2011

ENTERPRISE NOTE NO. 27

WORLD BANK GROUP

Business Environment Perceptions in Afghanistan and Pakistan

Judy S. Yang

This note compares business environment perceptions using a unique panel data set of Afghani and Pakistani firms interviewed between 2007 and 2010. Examining the evolution of business climate perceptions within the same group of firms over time allows for a clear picture of how the broad business environment is changing. Firms in both countries are operating in a time of dynamic economic, political, and social changes. However, perceptions of the severity and challenges posed by certain business environment elements differ in the two countries. The World Bank's Enterprise Analysis Unit surveyed the same group of 319 Afghani firms in 2008 and 2010, as well as a group of 385 Pakistani firms in 2007 and 2010. Survey results show that firm perceptions of the severity and priority of certain business environment elements have changed over time, especially in the areas of electricity, political instability, and corruption.

Subjective and objective measures of the business environment

The World Bank's Enterprise Surveys have been completed by over 120,000 firms in over 125 countries. Responses offer objective statistics and subjective opinions regarding business environment elements affecting firm operations. The first type of statistic used in this note is objective, such as the number of power outages in a month or the number of visits by tax officials.

Additionally, two subjective measures are used; they are the "top obstacle" and the "major constraint." The top obstacle statistic captures which business environment element is the most *relevant* obstacle faced by a firm, while the major constraint reflects the degree to which each individual element is an obstacle to daily operations.

Firms identify only one business environment element out of a list of fifteen[1] that "represents the biggest obstacle faced by this establishment." The frequency an element is selected as the top obstacle in a country will accurately reflect what firms perceive to be the most relevant business environment obstacle affecting daily operations. When there are changes in top obstacle reporting, this should not be interpreted that a specific element is improving or deteriorating. Changes in top obstacle reporting should only be interpreted as changes in what element is currently most relevant to firms.

For example, suppose a firm in Afghanistan considers electricity and corruption to be its top two concerns. In 2008, the firm selects electricity as their top obstacle because it is fundamental to daily operations. The firm acquired a generator by 2010, so electricity was no longer a top concern, and corruption was selected as the top obstacle. The important nuance is that the severity of corruption may not have improved or worsened, it was identified as the top obstacle only after their electricity supply was resolved.

The degree of obstruction a business environment element poses to firm operations is captured by the major constraint statistic. Major constraints are derived from a different set of survey questions, where firms are asked to assess each business environment element individually and to report the element's degree of severity as an obstacle to operations. A business environment element is labeled a "major constraint" if a firm reports it to be a major or severe obstacle.[2]

Responses to subjective survey questions may be confounded by unobserved attitudes and individual interpretations. Subjective responses may not align with answers from objective questions. Even though a panel data set is used where identical firms are interviewed over time, different managers from the same firm may respond, or individuals' tolerance for certain business environment elements may have changed over time. Nonetheless, large changes in perception across hundreds of firms can still suggest that there are real changes in the business environment.

Perceptions of the top obstacle

Table 1 displays the percentage of firms that report a particular business environment element to be their top obstacle globally, in the South Asia region, and in Afghanistan and Pakistan. There are a number of observations that stand out. First, the percentage of firms in Pakistan reporting electricity or political instability to be the top obstacle to daily operations increased from 2007 to 2010 (from 44 percent to 65 percent in electricity, and 4 percent to 20 percent in political instability), while the percentage reporting corruption decreased (from 19 percent to 2 percent). Changes in the reporting of corruption as a top obstacle should not necessarily be interpreted as a result of improvements or declines in corruption; but possibly the result of shifting attention to the deterioration of electricity.

Firms in Afghanistan have opposite changes in their perceptions, with fewer firms reporting electricity and political instability to be top obstacles, and more firms reporting corruption as their top obstacle. The percentage of firms in Afghanistan selecting crime in both survey years is also high compared to the South Asia region and global averages. About 20 percent of Afghani firms report crime as the top obstacle in both survey years compared to only 6 percent globally.

From top obstacle reporting, the business environments in Pakistan and Afghanistan appear to have different weaknesses. In Pakistan, opinions on electricity reflect a low quality of basic infrastructure. In addition, the fact that the number of Pakistani firms selecting political instability as the top obstacle increased from 4 percent to 20 percent shows that these firms are also operating in a country that is becoming more conflict ridden. Together, electricity and political instability are the top obstacles for 85 percent of the Pakistani firms surveyed in 2010, nearly twice as many as in 2007. In Afghanistan, top selections of crime, corruption, and practices of the informal sector suggest operational difficulties are primary concerns.

Electricity improving in Afghanistan

In Afghanistan from 2008 to 2010, firms have improved perceptions on the severity of electricity as an obstacle to daily operations. The percentage of firms perceiving electricity to be a major constraint fell from 66 percent in 2008 to 38 percent in 2010. The percentage of firms that ranked electricity as the top obstacle facing their business also dropped from 17 percent in 2008 to 7 percent in 2010. Over half of Afghani firms assessed electricity less severely in 2010 than in 2008. Changes in perceptions also vary across subnational regions—in the northern Mazar region for example, 60 percent of firms assessed electricity more severely in 2010 than in 2008. This is in contrast to firms in Kandahar and Kabul where almost 80 percent

Table 1 **Percentage of firms reporting a business environment element to be the top obstacle**

Country	Access to finance	Access to land	Business licensing and permits	Corruption	Courts	Crime, theft and disorder	Customs and trade regulations	Electricity	Inadequately educated workforce	Labor regulations	Political instability	Practices of competitors in the informal sector	Tax administration	Tax rates	Transport
GLOBAL[3]	15	3	3	7	1	6	3	16	6	2	9	11	3	11	3
South Asia region[4]	13	4	2	6	0	6	2	29	2	2	14	6	3	4	3
Panel Firms															
Pakistan 2007	6	6	1	19	0	8	1	44	2	1	4	1	1	5	1
Pakistan 2010	2	2	1	2	0	3	1	65	1	0	20	2	0	1	0
Afghanistan 2008	17	12	0	9	0	20	1	17	0	0	17	3	2	0	1
Afghanistan 2010	5	2	1	24	0	18	5	7	2	1	10	10	5	6	2

Source: Enterprise Surveys.

of firms perceive electricity to be less severe in 2010.

By firm size, the perception of electricity as an obstacle did not vary in 2010. Improvements in perceptions were seen across all firm sizes—in contrast to Pakistan where small firms are more likely to perceive electricity to have become more severe. The incidence of power outages per month and the durations of power outages declined across all firm sizes in Afghanistan as well. Declines in the average number of power outages per month ranged from 18 to 8 power outages for large firms and 23 to 12 outages for small firms.

Objective statistics on the status of electricity are also consistent with perceptions that electricity is improving. By region, some areas saw more reduction in outages than others. The average reported number of power outages country-wide dropped from 22 to 12 per month, and the average duration from 11 to 4 hours. In Jalalabad, not a single firm reported more power outages per month in 2010 than in 2008. Improvements in electricity were also reported by firms in the Kandahar and Kabul regions. However, there is still room for progress in electricity provision in the Hirat region as well as in five smaller cities that were surveyed throughout Afghanistan.

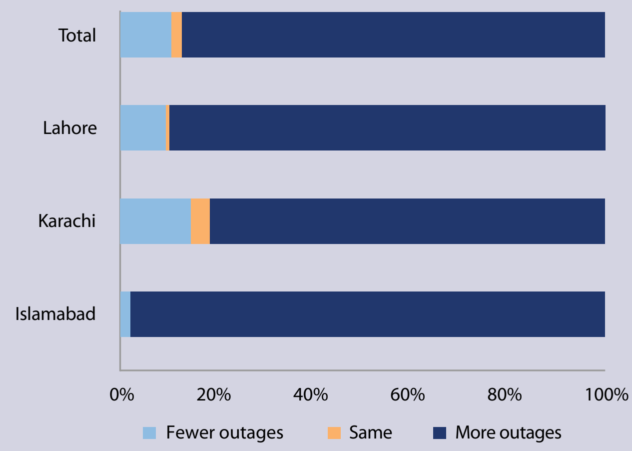
Electricity is a severe obstacle in Pakistan

The perceived severity of electricity as an obstacle in Pakistan could not be more different from Afghanistan; the deterioration of electricity provisions in Pakistan is indisputable. Almost 60 percent of panel firms (224 firms out of 380) assessed electricity more severely as an obstacle in 2010 than in 2007. In the Islamabad area, almost all firms perceive electricity to be more severe in 2010 than when surveyed in 2007 (69 out of 75 firms). In addition, 100 percent of firms in Islamabad experienced power outages in 2010 compared to 66 percent in 2007. Firms in the Karachi region, however, are about evenly split between how they perceive electricity to have changed as an obstacle from 2007 to 2010.

Small firms are more likely to view electricity as a major constraint to daily operations. In 2010, small and micro-sized firms reported electricity to be a major constraint at a significantly higher rate than medium or large firms (90% of small, 78% of medium, and 74% of large).

The deterioration of electricity is evident from objective reporting on outages. Although the average duration of power outages decreased in Pakistan from 3 to 1.5 hours, the number of power outages per month increased substantially. Electricity supply is intermittent and inconsistent and almost all firms in Pakistan report more power outages per month in 2010 than in 2007—from 30 in 2007 to over 120 in 2010, or an average of once a day to four times a day (figure 1). The Karachi region saw the smallest increase (from 33 outages per month in 2007 to 80 in 2010), while firms in Islamabad and Lahore both saw much higher increases in the number of power outages (averaging about 150 outages a month in 2010). While these numbers appear incredibly large, the demand for power in Pakistan vastly exceeds the supply and the shortage of electrical power in Pakistan is a real and urgent problem.

Figure 1 **Change in the number of power outages 2007 to 2010, Pakistan, by region**



Source: Enterprise Surveys.

Firms in Afghanistan perceive corruption to be a more severe obstacle

Among countries in the South Asia region, Afghanistan in 2010 leads in the percentage of firms that rank corruption as the top obstacle to business operations—at 26 percent. Corruption is more commonly a top obstacle for large firms (32 percent) than small firms (22 percent). By region and over time, fewer firms reported corruption to be a top obstacle in Kandahar (from 26 percent in 2008 to 12 percent in 2010), while there was an increase in Mazar (3% to 28%) and Kabul (12% to 27%) (figure 2). The Jalalabad region saw the highest change in the percent of firms reporting corruption as their top obstacle, up from 0 percent in 2008 to 32 percent in 2010.

Twenty-seven percent of firms in Afghanistan reported corruption to be a severe obstacle in 2008, and 47 percent did so in 2010. Sometimes there is contradictory evidence in what firms report subjectively and what objective data illustrates. Even though more firms selected corruption as their top obstacle, over time and across most firm sizes, fewer firms reported that they were asked to give informal gifts in 2010. Discrepancies among responses to corruption questions can be expected since it is a sensitive topic; honesty and candor to this particular topic is a noted concern.

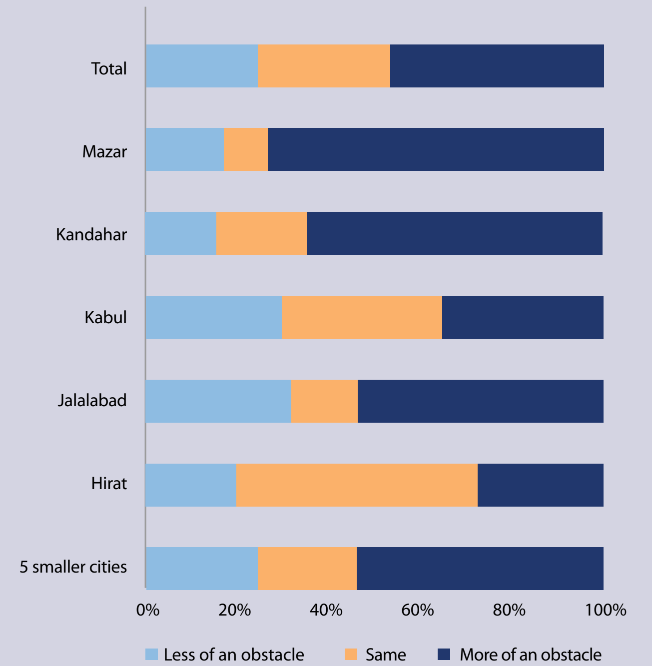
Firms in Pakistan report corruption to be less severe

In Pakistan, perceptions on corruption are improving. From 2007 to 2010, the percent of firms that consider corruption to be a severe obstacle decreased from 27 percent to 14 percent, and the percent perceiving it to be a major obstacle decreased from 38 percent to 15 percent. Among objective measures, Pakistani firms spend more time dealing with regulations, face fewer visits from tax officials, and are less likely to be expected to give gifts in meetings with tax inspectors.

Across regions, firms in Islamabad report the fewest visits by tax officials (1 visit) and managers spend the least amount of time dealing with tax officials (6 percent). In all regions of Pakistan, at least 75 percent of firms ranked corruption less severely as an obstacle to daily operations in 2010 than in 2007. The Lahore region showed the greatest decline in the percent of firms reporting that they were expected to give gifts, 35 percent in 2010 compared to 54 percent in 2007.

Similar to Afghanistan, large firms in Pakistan also face more interference from regulation and corruption. In 2010, senior management from large firms spent about 15 percent of their time dealing with regulations, had about 6 visits a year from tax officials, and 66 percent of large firms were expected to give gifts in these meetings. Compared to Afghanistan, large Pakistani firms have more visits and are more likely to be asked to give gifts. Although objective measures appear more negative in Pakistan than in Afghanistan, the improvements in subjective perceptions on corruption may be due to the fact that other elements such as electricity and political instability are much more severe in comparison. In other words, tolerance for corruption may have changed in light of the emergence of more urgent issues, and corruption appears relatively less problematic.

Figure 2 **Corruption in 2010 vs. 2008, Afghanistan, by region**



Source: Enterprise Surveys.

Notes

1. The Pakistan 2007 survey also includes macroeconomic instability as an option for Top Obstacle.
2. In the 2010 surveys, the Very Severe Obstacle is labeled as Severe Obstacle.
3. Global surveys include all Enterprise Surveys following the global methodology and all South Asia Region surveys. In cases where a country has two global surveys, only the latest surveys are included to compute the global average.
4. South Asia Region surveys include: Sri Lanka 2004 & 2010, Nepal 2009, Bhutan 2009, India 2006 & 2010, Afghanistan 2008 & 2010, Pakistan 2007 & 2010, Bangladesh 2007 & 2010.