined in Table 15.

	Passenger Services			Freight Services			Total	
	Core	Non-core	Total	Core	Non-core	Total	Core	Non-core
Revenue	6,673	1,548	8,221	3,450	1,115	4,566	10,123	2,663
Train cost*	4,944	2,044	6,988	2,635	926	3,561	7,579	2,970
Surplus	1,729	-496	1,233	815	189	1,005	2,544	-307
Depreciation	1,984	1,071	3,078	471	210	681	2,455	1,281
Surplus	-255	-1567	-1845	344	-21	324	89	-1,588

Note: * includes use-related track maintenance (20 percent of total maintenance)

179. The results of the analysis can be summarized as follows:

- Both passengers and freight cover their direct train-related operating costs and generate a surplus. Non-core passenger services run at a deficit;

³⁹ Pension payments to past employees have been excluded from the cost analysis as they are unaffected by present operations.

- Once depreciation is included, the total system runs at a substantial loss, although the core network still covers its costs;
- Passenger services on the core network fail to cover their depreciation costs but, with higher train speeds, the burden of depreciation will decline and passenger services should generate some surplus to be set against access and infrastructure costs⁴⁰;
- Core freight services already generate a surplus toward access and infrastructure costs and even freight on the non core network almost covers its long-run direct costs;
- Taken together, services on the core network run at a small surplus, services on the non-core network run at a substantial direct deficit.

4.5.2. Total cost recovery on the core the non-core networks

180. Direct train costs are only part of the total costs for providing train services. In addition to the motive power and rolling stock costs, there are also the costs of signaling, track maintenance, train control and corporate administration. Eventually, rail and sleepers have also to be replaced and, for long-term sustainability, provision has to be made for track replacement (see Table 16).

	Core	Non-core
Revenue	10,123	2,663
Train costs	7,579	2,970
Direct short-run surplus	2,544	-307
Access costs	1,489	1,265
Network short-run surplus	1,105	-1,572
Train depreciation	2,455	1,281
Track depreciation	1,720	618
Network long-run surplus	-3,070	-3,471

181. The analysis indicates:

- The core network covers all its short-run costs (costs excluding depreciation) and generates a surplus;
- The core network is not sustainable, once depreciation is included. Revenue has to be increased by about 30 percent to cover total costs;
- The non-core network operates at a short-run deficit, equivalent to almost 60 percent of revenue. If depreciation is included, the deficit is significantly greater than its total revenues;
- PR's financial results would be significantly improved if the non-core network and its services were closed, the operating assets redeployed and the surplus staff retrenched.

⁴⁰ Timetabled speeds for passenger trains average 43 km/h, and even the mail, express and intercity trains average less than 50 km/h. Freight trains average about 25 km/h.

4.5.3. Financial results on core network by business segment

182. In addition to passenger and freight services, there is also “other coaching income” derived almost entirely from the core network. This income includes the dedicated parcels’ service on which the wagons are subcontracted to freight forwarders (Table 17).

	Passenger	Other Coaching	Freight	Total
Revenue	6,673	925	3,450	11,048
Train costs	4,944	797	2,635	8,376
Direct short-run surplus	1,729	128	815	2,672
Access costs	866	190	574	1,630
Network short-run surplus	863	-62	241	1,042
Train depreciation	1,984	385	471	2,840
Track depreciation	997	251	723	1,971
Network long-run surplus	-2,118	-698	-953	-3,769
Long-run operating ratio	1.32	1.75	1.28	1.34

183. The cost analyses indicate rather different financial positions for the short and long-run scenarios:

- Both passenger and freight services show surpluses over their short-run costs; other coaching services generate a small short-run deficit;
- Neither passenger nor freight services cover their full long-term costs although, as showed previously, freight services do cover their above rail (train) depreciation costs;
- The total long-run operating ratios of passenger and freight services are similar, at around 1.30.

184. The cost model used in these analyses distributes common costs, such as access and track costs, simply on the basis of train-km or gross ton-km. The use of “prime user” cost allocation would give a rather different distribution of common costs⁴¹. Passenger traffic is clearly the prime user on PR’s core network with about five times more train-km than freight. Track quality, maintenance and the signaling requirements for passenger services are also far higher and more costly than for freight services. The prime user cost model would allocate the entire cost of raising permissible track speeds to 140 km/h to passenger services. A distributed cost model would allocate some of these costs to freight.

185. If prime user costing was adopted on PR, there would be a substantial redistribution of common costs from freight to passenger services – the operating deficit on passenger services would rise substantially and correspondingly fall on freight services.

⁴¹ This method of cost allocation was used on British Rail, prior to privatization, as part of its lines of business approach

4.6. FUTURE ROLE FOR PAKISTAN RAILWAYS

4.6.1. A viable commercial railway

186. The core business/network comfortably covers its above-rail operating expenses but the surplus is only sufficient for about 40 percent of its access and depreciation costs. The unit costs of PR are comparable with those of many efficient railways and suggest that the main thrust to improving the business performance of PR should be directed toward the improved utilization of its capital assets⁴². Increasing levels of traffic would use the track assets more intensively and reduce unit track access costs. Higher utilization of the operating assets, particularly its passenger coaches, could be achieved through increased operating speeds. Raising operating speeds by 20 percent would reduce depreciation by broadly the same level, though with a small increase in fuel costs. This should easily be within the capability of the system as the main line is improved and more wagons, capable of higher operating speeds, are introduced.

187. While increasing traffic and asset utilization may be the primary route to commercial viability there are opportunities for reducing costs:

- Track replacement costs can be reduced by introducing modern maintenance procedures, such as rail grinding on the higher density lines, which would enable track life to be extended considerably beyond the 400 million gross tons now assumed;
- Substantially increased labor productivity should be possible. PR has a large staff, with far too many grades and levels. Though unit costs are low, overstaffing may encourage inefficient management, reduced staff performance as well as poor motivation. Streamlining staff levels and deployment could result in significant direct and indirect benefits, but may require a generous labor adjustment program;
- Streamlining operating practices could reduce costs as well as increase asset utilization. PR is a diesel system with one relatively short route section which was electrified many years ago. This configuration increases both operating and asset costs:
 - Delays to trains at the change of traction, resulting in reduced asset utilization and lower service levels. The high priority mail/express passenger trains use diesel traction throughout and only goods trains and minor passenger services change traction;
 - Small fleet of under-utilized electric locomotives. In FY2003, the average hourly utilization of electric locomotives was only 60 percent of diesel locomotives, and the distance utilization only 36 percent;
 - Additional locomotive maintenance facilities, increased stockholdings of locomotive spares and the requirement of additional staff skills.

⁴² Comparison of Pakistan Railways with three neighbouring networks

System	Year	Passenger-km (bn)	Net tonne-km (bn)	Working ratio (%)	Working cost (US cents)	
					Per pkm	Per tkm
Pakistan	2003/4	23	5	103	0.7	1.5
India (NR)	2004/5	83	37	70	0.6	0.8
China	2000	441	1334	80	0.8	0.5
Indonesia (Jawa)	2002	11	1	92	1.4	3.1

PR is comparable with both China and India, two of the world's major passenger railways, for its main traffic, passengers. It compares less well for freight. This largely reflects the lack of investment in freight, which in both Jawa and Pakistan was until recently operated with obsolete rolling stock. While labour productivity in PR has plenty of room for improvement (about one-third of India) the overall financial unit costs are comparable with the world's major railways.

Electric traction has traditionally been considered as more energy efficient and justified at high traffic levels. But, this may no longer be the case with the fuel efficient diesel locomotives developed in the past few years.

4.6.2. Focused commercial rail investment program

188. PR can only become a commercially viable railway if it can substantially increase traffic and charge remunerative rates. Increasing the utilization of existing operational assets has to be the first priority through, for example, reducing terminal times, faster wagon turnaround and higher passenger load factors. However, such increased utilization may have a relatively limited impact and investment in the commercial rail sector will be necessary. Investments need to be subject to critical financial examination to ensure that they add to capacity in the most effective manner:

- Wagons: under-investment in previous years has resulted in PR owning a very small fleet of modern, high capacity wagons able to run at the speeds necessary to compete with road transport. A substantial investment in modern wagons will be necessary if the rail sector is to carry more freight. While the investment is undoubtedly required, the source of the investment and the ownership of the wagons need not necessarily be the public sector. Many railways, even those within the public sector, operate with wagons owned by customers. Within the appropriate commercial and legal frameworks, private sector investment in rolling stock may have potential in Pakistan;
- Locomotives: locomotive utilization on PR, given the average haul lengths, is low, averaging only about 350 km per locomotive in service. The very slow speed of freight trains reduces average locomotive utilization⁴³ and more modern wagons should raise locomotive utilization. More locomotives will be required but, to achieve the reduced transit times and improved reliability of the freight services, a change in locomotive allocation will be needed, giving much higher priority to freight traffic;
- Track capacity and quality: PR's present plans allocate substantial investment to track improvements. These should perhaps be re-assessed according to such criteria as cost-effectiveness and the policy support to giving priority to freight:
 - Given the reduction in the number of trains operated, since the peak levels of the past, the immediate priority for substantial additional track capacity may appear somewhat uncertain. Could the required capacity and improved train service levels be provided by modern train control systems at lower cost?⁴⁴
 - Are the signaling and train communication investments included in the investment plan cost-effective in terms of their likely impact on rail safety, given the number of trains run on the system?⁴⁵
 - Does the investment required to raise maximum permissible train speeds from 110 km/h to 140 km/h support PR's commercial viability? Such speeds are not required for the freight business, are PR's passengers willing to pay the fare premiums necessary to justify/finance such investment? Express, Mail and Inter City trains average <50km/h, could significant average speeds be raised without major track investment?

⁴³ Utilization of locomotives hauling freight trains average 240 km per day.

⁴⁴ In the longer-term, however, completing the double track from Karachi to Lahore may well be necessary.

⁴⁵ Similar concerns have been expressed regarding the cost-effectiveness of new safety investments on railways in the UK. Rail investment decisions made after major accidents often implicitly value life at very substantially higher rates than applied in other sectors.

- Is the rehabilitation of the existing electrified track section, and its extension, cost-effective in terms of cost and/or energy efficiency, in comparison with using the same resources to invest in modern, fuel efficient diesel locomotives?

Some, at least, of the proposed investments still seem to reflect the priorities of an engineering-led passenger railway, rather than a business-led transport enterprise.

4.6.3. Commercial focus for the commercial businesses

189. *Removing the burden of history:* PR's core commercial businesses are presently held back by the legacy of history (the need to cross-subsidize a large network of lines which are no longer commercially viable nor, perhaps, socially/strategically necessary). To achieve commercial viability and meet their potential objectives in Pakistan's transport sector, the commercial rail-businesses need to be able to compete without these costs. Rail's commercial businesses should be placed on the same commercial basis as its road competitors. If PR's core freight and passenger services are to compete effectively on the basis of current avoidable costs, they need to be relieved of:

- The costs of operating the large non-commercial network of lines and services;
- The costs of providing pensions to past employees.

190. In addition, the financing for infrastructure costs and treatment for taxation in the road and rail sector should be placed, as far as possible, on an equal basis.

191. Some form of financial restructuring will be necessary, but such restructuring needs to be undertaken within the framework of modern commercial cost accounting and financial targets for management. PR should be expected to make adequate provision for the replacement of its operating assets and meet normal financial returns on the commercial assets employed.

192. *Rebalancing freight and passenger priorities:* Restructuring PR's finances is unlikely to raise significant issues within PR; rebalancing the priorities accorded to freight and passenger businesses may be more problematic. It is clear that freight is much closer to covering its costs than passenger services. Moreover, there is a very large freight market within which the railways should be able to compete. Recapturing the long distance freight market will require not only the provision of attractive rates and conditions of service, but also re-establishing market credibility for delivering reliable services. Separating the finances of the freight and passenger businesses, should allow both businesses to focus on their strengths, allowing them to take decisions on the basis of realistic financial information. Eliminating the subsidies should allow the freight business to offer more attractive rates, but regaining market confidence may be more difficult.

193. The new container train services connecting Karachi and the Punjab are a start but they have yet to offer guaranteed delivery times which may be critical to regaining the market, especially for export traffic⁴⁶. To provide guaranteed delivery times, the freight business has not only to have reliable motive power but also guaranteed train paths and an equal priority to passenger services, so that locomotives are not switched from freight to passenger services if passenger locomotives fail. It is very difficult to see how the freight service will re-establish such credibility if the present organizational structure continues. Operational and commercial autonomy, together with effective control over its assets, appear to be basic conditions.

4.6.4. Freight the key to developing a commercial viability

194. Substantially increased freight traffic and earnings is the key to a commercially viable railway network in Pakistan:

⁴⁶ Delays to imports can be accommodated by higher inventory levels, delays to export cargo results in missed shipments and substantial market penalties.

- Long haul, dense freight market between limited points, allowing regular point-to-point services;
- Very small share of the existing freight market, large market potential under the right conditions;
- Freight traffic already covering its full above-rail operating costs;
- Main line infrastructure already available for commercial freight operations;
- Ability to reduce significantly unit operating costs and increase service standards with the introduction of modern rolling stock, reliable motive power and higher operating priority;
- Limited scope for road transport to reduce costs/rates (the introduction of effective axle-load control would raise trucking costs/rates substantially) though scope to increase service standards for higher value cargo with improved roads and modern trucks.

195. Passenger traffic will clearly retain importance but will face challenges from coaches for its mass market and low cost air transport for its high-end market. To achieve commercial viability, almost a paradigm shift in political/governmental attitudes toward the railway and its management will be necessary.

4.7. A REFORM AGENDA TO REVITALIZE THE RAILWAY SECTOR

196. A reform agenda for the Pakistan railway sector can be broadly identified. The agenda is based on the premise that the Government of Pakistan (GOP) wants the core railway sector to move toward becoming a viable commercial enterprise, able to compete in the transport market and perform its potential role in the National Trade Corridor (NTC) and the economy, more generally⁴⁷. The reform agenda requires difficult issues to be faced, major decisions to be taken and changes to be implemented which may be at variance with established interests. Crucial to implementing any major reform is firm, high-level commitment, careful preparation, the introduction of effective change agents, generating acceptance by involving those within the system and responding to their concerns, as well as possibly the redeployment of those that resist change. Previous attempts at major reform seem to have failed because there was insufficient commitment to change, too little implementation planning and/or communication to achieve acceptance, and too little follow-through.

197. The agenda consists of a set of inter-related activities which can be grouped under the following broad headings:

- Creation of a focused railway enterprise;
- Financial restructuring;
- Institutional reorganization;
- Detailed restructuring;
- Rail cost reduction program;
- Re-establishment of rail freight credibility;
- Opening access to the private sector.

198. Each of themes is discussed in more detail below. Development and implementation of the reform agenda will involve both GOP and railway management. GOP has to establish the overall objectives and reform framework, rail management needs to translate these to detailed plans and implementation.

⁴⁷ Commercial viability for the core railway does not equate with complete self-financing of the sector. As with the road sector, some public funding of infrastructure may still be required as well as deficit financing for the non-core railway, if the GOP decides to maintain the network and services.

4.7.1. Creation of a focused railway enterprise

199. At present, PR encompasses a wide range of assets and activities, large non-operational land holdings, factories, extensive workshops, schools, housing, hospitals, sports facilities, etc. Such a spectrum distracts management from its core business of operating the railway and providing transport services.

200. As a first step to restructuring the rail sector, GOP should create an enterprise whose sole function is the provision of efficient rail services:

- The operational rail assets should be separated from the non-core assets. Separate institutions should be created for the rail assets/activities and the non-rail assets/activities with their own managements, finances, operating targets and governance arrangements;
- Only operational land should be transferred or leased to the new railway enterprise. The development of non-operational land can be very remunerative, but is a quite separate activity from running an efficient railway;
- A system of transfer prices will need to be established for transactions between the two institutions.

201. The decision to create separate institutions has already been taken, in principle, by GOP with the proposed establishment of Pakistan Railways as a state corporation. Though the draft bill may be a little ambiguous, the intention is to create Pakistan Railways Corporation (PRC) as a focused railway enterprise, and transfer all the non-core activities and assets to a Holding Company. Eventually, the non-core assets may be established as separate enterprises, sold to the private sector or transferred to more appropriate departments. The management/development of the extensive landholdings may require very careful consideration given their value, scope for misuse and the interest of the Provinces.

202. With the establishment of PRC, the role of the Ministry of Railways (MOR) should change from day-to-day involvement to high level policy. With these more limited functions, it may be more efficient to incorporate the MOR into a Ministry of Transport with a broader mandate.

203. Converting PR to a state corporation is an important step but it is unlikely to be the panacea for the sector. The management problems of operating as a department are, as often, raised with regard to state corporations:

- Political interference in management and operating decisions, particularly passenger fares, movement priorities, special treatment for favored groups/commodities, recruitment, station closure, etc.;
- Lengthy bureaucratic systems for investment decisions and procurement;
- Lack of clear management objectives;
- Political appointment of senior management;
- Inadequate management incentives with salary structures subject to inflexible public sector regulations.

204. Whether as a government department or State Corporation, railways in the public sector are often expected to respond to political rather than business priorities and are thus unable to achieve the financial viability which can lead to greater management autonomy⁴⁸. Attempts were made, in many

⁴⁸ Public sector ports have often much greater management autonomy than the railways, because they make money and are thus not dependent on annual subventions from government and the negotiations necessary to obtain such subventions.

countries, during the late 1980s and early 1990s to provide autonomy through contract plans or performance contracts; they all failed⁴⁹.

205. Whether PRC will succeed has less to do with its governance status, and much more to do with GOP policy for the railways, the translation of this policy into clear financial and management objectives against which management and enterprise performance can be realistically measured and assessed, and the real degree of commercial and operational autonomy allowed to rail management.

4.7.2. Financial Restructuring

206. The financial restructuring of the railway sector has been under discussion for some considerable time, largely with respect to GOP formally taking over the debts and liabilities for which it has already taken effective responsibility. Clearly, financial restructuring needs to accompany the creation of PRC which should start with a viable financial structure and a balance sheet with an appropriate level of debt. However, financial restructuring should go much further than simply writing off the debts of the railway sector:

207. *Separation of the assets and accounts of the core and non-core railways:* if the railways are to compete effectively on the main transport routes, they need to be able to adopt pricing policies similar to its competitors, i.e. based on the actual costs incurred in providing services on particular routes. Road transporters do not charge higher rates on the Karachi – Lahore route in order to cross-subsidize rates on minor rural roads. Similarly, rates on the core railway network should be based on the costs of providing services on the core network. The non-core network should be financed by other means.

208. *Introduction of lines of business accounting:* management decisions should be guided by accurate information on the costs and profits of providing the different services offered by the railway. Presently, there is information on the revenue generated by the different services but very little information on the costs of providing individual or classes of services. Lines of business accounting should allow the determination of costs and revenues by route and by type of service (express, mail and local passenger services, freight by broad commodity, such as the dedicated express container trains).

209. More detailed accounting is an imperative in the competitive market. Railway management needs to establish rates and make decisions on the level of services knowing both the costs of providing these services and the rates charged by their competitors, expanding services with large surpluses, cutting back where there is no competitive advantage. Such accounting would support a move from a deficit subsidy to targeted subsidies for specific activities. Government needs to understand the costs of its decisions and the basis for the subsidy payments should be explicit and derived from accounting information. Lines of business accounting is also necessary if greater autonomy is to be given to the freight and passenger businesses and if a more flexible approach to service provision, involving outside parties, is allowed.

210. *Elimination of cross-subsidies:* PR has a monopoly on rail services in Pakistan⁵⁰, but no transport monopoly. The pervasive but implicit system of cross-subsidization within the railway sector should be replaced. Targeted subsidies (whether for lines, services or fare levels) should replace the internal cross-subsidies and deficit subsidy to cover overall losses. Such subsidies should be structured so as to create incentives for PRC to reduce costs/increase yields, such as an explicit subsidy per seat-km offered. With the detailed accounting proposed above, GOP will have the

⁴⁹ Boards consisting primarily of independent members drawn from the private sector may assist in providing management autonomy from political interference but they are certainly no guarantee.

⁵⁰ It has recently contracted out the marketing and organization of a few services to its consultancy group.

information available to make informed decisions on whether to close services/lines, scale back the services and/or provide explicit subsidies⁵¹.

211. *Debts and Pension Liabilities*: while financial restructuring should be far wider than simply GOP's assumption of PR's debts and pension liabilities, some restructuring of the debts is desirable if PRC is to be established on a sustainable basis. Placing rail and road services on the same basis suggests that, at the very least, any debts attributable to infrastructure investment should be assumed by GOP. Moreover, in view of GOP's perceived requirement to continue the present passenger services and fare levels, there may well be an argument for GOP to assume the debts attributable to providing PR's passenger services (both locomotives and coaching stock), though explicit subsidies, based on the actual cost of providing services, would very probably be a preferable approach.

212. Pension payments are already a substantial part of PR's total operating expenses, slightly under 20 percent, and the pension payments are likely to rise with rising numbers of pensioners and increased life expectancy. Pension payments for past and present employees are unfunded, resulting in large unfunded liabilities. GOP's assumption of present liabilities and the introduction of revised funding for future pension liabilities should form part of the financial restructuring for the establishment of PRC⁵². Whether this should also be accompanied by a shift to a contributory pension scheme and defined contributions rather than defined benefits is a much wider issue with ramifications throughout the public sector.

213. PR's debts and pension liabilities are sunk costs which cannot be escaped and are already effectively financed by GOP. No resource costs will be involved in GOP's formal assumption of the debt servicing and pension liabilities. It is necessary, however, that structures and processes accompany any financial restructuring to ensure that, having been relieved of one set of debts, the railway sector does not accumulate further debt and obligations which cannot be serviced by operations.

4.7.3. Institutional re-organization

214. The freight business is the key to improved rail finances; almost invariably, freight makes money, passengers lose money. In his discussions on NTC, the Prime Minister was very explicit that expanding freight was the way forward. Presently, however, PR is primarily a passenger railway and passenger services receive priority. The establishment of separate business units for the passenger and freight sectors, with separate managements and control over their own resources, should accompany the creation of PRC. The lines of business accounting would provide the financial information necessary for such separate business units. GOP might decide that a more formal separation was desirable, in which case the freight and passenger units could be established as subsidiaries of PRC.

215. Such separation was attempted previously but with little will to make it work. Greater participation within the railways in planning the separation, more effective communication on the reasons for change and a higher level of commitment by both top railway management and GOP are probably all necessary, but the failure to achieve change within a unitary organization may suggest advantage in a more formal separation, as subsidiary companies.

216. Further separation of functions within the sector may be desirable depending partly upon the requirements for specific subsidies and partly on policy decisions regarding the outside provision of

⁵¹ For rural branch lines, the Provinces may be the appropriate level of government to determine priorities and fund subsidies.

⁵² World Bank funding of PR's pension liabilities would be a possibility under a DPL for the railway sector. Present obligations on pensions and related services (health care, travel, etc) are thought to total about the equivalent of US\$450 million.

rail services. Both infrastructure and motive power could be established as separate businesses with their own accounts:

- *Infrastructure*: the separation of infrastructure from operations is now common, with rail services charged an access fee. Infrastructure becomes a business unit rather than simply a cost center. For PRC, such separation would facilitate a system of targeted subsidies – there would be auditable transactions for the provision of train services and a much clearer definition of the costs. Such separation would provide a defined basis for more equal treatment of the rail and road sectors with regard to infrastructure financing and cost recovery. Infrastructure separation and access charges would also provide the basis for allowing other providers to run train services over the network;
- *Motive power*: while coaching and wagon fleets should be transferred to the passenger and freight businesses, locomotives are more non-specific. One possible arrangement would be to transfer locomotives to the business units, including the infrastructure unit for running engineering trains. An alternative would be to establish motive power as a separate business, hiring motive power to the business units. Both arrangements have been successfully employed. British Rail used the former approach, prior to privatization. Spoornet (South Africa's railways) adopted the latter and the operating divisions discovered that, when faced with specific hiring charges, they needed far fewer locomotives and Spoornet found itself with a substantial motive power surplus. The business unit approach would also facilitate the introduction of the private sector, reducing substantially the entry costs by providing a source of hired/leased locomotives.

217. PRC could thus consist of the central administration and services and four self accounting businesses: passenger, freight, infrastructure, and motive power. Each of the operating businesses should have clear and measurable management objectives and prepare annual business plans indicating how these objectives will be attained.

4.7.4. Detailed restructuring program

218. The reform agenda deals with the broad changes required in the sector, implementing such changes will require a much more detailed restructuring implementation plan. Once PRC is established, its management should be expected to prepare, within a specified period of time, a restructuring plan for the railway sector. Such a plan would include the detailed framework for the operating businesses, the pricing rules and policies to govern the relationships between the businesses, the implementation of the revised accounting rules, the identification of the un-remunerative lines and services and PRC's proposals to deal with such activities, etc. The restructuring plan should put the body to the bones of the reform agenda.

4.7.5. Rail cost reduction program

219. Railways have greater control over their costs than their revenues, which depend crucially upon the reactions/choices of the users, the state of the economy and the actions of competitors. PRC needs to identify a coherent plan to streamline operations, increase efficiency and reduce costs. The elements of such a plan might include such measures as:

- The closure of loss-making lines and/or services unless required for social/strategic reasons and specific subsidies provided (GOP, in effect becomes PRC's customer);
- The reduction of costs on lightly used making lines: this might be achieved by modified operating practices and/rules – conversion to siding status with consequent changes in train control, removal of station staff, ticket sales on the trains, replacement of permanent track maintenance gangs by mobile gangs, etc.;

- Streamlined staffing: enhanced human resources deployment could, but need not, include immediate staff reduction, through either early retirement or retrenchment. It should include greater staff flexibility by amalgamation of grades and functions (multi-tasking), retraining and deployment to where staff shortages are expected, longer term staff rightsizing through adjusting recruitment to eventual staffing needs through natural staff attrition and selective recruitment, etc. Overall cost savings may be relatively small as increased incentives may be desirable for remaining staff; the real benefit is in terms of increased efficiency and productivity;
- Open procurement for locomotives and rolling stock: the creation of PRC and the transfer of the factories to a separate enterprise should allow arms length procurement and greater competition. Given the scale of the capacity needs in these areas, especially modern wagons, international competitive bidding would appear the most effective stratagem perhaps accompanied by opening the factories to private sector investment and participation;
- Outsourcing to the private sector: railways have traditionally been very self-contained, providing a very wide range of activities and functions in-house, often because there was little or no alternative. With the growth in the Pakistan economy and its diversification, many of the activities now undertaken by PR could perhaps be more cost-effectively performed by others through outsourcing.

220. The details of the plan will take new management time to develop and may require both initial studies, such as the proposed human resources audit, and time to implement giving, for example, the factories time to adjust to more open procurement and the potential for greater competition.

4.7.6. Re-establishment of rail freight credibility

221. While there is considerable market potential in long distance freight, it may be difficult to translate potential into actual traffic and increased revenue. PR has lost the confidence/trust of the private sector. Moreover, its low freight rates, flexible pricing, door-to-door delivery, increased control (by mobile phone) and easier integration into modern logistic systems give road transport a powerful competitive position. Though the supply-driven management approach is beginning to change, a much greater customer focus will be needed if the railways are to recapture a significant share of this market.

222. Given the inherent advantages enjoyed by road transport, rail freight may need to be priced at a significant discount, but cost is only one attribute of shipper choice. PRC will need to understand not only the size and composition of the market but, as crucially, the attributes valued by customers and rail's competitive position. Emphasizing lower rates may evoke little response, if guaranteed delivery is the critical dimension. Similarly, faster line-haul may not be sufficient, if the basic need is factory delivery. One of the first actions of a freight business should be to commission basic market research to identify the scale of the market, the most likely prospects for rail expansion and attributes of the services that need to be provided. Such research would guide both marketing and rolling stock acquisition.

223. Public sector railways are in an inferior position to road transport with respect to marketing. The marketing and pricing of rail freight services is normally governed by rules and procedures that greatly limit commercial flexibility:

- Often there is a rate book which sets out the rates, rather than individual contracts negotiated with customers;
- Discounts are sometimes possible, but are often either very small or require sanction at very high levels, which prevents a rapid response;

- Rates are normally set by commodity, weight and distance. Back haul rates are rarely as extensive or as discounted as road transport rates;
- Rates have to be formally changed; the railways cannot respond quickly to changes in local or national markets;
- Inflexible, bureaucratic rules tend to a homogenous product at inflexible prices.

224. PRC should be able to improve many of the basic attributes of its freight services, such as speed and reliability, and improve customer information with tracking systems, but it will be extremely difficult for PRC to offer pricing flexibility. Long-term contracts for the provision of regular bulk traffic seem most suited to rail, but much of the expanding demand comes from smaller customers with a wider range of requirements. Rail finds it difficult to market to such customers.

225. There may be greater scope for PRC to wholesale freight services and then allow the private sector to organize the details. PR is moving in this direction already with the parcels train, wholesaled to freight forwarders, and has considered contracting the marketing and organization of its scheduled container trains to PRACS, its consulting subsidiary. The division of responsibilities inherent in wholesaling may match the potential strengths of the sectors. The railways can concentrate upon delivering efficient train services, while the private sector has the flexibility to differentiate pricing to maximize traffic, minimize empty running and organize door-to-door collection and delivery. Such wholesaling may allow more freight forwarders/logistics suppliers to incorporate rail within their overall pattern of operations. The railways would only have to deal with a limited number of primary customers which would simplify considerably the commercial aspects of its expanded freight business.

226. It is likely, however, that customers would expect guaranteed delivery. Wholesaling would not remove this requirement. Whether through the railways directly or indirectly through the private sector, reliability of delivery times has to be improved to the extent that delivery guarantees become possible. This will only be achieved with higher track priority to freight.

4.7.7. Opening access to the private sector

227. PR has a monopoly of rail services in Pakistan, providing all the motive power and rolling stock. Wholesaling trains does not change this but may allow it to work more efficiently and compete more effectively. All investment risk remains with the railway/GOP. The investment needs are large and the risks high.

228. Most railways are now involving the private sector. This involvement ranges from the complete privatization of rail operations through sale (UK and New Zealand) or concession (South and Central America, Africa, and East Europe), through the provision of track access to private operators on publicly managed systems (Europe) to the private ownership of wagons (most of the world). Bringing in the private sector can introduce new assets/investment and management expertise.

229. The railways in Pakistan need both investment and modern freight management skills. Integrating the private sector may also help regain trust in the effectiveness of rail for long distance freight. PR has already issued a request for expressions of interest to run freight services, but without specifying the terms and conditions, under which such services might be operated or the commodities/routes for which private services might be allowed. A number of possible arrangements could be introduced:

- (i) *Private ownership of rolling stock:* private investments in wagons, compensated by discounted rates, have been common for many years. Often, the wagons are of a specialized nature. The arrangement seems to have had relatively little success in South Asia; perhaps the discounts/rewards for investment were not sufficient;

- (ii) *Joint ventures involving both public and private participation:* CONCOR, in India, has been very successful but it has also had an effective monopoly for the inland movement of uncleared containers⁵³. CONCOR is, however, managed as a subsidiary of IR though with significant management and financial autonomy;
- (iii) *Private trains hauled by the railway:* in essence this would extend the PRACS type of concept. Instead, however, of PR assets being under outside management, the private operator would provide the own rolling stock. The rolling stock would be hauled by PR (PRC) locomotives (hook and haul contracts). Pricing of the freight services would be determined by the outside provider and PR (PRC) would be paid both an access fee (for the track and its management) and a haulage fee. The private sector may be able to source suitable wagons at significantly lower cost than PR, possibly modifying wagons from broad gauge systems in Europe;
- (iv) *Complete private trains:* this would be a further extension, with the haulage of the trains undertaken by the outside operator as well as providing the wagons. The railway would still control the track and train movement for which it would charge the outside provider an access charge. The outside operator could either own its locomotives or possibly lease them;
- (v) *Individual freight concessions:* the provision of private freight services within the existing structure of services could result in public and private freight services being offered in competition. In view of the marketing and pricing flexibility enjoyed by the private sector, it is difficult to see the public sector services being able to compete successfully. Instead, therefore, of private train provision, GOP might consider giving freight concessions to the private sector for the movement of particular types of traffic which either requires high levels of organization and/or marketing or which generate little profit⁵⁴. PR (or PRC) would receive access charges, lease fees for any equipment included, and receive royalty payments on the traffic carried/revenue generated. Concessions would confer a monopoly but road competition would severely limit these powers;
- (vi) *Concessioning PR's freight business:* rather than concessioning the movement of individual commodities, GOP might consider concessioning PR's entire freight business. The efficiencies of private sector management, marketing and investment would, therefore, impact all commodities and allow an integrated operation. Such a concession might well have the greatest impact on the transport sector and could be accompanied by open access to other train operators (though this would diminish the likely financial value of the concession). It is not clear, however, whether there would be private sector interest in managing such a large operation and making the necessary investment, given that track access and control would remain with PR (PRC).

230. There may indeed be the potential to introduce several forms of private sector participation – the provision of both hook and haul services and complete train provision by the private sector. Similarly open access for some commodities and freight concessions for others. Open access for domestic container operations would, for example, be compatible with a freight concession for the movement of Afghan transit traffic. Indeed, the private provision of freight services for some commodities, freight concessions for other commodities/routes and an overall concession for residual/general freight operations would be more complex but still possible.

⁵³ There have been several announcements recently that other operators will be allowed to compete with CONCOR. The arrangements for new entrants have recently been announced.

⁵⁴ According to PR's freight management, container traffic is not very profitable for PR, relatively low rates in comparison to oil products and high empty running factors.

231. Essentially the choices for opening the freight sector to private sector participation may depend upon four factors:

- The arrangement which will result in the largest increase in rail freight;
- The arrangement which will result in the largest inflow of net revenue to the rail sector/GOP;
- The arrangement(s) which is/are likely to evoke private sector interest and investment;
- The arrangement(s) which is/are acceptable to GOP.

232. There is private sector interest, for example, from the port terminal operators, but it is not clear the extent to which the private sector is prepared to invest rather than utilize PR's existing assets. While there may well be private sector interest in running individual freight services, the interest in taking a concession for the freight business may be very limited with the risks perceived as being too great⁵⁵. If GOP wishes to shift some of the investment/risk and utilize the private sector, opportunities exist but will require detailed analysis and extensive discussions with potential operators. GOP has advertised for expressions of interest from the private sector to run train services and more than 50 responses were received. However, such investments would be restricted to Pakistani investors only, thus limiting substantially the range of potential investment.

233. If GOP moved down the route of opening access to the private sector in the freight sector, it might also consider introducing the private sector into the management/operations of the passenger sector, through some form of concessioning or leasing arrangement. However, the demand from the private sector to become involved in passenger services, even on the basis of negative concessioning, is likely to be much smaller.

4.8. RAILWAY REFORM AGENDA AND THE NATIONAL TRADE CORRIDOR

234. Many of the high level proposals in the reform agenda have been incorporated in the policy framework for the National Trade Corridor and broadly endorsed by the Prime Minister:

- *Establishing a reform team and preparing a restructuring plan* by (i) appointing a CEO and railways reform team (and transitional support consultants), (ii) preparing a rail restructuring plan and advising on the new structure of autonomous board, and (iii) completing a human resource audit;
- *Developing a Business Plan and Marketing Strategy;*
- *Transforming of its present departmental structure and governance* to commercial management and priorities. State Corporation status may be necessary, but other measure will also be needed to provide the required commercial management;
- *Separating core and non core services and freight/passenger or non-commercial* by establishing separate holding companies for non-core activities and land assets with an increased operational and management priority to freight (freight should have its own accounts, dedicated motive power and train paths);
- *Treating infrastructure recovery for road transport equal to rail* while commercial rail services should fund their above rail costs, including track maintenance, but not major track investment. PR should also be relieved of its past sunk costs – debt servicing and existing pension obligations;
- *Introducing modern financial management and accounting* through IAS accounting designed on a business lines approach;

⁵⁵ In general, railway concessions have generated relatively little bidding interest. Two bids for a concession would be normal.

- *Resolving the social/strategic cost* of keeping loss-making lines open for business by insulating the cost burden of these activities.

235. A draft bill for the establishment of PRC has been drafted and submitted to the Cabinet for approval, and consultants are being recruited to assist with the introduction of commercial accounting systems.

236. The issue is not so much, therefore, the principles of the broad policy agenda but very much the translation of those principles into the detailed actions necessary to reform and restructure the railway sector and to build the organization and constituency which will be necessary to implement such actions.

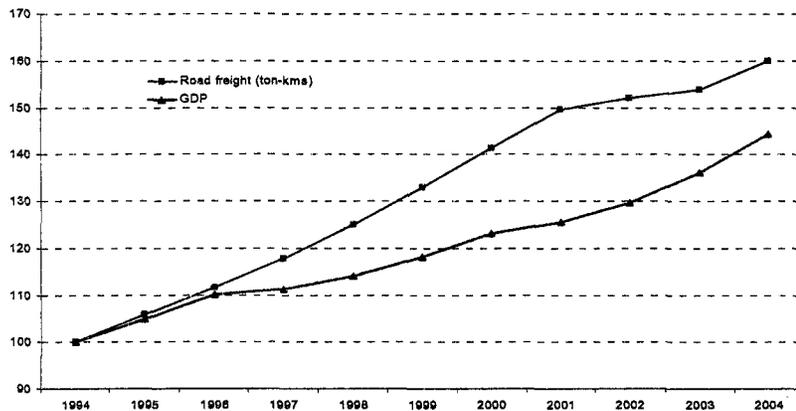
5. MODERNIZATION OF THE TRUCKING SECTOR

5.1. PRESENT STATE OF THE TRUCKING INDUSTRY

5.1.1. Dominance of the Freight Market

237. The road freight industry has achieved remarkable growth since deregulation in the mid-1960s and now totally dominates the domestic freight sector with >95 percent of the market. Pakistan Railways (PR) failed to compete and is now largely confined to public sector traffic. Over the past ten years, road freight (ton-km) has grown at 4.8 percent per year, significantly faster than economic growth, 3.7 percent (Figure 2). With the increasing importance of export-oriented manufacturing, freight demand is now likely to track GDP growth more closely. Land freight transport is expected to double within the next 10 years in Pakistan, and the country's economy will stay reliant on the trucking industry to accommodate much of this demand.

Figure 2: Road Freight and GDP



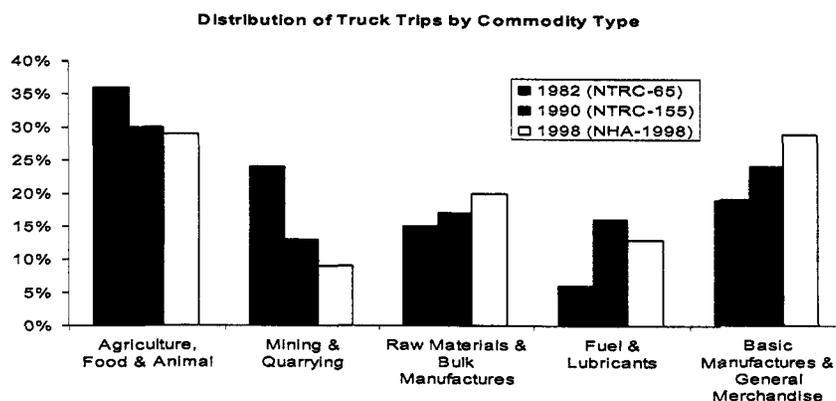
240. Trucks comprise close to half non-urban traffic, compared with 30 percent cars/light vehicles and 20 percent buses. On some sections of N5, trucks reach 70 to 80 percent of the total flow. Approximately 30 percent of loaded trucks carry agriculture products or animals (Figure 3), but the importance of basic manufactures and general merchandise has been increasing steadily, reflecting the transformation of the economy.

5.1.2. The Structure of the Industry

238. The trucking industry is dominated by large numbers of individual owners providing “for hire and reward” services, coordinated by numerous small-scale transport agents. Four types of ownership/management can be distinguished:

- Small fleet owners, few own more than ten trucks;
- Investors who purchase vehicles and lease them on installment purchase arrangements to operators;
- Freight brokers who are not owners but manage fleets; and
- The driver/owner crew, estimated to be about 10 percent of the industry.

Figure 3: Share of road freight trips by commodity type



239. This fragmented structure is common in most deregulated trucking sectors, especially in the full-load segment. Trucking companies in the EU have an average of only 3.9 employees, and only three OECD countries have trucking companies with an average size of >13 workers. There are large trucking companies in deregulated markets but their market share is small. For example, the three largest trucking companies in Turkey have a market share of 10.5 percent, six percent in the Netherlands, five percent in Finland, 3.8 percent in Canada, Mexico and Portugal, and 1.5 percent in France⁵⁶.

240. By far the largest trucking fleet in Pakistan is owned by the National Logistic Cell (NLC). It was established, in 1978, to move public imports of wheat and fertilizer during a transport emergency. Until the mid-1980s, NLC accounted for 3-4 percent of the market but, with the rapid growth in the sector, its share has been declining. Today, NLC operates some 1,400 modern high-powered modern trucks and employs more than 7,000 staff⁵⁷.

5.1.3. Competition in the Freight Market

241. The customers for long-haul freight are relatively large enterprises. The great majority of the cargo is shipped in full loads. Pakistan has avoided restrictive regulations and the industry is highly competitive with minimal entry barriers and large numbers of operators. Anyone with a licensed truck driver and a registered truck can operate; rates are determined by the market.

242. Competition has led to lower freight rates. Over the last 20 years, revenues per km have fallen, in real terms, by an average 1.4 percent per year (Table 18), while fuel prices, for example, have increased by an average 3.2 percent per year.

⁵⁶ OECD, 2001.

⁵⁷ NLC has expanded into dry ports, engineering and construction, road toll collection, tire re-treading, etc. and has plans to expand into border terminals and security scanning. Unfortunately, NLC was unable to meet the mission undertaking the basic research and has disagreed with the comments made on NLC by other participants of the study.

	1984 ⁵⁸	2004	Annual change
Mean new purchase price Tractor-Trailer	2,283,750	2,700,000	0.8%
Diesel Price	16	29	3.2%
Tire price	8,313	14,000	2.6%
Revenue per loaded km	22.65	17.14	-1.4%
Revenue per day	7,005	5,408	-1.3%
Estimated Rate of Return	>15.5%	low/negative	
Source: Consultant's estimates.			

243. Road freight rates in Pakistan are now among the lowest in the world (Table 19). The small trucking firms provide a very low cost service. Very long-haul rates for high-loading, low value commodities can be below US\$1.0/ton-km. PR's revenue, in comparison, averages about US\$1.3/ton-km for an average haul of about 800 km.

Country	Average cost per ton km (US\$)
Pakistan	0.015 - 0.021
India	0.019 - 0.027
Brazil	0.025 - 0.048
United States	0.025 - 0.050
Central Asian Republics	0.035 - 0.085
Australia	0.036
China	0.040 - 0.060

244. NLC has a privileged position for government cargo and politically sensitive commodities: over 80 percent of its trucks are moving government cargoes⁵⁹. In open competition, NLC's performance is weak, with high rates and poor service⁶⁰, and none of the major commercial organizations interviewed includes NLC in its plans. Public sector entities are directed to use NLC and cannot seek more competitive rates in the open market. Their alternative is PR.

5.1.4. Service Quality

245. Shippers in Pakistan generally receive the level of service for which they are prepared to pay. Periodic supply shortages are a fairly common complaint of shippers but in the competitive sector there is no reward for standby truck capacity. Large private bulk shippers such as cement manufacturers are generally very satisfied with both the rates and level of service received. They generally demand low quality but powerful trucks. Major customers secure two to three-month contracts with local brokers (addas) to provide enough trucks at a fixed rate. One cement

⁵⁸ TRRL Research Paper 314 by J. Hine, adjusted for inflation.

⁵⁹ NLC denies the privileges and direction of government cargo and asserts that any cargo lifted by NLC is on the lowest rates available in the market. However, this runs counter to the general view of the sector. Certainly it appears, at the very least, to have a favored position with regard to the movement of Afghan commercial traffic.

⁶⁰ Trucks, serving the private sector, may be withdrawn to meet demands for the movement of public sector cargoes, primarily fertilizer and wheat.

manufacturer interviewed has contracts with local brokers to supply 200 trucks daily for cement distribution as well as 25 to 30 trucks to move coal from Karachi to the factory, some 850 kilometers.

246. Major exporters are satisfied with the rates but only to a certain extent with service. In the Punjab, exporters have largely overcome some of the service deficiencies, without losing much of the low rates, by setting up transport cooperatives and dry ports. These cooperatives share the cost of en-route monitoring of their cargo. This is not the case in Peshawar, where there are many dissatisfied customers. Exporters complain about the shortage of suitable trucks for their high-value goods. They need tractor units that can pull containers, loaded with heavy goods, at reasonable speed. Some use an express service which provides a 28-hour transit from Lahore to Karachi, at higher rates, rather than the standard 42 hours⁶¹.

247. There are customers who complain freight rates are too high. They are usually small shippers involved in local freight. Although they pay the lowest rates in the world, they have little negotiating power and are very exposed to seasonal fluctuations in the supply of trucks and freight rates. Importers and transit customers are satisfied with road transit times, 3-4 and 4-5 days from Karachi to the Punjab and Peshawar, respectively. But they are extremely critical about the very long customs delays and the poor train service beyond Lahore.

5.1.5. Contractual Practices

248. Shippers⁶² may arrange for transport services directly or rely on various "fee-people" who arrange the transport for a fee or undertake the transport management. The outbound shipper, either individually or through one of the shipping cooperatives develops a small group of "base-load carriers." These are small trucking companies that own some trucks and charter in additional units until they can meet the customer need. These carriers also usually act as freight brokers, finding return loads for trucks unloading in their locality.

249. The base-load carriers reach price and service agreements with the shippers that usually cover the bulk of the shippers' transport need. While shippers may use other brokers to arrange additional trucks for "overflow" freight, they have a priority to reach as long a commitment as possible with the base-load carrier for both rates and capacity. Some large shippers mentioned monthly, quarterly and even annual commitments for rates and capacity. The commitments usually include a road transit time and occasionally an extra price for expedited service. The shippers of higher value goods, like textiles and sporting goods for exports, tend to have more formal agreements and careful service monitoring. Overflow freight usually moves at the spot market price.

250. Shippers of low-value goods rely more on the spot market and less dependable services. The lower the cargo value, the more price sensitive is the shipper and the more willing to compromise on transit time and service quality.

251. The road freight industry also includes a segment of specialized haulage, tailored to meet specific market needs, primarily liquid and dry bulk. These segments are more organized and generate better revenues than general cargo. The four major oil companies ensure that their haulage contractors and their crews become more efficient and safety oriented. Such transport accounts for a relatively small percentage of the total trucking fleet.

⁶¹ An additional driver is included and the truck is driven continuously.

⁶² Shipper may be the consignor of the goods or the transport agent, whichever exercises control over carrier selection.

5.2. REFORMING PAKISTAN'S ROAD FREIGHT INDUSTRY

252. To date, it is estimated that sector inefficiencies are costing the economy about Rs 150 billion per year⁶³, while low service quality is impeding Pakistan's trade competitiveness (both internal and external). Key issues facing the trucking sector include:

5.2.1. Low Vehicle Distance Productivity

253. Trucks are operated long hours and are modified to take excessive loads. Productivity is, however, constrained by low speeds, which have changed little over 20 years. Running speeds are between 40 and 50 km/h, and loaded trip speeds are around 25 km/h.

254. Compared to India or Africa, annual vehicle mileage is reasonable, 100,000 to 130,000 km. This is, however, less than half the utilization in industrialized countries, such as the USA. Low speeds are partly offset by the low empty load ratio, <20 percent. Transit times between Karachi and Punjab are around 48 hours, and between Karachi and Peshawar 72 hours. In comparison, transit times between Algeiras, in Spain, and Perpignon, in France, (1,320 km) are 15 hours, and between Algeiras and Paris (1,855 km) 24 hours.

5.2.2. Low Service Quality for High-Value Exports

255. Although major shippers are broadly satisfied with service levels, the overall quality of road freight services is far from optimal, especially with regard to reliability and timely delivery. Manufacturers keep a "buffer" of one/two days to compensate for slow/unreliable delivery.

256. For exporters of high-value goods, the cost of the "buffer" is increasingly an issue. Private dry ports have enabled large exporters, in Faisalabad and Sialkot, to control transit time, reliability of delivery, and supply of capacity. The contract transit time is 48 hours but shippers who need faster service, can hire the same transporters for a delivery time of 28 hours at a premium of 50 to 60 percent. Table 20 shows transport choices of three textile exporters.

	Company "A"	Company "B"	Company "C"
Total export value (US\$)	300,000,000	100,000,000	500,000,000
Containers (FEU)/year	3,300	3,500	400
Average 40ft container value (US\$)	90,909	28,571	1,250,000
% of freight using express service	3.50%	0%	25%
Contract Transit Time (hours)	48	48	48
Rate for Contract Time (US\$)/FEU	250	283	283
Express (Potential) Transit Time	28	28	28
Rate for Express Transit Time (US\$)/FEU	417	417	417
Express Service Premium (US\$)/FEU	167	133	133
Inventory Saving (US\$)/FEU	21	7	285

⁶³ The estimates include (a) extra fuel costs and subsidies (Rs 60-90 billion/year), (b) additional road user costs (Rs 30-35 billion/year, and (c) contributions to the infrastructure deficit (Rs 25 billion/year).

Only the exporter with the high container value uses the express service significantly. Company A uses the express service when production delays threaten vessel loading dates at Karachi.

5.2.3. Old Truck Technology

257. The trucking fleet is mainly old, obsolete and under-powered. There are over 184,000 registered heavy commercial vehicles (exceeding seven tons payload), but such estimates should only be taken as suggestive as registration statistics are unreliable. It is even harder to disaggregate the fleet by vehicle type and axles. About two thirds of the fleet is outdated two/three axle rigid trucks with worn-out and underpowered engines. The fleet has not changed greatly in 20 years; though there are more tractor-trailers, they are still a small percentage of the total fleet. Traffic counts on N5, between Lahore and Karachi, show a gradual increase in the proportion of articulated and 3-axle units (Table 21), and are suggestive of the transformation in the long haul fleet. They are not, however, representative of the overall fleet as small 2-axle units still dominate on local routes.

	Rigid 2-axle	Rigid 3-axle	Articulated
1988	84%	6%	10%
1998	62%	23%	15%
2001	55%	27%	18%

258. Full efficiency gains on new trucks have not been realized. Nissan, Hino and Isuzu assemble trucks from imported kits, using about 30 percent local components. The vehicle design is old and use naturally aspirated engines which were replaced in industrialized countries by turbo-charged engines some 30 years ago. More advanced truck technologies have almost doubled truck km/liter but Pakistan is still importing old technology for local assembly.

259. The import of secondhand trucks, other than dump trucks, is not permitted, though many used dump trucks are soon modified for general freight. Over 3,000 such units per year are imported, while local production is about 2,000 heavy vehicles per year. The illegal modification of both imported and locally assembled rigid trucks to under-powered tractors is not uncommon.

5.2.4. Under-Developed Cargo Insurance

260. There is a conspicuous absence of cargo insurance. Some shippers buy coverage from the broker or freight forwarder but most shippers, especially for local cargo, carry the risk themselves. There is no regulated practice of holding the trucker primarily responsible for damage/loss; there is thus little incentive for the trucker to take care of cargo. There is also no meaningful third party liability insurance.

261. Shippers can buy cargo insurance coverage from freight forwarders for 0.5-1.5 percent of the invoice value. In the USA cargo losses are 1-2 percent of carrier revenues and these revenues average about 3-4 percent of the cargo value, so the actual value of goods lost is extremely small. This is tremendously lower than the rates being paid in Pakistan for cargo coverage. One shipper of sporting goods calculated that the freight cost was about 2 percent of cargo value and insurance could be 25-75 percent of the transport cost.

5.2.5. Serious Sector Externalities

262. In developed countries, there is growing concern about truck externalities: damage from overloaded vehicles, congestion, accidents, noise, pollution, and greenhouse gases. The focus of policy has shifted toward internalizing these externalities through more economically efficient road pricing.

263. Intense competition pushes truckers to cut costs by infringing regulations. This is not unique to developing countries. A study⁶⁴ in France suggested that, if all carriers complied fully with their legal obligations, freight costs would increase by a third. Infringing the regulations can bring substantial operating benefits to noncompliant operators and, with competition, all operators then have to infringe the regulations. Overloading trucks brings no additional profits to truck owners when all trucks are overloaded, but lower freight rates and higher road damage costs.

264. In Pakistan, there has been little/no enactment or enforcement of regulations controlling overloading, safe operations, crew hours, truck modifications or trailer manufacture. Hazardous cargo is treated no differently than other cargo and no efforts are made to control vehicle pollution. The major externality is road damage from overloading; trucks are loaded to their maximum cubic capacity, irrespective of axle loads or resulting vehicle speeds. Overloading causes excessive road damage and, along with excessive driving hours, presents a serious safety problem. The sudden enforcement of axle load regulations may not be feasible as it would cause supply shortages and large and rapid increases in freight rates, but a strategy for the gradual reduction in overloading is required.

265. Various studies and reports suggest that about 25 percent of road accidents and fatalities in Pakistan involve a truck. The record for trucks may be better than buses but is still extremely poor. In more developed countries, the share of trucks in road fatalities does not exceed 5 percent but the proportion of trucks in total traffic is also very much lower. However, the fatalities/100 million vehicle kilometers are 10 – 20 times higher in Pakistan than in Europe, North America or Australia. Overall, the safety record of trucks is poor and could be substantially improved by changes to vehicle standards, road improvements, reduced loading and appropriate operating regulations.

5.2.6. Low Industry Profitability

266. The general cargo trucking sector has low profitability and a high rate of bankruptcy. Market rates in May 2005 indicate an average freight rate of Rs. 17.14 per km for a 40ft container (10 and 25 tons), and Rs. 10.76 per km for a 20ft container (Table 22). Back-haul rates from Lahore, are 40 to 50 percent lower than the outward freight rates.

⁶⁴ “Privatization and Regulation of Road Freight Transport” ECMT Seminar. Paris, 5 September 1996”.

From	To	Freight Rate (Rs/truck)	Distance km	Freight Rate (Rs/truck km)	Freight Rate (Rs/ton-km)
Lahore	Karachi	15,000	1,300	11.54	0.77
Karachi	Lahore	25,000		19.23	1.28
Peshawar	Karachi	25,000	1,800	13.89	0.93
Karachi	Peshawar	48,000		26.67	1.78
Faisalabad	Karachi	17,000	1,200	14.17	0.94
Karachi	Faisalabad	25,000		20.83	1.39
Sialkot	Karachi	20,000	1,420	14.08	0.94
Karachi	Sialkot	27,000		19.01	1.27
Rawalpindi	Karachi	18,000	1,500	12.00	0.80
Karachi	Rawalpindi	30,000		20.00	1.33
<i>Average</i>				<i>17.14</i>	<i>1.14</i>

267. Back-haul rates are not sufficient to cover all operating expenses. On the Lahore - Karachi route, for example, the fuel cost for a tractor trailer would be around Rs. 13,500 leaving only Rs. 1,500 for other expenses, just enough to cover the crew cost. Even with the higher front haul rate, overall profitability is very low.

268. Low freight rates may be explained by the combined impact of very low cost trucks, the massive overloading, low wages, and a truck technology which allows easy maintenance and locally fabricated parts. Overloading transfers part of the trucking costs to the government in the form of additional road costs and the low vehicle maintenance costs are a reflection of low wages and labor productivity. But the small, old trucks are only cost effective because import restrictions unnecessarily inflate the cost of big, modern trucks. As elsewhere, with less restrictive import policies and reasonable highway management, truckers would move to a tractor-trailer fleet, for long haul operations. While rates are low, the potential savings from more efficient equipment and better highway management are still available.

5.3. ACTIONS TO MODERNIZE THE TRUCKING SECTOR

5.3.1. Status Enhancement of the Trucking Sector

269. At the present time, the trucking sector is perceived as operating primarily within the informal sector of the economy. Part of modernizing trucking will require the shift of the industry more into the formal sector of the economy. GOP can assist the formalization of the sector:

- GOP should proceed, as a high priority, with the formal recognition of the trucking sector as an Industry. This recognition would, among other things, result in improved financing possibilities.
- The more 'developed' truckers in the industry are greatly interested in entering international transport, but this requires GOP ratification of the relevant international transport conventions (TIR & CMR).

- GOP should also facilitate formation of a Federal Road Transport Association (FRTA). As a nationwide non-governmental transport association, FRTA would qualify for membership of the International Road Transport Union (IRU) and thus represent the interests of the Pakistan's road transport operators at the international level. It would also work with GOP, in implementation of UNESCAP Resolution 48/11 in Pakistan.

5.3.2. Highway Conditions and Management

270. The quality of infrastructure is consistently rated as the major problem by both shippers and carriers. Pakistan has the structure for an ideal highway freight system with its long corridor connecting the major urban centers. But present highway conditions and highway management permit only very low travel and trip speeds:

- Poor physical condition of the roads -- about 3,800 km of the national highways (40% national network) is in poor condition and in need of reconstruction/rehabilitation;
- Dysfunctional access to ports and dry ports;
- Non-motorized transport (NMT) taking available capacity;
- Very slow speeds of grossly overloaded, small, obsolete trucks.

These poor operating conditions affect not only the less important routes but also the main North – South arterial links (Table 23):

	N5	N55
	Karachi – Lahore – Peshawar	Hyderabad – DG Khan – Peshawar
Total distance (kms)	1700	1400
Six lane kms	0	0
Four lane kms	1670	0
Two lane kms	30	1400
Traffic flow (vehicles/day)	8,000 – 60,000	2,000 – 8,000
Commercial vehicle speeds (kph)	35 – 45	35 – 45
Travel Time (hours)	72	58
Road condition (kms*)		
Good	1900	700
Fair	650	250
Poor	850	450
On-going construction		
Rehabilitation (kms)	850	255
Rehabilitation + Widening (kms)	216	319
Planned construction**		
Rehabilitation (kms)	200	200
Rehabilitation + Widening (kms)	275	200

* 2-lane kms; ** Planned to commence within two years

271. These conditions substantially reduce incentives to modernize the fleet: why purchase an expensive, adequately powered truck to run behind very slow overloaded trucks and NMT? Roads provide maximum capacity, and optimum fuel efficiency, when all traffic moves at the same speed.

A concerted move toward achieving this objective would increase transport efficiency, reduce fuel consumption and improve road safety. The following would help move toward this objective:

- A designated system of Pakistan's existing highways carrying the bulk of the freight traffic should be identified for upgrading;
- Where there is substantial NMT, separate facilities should be constructed; similarly there should be bypasses around towns. As facilities are constructed, NMT should be banned from the designated highways;
- Existing regulations on construction encroachment within the highway right of way should be enforced;
- Minimum as well as maximum legal speeds should be introduced on designated highways. The minimum speed should be gradually raised, helping to reduce overloading, increasing flow capacity and reducing trip times;
- Off-road vehicles (i.e. agricultural tractors and trolleys) should be prohibited from long distance hauls on designated highways.
- Only National Highways & Motorway Police (NH&MP) be authorized to regulate traffic on the national highways. Check posts of all other agencies like anti-narcotics force, customs, provincial police, etc. should be removed (only intelligence-based interventions allowed and in coordination with NH&MP).

272. The objective would be to ensure that the high cost highways provide the speed, capacity and level of service for which they were designed.

5.3.3. Relaxation of Import Restrictions and Tariffs

273. Pakistan's industrial and import policies are disincentives to the modernization of the trucking industry:

- Import duties on trucks and truck components are very high;
- The import of used trucks is banned (except for construction vehicles);
- Preference, under the "deletion program" is given to raising the local component of vehicle assembly.

274. These barriers may enable Pakistan to raise local industrial production but they block the transfer of new technology and the modernization of the fleet. Modern trucks (EURO-2 or better) are essential to realize significant travel time and environmental improvements in Pakistan. With annual local production of 2,000 trucks, it is questionable whether the benefits to local industry out-weigh costs to the economy from an out-dated trucking fleet.

275. High custom duties on Completely Built Unit (CBU) and Completely Knocked Down (CKD) kits provide protection to the auto industry but also lead to high costs for the final customers. A 2002 study⁶⁵ found that local prices for imported automotive parts were 15–100 percent higher than their import costs and that the prices of most locally-produced auto parts were higher than those of imported parts. The same survey also showed very low capacity utilization in the vehicle-related manufacturing sector: 30-40 percent for vehicle assembly and 30 percent for auto part manufacturers.

276. If GOP wants a modern trucking industry, it has to review its present import policies which favor the continued import of obsolete technology. The high import duties on both vehicles and parts

⁶⁵ International Trade Center. 2002. "Demand Survey on Automotive Components." Pakistan..

should be reduced substantially. Given the competitive nature of the trucking industry, cost-savings will almost certainly be passed to consumers/producers through lower freight rates.

277. GOP should also review its policy on secondhand trucks. The importation of used trucks should be permitted, though possibly with age and/or other restrictions. Truck leasing companies in developed countries normally replace their vehicles after 4 or 5 years, and the trucks are then bought by owner-operators, small companies or exported. Many successful trucking fleets in both developed and developing countries have been established with imported secondhand vehicles. The practice is particularly cost-efficient in countries, like Pakistan, with an effective truck maintenance sector⁶⁶. Truckers will take full advantage of the remaining life of imported used units and will soon focus on those manufacturers that provide training and parts supply.

5.3.4. Modernize Existing Domestic Manufacturing Industry

278. The truck assembly plants (such as NISSAN, HINO, ISUZU, BEDFORD) in Pakistan assemble trucks with 1960 technology aspirated engines (HINO is trying to upgrade some engines to EURO-1 standards). The GOP should provide import/manufacturing incentives to the domestic truck manufacturing/assembling industry to shift to assembly of multi-axle trucks of EURO 3 standards to meet 60 percent of the capacity progressively over the next three to five years, while weeding out the existing assembly units.

5.3.5. Improved Access to Formal Sector Financing

279. Truck operators rely on the informal sector for vehicle financing. Loans are repaid through monthly installments, with interest rates of around 20 percent. Commercial financing is very largely absent, especially for small and medium sized operators. To modernize the truck fleet, it is imperative to shift to many more multi-axle vehicles in the fleet. Small and medium truck operators' inability to receive credit lines and loans from commercial banks on normal or reduced (subsidized) interest rates with favorable payment terms makes it difficult, if not impossible, for these operators to purchase modern multi-axle road transport equipment. There are relatively few owner-drivers; the great majority of drivers have almost no ownership interest in the vehicles. Owner-operator financing is presently not available from the financial institutions but, in line with SME promotion, it may be an area in which GOP could take a sponsoring role.

280. GOP may consider: (a) formulating a Truck Leasing Concept involving commercial banks, (b) setting up a revolving National Guarantee Fund (NGF) to provide interest reducing incentives to the commercial banks. NGF may act as a guarantor in relation to the commercial bank for part of the committed loan to the truck operator or, as a backup, may re-finance part of the commercial bank's obligation and/or (c) establishing a fund to purchase and scrap old but operational two-axle trucks, thus providing truckers with the down payment for newer trucks. However, financing from the formal sector would also result in the trucker becoming part of the formal sector, a major deterrent to truck owners unless there are other benefits.

281. Large commercial companies should, in principle, have easier and cheaper access to finance but there are no such trucking companies in Pakistan. Large companies in other sectors are reluctant to enter into trucking because of the intense competition, lack of scale economies, the likelihood of much higher overheads and low profitability. In highly competitive road freight markets elsewhere, such as the USA, owner-operators and small scale operators form the core of the industry.

⁶⁶ Interestingly, NLC reports that, despite the official restriction, it is acquiring a fleet of four year old Euro 2 prime movers, exactly the type of purchase that should be encouraged for the overall modernization of the fleet.

5.3.6. Increasing the Effective Role of the Insurance Industry

282. Effective insurance should play a critical role in underpinning the performance of the trucking sector. The insurance companies presently play no real role in the road freight industry.

283. *Third Party Insurance:* There is no effective functioning third party liability insurance system: nominal insurance premiums are paid to meet legal requirements, but few claims for compensation are actually met. This is a subsidy from third parties to the trucking sector. In the USA, public liability insurance costs, on average, around 4 percent of trucking company revenues. But the costs for any individual company depend on accident experience and are thus an effective incentive for improving driving standards and safety records. A functioning third party liability insurance system should be a basic requirement of GOP policy.

284. *Collision Insurance:* with no functioning third party insurance, there is certainly little truck collision insurance. However, if formal sector financing of trucks is to emerge, collision insurance is certain to be a requirement of the financing package.

285. *Cargo Insurance:* GOP should encourage the private sector to develop the cargo insurance market by imposing carrier liability for the loss/damage to goods carried. Experience-rated insurance utilizes financial incentives to improve trucking discipline and reduce cargo loss and damage. Unfortunately, with the informal nature of the Pakistani trucking industry, insurance companies have a very limited ability to get any experience rating information. Some form of carrier registration may be part of the solution.

5.3.7. Carrier Registration

286. Both freight carriers and shippers indicated the need for the “registration” of freight transport operators. The carriers would like registration as an entry barrier, similar to the restrictions on bonded carriers, to help reduce competition. Shippers would like registration to help provide carrier responsibility for cargo loss/damage and make them less dependent on the brokers for guaranteeing the reliability of transporters.

287. The Government should consider introducing a voluntary national registration scheme for truck operators. Such registration should not act as an entry barrier into the sector and should impose no conditions other than “fitness” as a recognized freight transport operators. Registered carriers would need to operate to minimum national standards but would require neither bonding nor minimum fleet size. On these terms, there would be no reason for a carrier not to register beyond entering more into the formal sector. GOP should then work to make registration something that carriers found to be in their own financial interest.

288. GOP could help put together insurance programs for cargo loss/damage and collision damage which would be available to registered truckers. GOP could induce insurance companies to participate in insurance pools. This type of insurance, with many small predictable losses, should be the type of business that insurance companies like because they are easy to operate profitably.

289. For the carrier, the availability of physical damage insurance would both provide needed risk coverage and facilitate truck financing. Banks always want a carrier to have this coverage as a source of repayment in the event of the vehicle being written off.

290. Carriers, with reasonable cargo loss insurance, would find it easier to obtain higher-value loads. When enough carriers have such insurance, shippers usually demand this coverage. Cargo loss coverage would be extended while, at the same time, costs would be reduced in comparison to the present load coverage provided by brokers and freight forwarders.

291. Voluntarily-registered trucks would have advantages in obtaining business and this should both stimulate their growth and encourage other truckers to join. Gradually, therefore, there should be an extension of registration and more modern business systems within the trucking sector.

5.3.8. Driver Education and Licensing

292. Shippers complain that truck drivers are not very client-responsive. In other countries with open markets, the alignment between drivers' incentives and customer service is quite close; drivers are paid for production and penalized for service failure⁶⁷. In Pakistan, few trucks are driver owned and drivers are normally obtained from a labor contractor, not directly hired by the truck owner. The majority of the truck owners/operators/drivers have little or no formal education and the drivers work long hours under harsh conditions.

293. Shell Pakistan has been successful in raising driver standards through education and training. This approach may be successful when a large organization demands high standard from their contract haulers and are willing to support the training. It may not be easily transferred to the rest of the industry without registration and the support of the Government.

5.3.9. Truck Parks and Stands

294. The lack of truck parks on the major freight routes imposes parking burdens on the cities/towns along the route. Clearing and paving some simple parking areas would provide public benefits at little cost. They would also provide the opportunity for focused health interventions (both treatment and prevention) on truckers who have a bad reputation for the spread of STDs.

295. Similar improvements could be made for the "addas" stands, where the trucks go for return loads. If government constructed parking lots, near the main freight routes, it would help reduce urban congestion, facilitate the matching of trucks and loads, and provide security for the industry.

5.3.10. Increased Rail Participation in Freight Sector

296. The trucking sector carries a much larger share of long distance low-value cargo than it might be expected. Truckers term this "cheap freight." This traffic is often routed directly by the shipper to the individual truck operator; it moves very slowly in old, overloaded rigid trucks. The haulage of such commodities would be better suited to rail and such cargo transfer would reduce pressure on the highway network.

297. But, at present, the private sector has no confidence in the service provided by Pakistan Railways. Pakistan is geographically well suited for rail freight, especially the 1,800 km corridor from Karachi to Peshawar. But it takes three weeks, sometimes longer, for PR to transit these 1,800 km, while it takes four days by road. Inefficiency and a focus on passenger traffic make PR uncompetitive in the freight sector. Major changes in railway operations and management will be required to reverse this situation.

5.3.11 Formulate and Announce Pakistan's Road Freight Industry Policy

298. There is a need to develop and formulate a Road Freight Industry (RFI) Policy (with caveats for those actions that will require political and legislative approvals) containing the above policy changes. This RFI shall be incorporated in the budget of fiscal year 2006-07 as well as Pakistan's the Trade Policy. The RFI policy will be complemented with an 'implementation strategy' in order to seek any required political and legislative approvals.

⁶⁷ In Malaysia, for example, most commercial trucking companies paid drivers no fixed salary but a percentage of the truck's freight revenues.

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