NUST INSTITUTE OF MANAGEMENT SCIENCES

MBA Final Thesis

On

"Impact of Inflationary Trend on Pakistan's Economy (Balance of Payments)"

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Executive Summary

Inflation is a term known by most of us, criticized by majority of us, feared by all of us but not understood by many of us. In common terms, rise in general price level of a country is regarded as Inflation. But economic analysis of inflation is very deep and in economics, the term inflation means much more than understood by a common man. Inflation is defined as the change in the level of prices. Rising prices has always been an important issue for a common man and the issue raised by many opposition parties to topple the acting governments. A common man has no knowledge of foreign debts, FDI or the foreign reserves. He only knows that if the prices increase too much then the government is not performing well which makes this issue all the more important.

What the balance of payments measures is the inflows and outflows of a nation's currency across its national borders with the rest of the world (ROW) over some period of time, usually a year, but often calculated quarterly or even monthly.

Increasing prices have a direct impact on Balance of Payments as they result in higher costs of production as well as increasing the prices of export commodities and therefore decreasing the export prospects .

The relation between Inflation and balance of payments is very sensitive and though some work has been already done on both the issues separately but no great efforts have been made to understand the relation between inflation and balance of payments.

Who controls inflation and whether it is even possible to control inflation are two very perplexing questions that have been dealt with detail in this thesis work. This research study includes extensive study of Pakistan's trade performance since 1947 to date along with discussing the driving forces behind those

economic conditions and it also gives practical recommendations to control the inflationary trend to improve the exports of the country

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Chapter 1

Overview - Inflation

It is of paramount importance to exactly comprehend the terms we are discussing. Inflation is a term known by most of us, criticized by majority of us, feared by all of us but not understood by many of us. In common terms , rise in general price level of a country is regarded as Inflation. But economic analysis of inflation is very deep and in economics, the term inflation means much more than understood by a common man.

Inflation is defined as the change in the level of prices.

In the words of Hanson

"Inflation is present when the value of purchasing power is persistently running ahead of the output of goods and services so that there is a continuous tendency for prices both for commodities and factors of production to rise, because the supply of goods and services and factors of production fail to keep pace with demand for them".

Gardener Ackley defines Inflation "As a persistent ad appreciable rise in the general level or average of prices".

Measuring Inflation

Most of the time, people mean the "Consumer Price Index" or "CPI" when they discuss inflation in a country. This is the change in the price "shopping basket" of consumer goods for a country that the national statistics agency has sampled over time on a monthly basis. The "core CPI" is the change in prices without the food and energy components, or "ex food and energy". Since food and energy prices are volatile, the "core CPI" is thought to be a more accurate measure of underlying inflation

The main challenge in measuring inflation as the change in level of prices is establishing which prices to use for the calculation. National statistics agencies usually measure various inflation rates:

- The "raw materials price index" (RPI), or so-called "crude goods" price index, which measures commodity price inflation;
- The "industrial product price index" (IPPI), which measures changes in the wholesale price of goods at 'the factory door'; and
- The "consumer price index" (CPI), which measures the change in retail prices.

Since economists, market strategists, and politicians are usually concerned with changes in consumer prices, the CPI is the most frequently used measure of price change in Pakistan . Across a country, however, prices vary with market conditions, availability, transportation costs and other factors.

The inflation rate for 2004 represents the rate of price increases of the weighted basket of goods (the CPI) since 2003. The calculation is:

$$\text{Inflation rate (2004)} = \frac{\text{CPI (2004)} - \text{CPI (2003)} \quad \times 100}{\text{CPI (2003)}}$$

Major Types of Inflation

When prices are moving upwards it is not necessary that the prices of all the commodities are rising. The price of some commodities may be relatively constant and some may even fall. The basic symptom of inflation is a rising general level of prices. If in a country, the prices are rising very sharply or at a phenomenal rate, it is termed as Galloping Inflation, Runway Inflation or Hyperinflation. Germany experienced hyperinflation in 1924 and Hungary in 1944. If the inflationary pressure is timely controlled with the help of price control rationing it is termed as suppressed Inflation. If the rate of general price level rise is between1% to 4% per annum, it is called Creeping Inflation. If high unemployment and inflation exist side by side in a country, it is termed as stagflation. Stagflation is in fact a mixture of recession and inflation. When hyperinflation occurs, the value of money becomes worthless and people lose all confidence in money both as a store of value and also as a medium of exchange. Often drastic action is required to stabilize an economy suffering from high and volatile inflation - and this leads to political and social instability. The International Monetary Fund is often brought into the process of implementing economic reforms to reduce inflation and achieve greater financial stability

Impacts of Inflation

If not controlled or estimated inflation can play havoc with a country's economy.

<u>The Effects of Unanticipated Inflation</u>.

In many ways the problem with inflation is not the higher prices, but the way it can creep up, suddenly creating a big stir and causing us to lose our balance and spill our cup of tea. Or put another way, as long as we properly anticipate inflation, we can prepare and absorb much of its shock. Problems occur when

inflation is greater than we predicted, when it is unanticipated. When the actual inflation rate is greater than the anticipated (planned for) rate, several problems may arise.

A Redistribution of Income and Wealth within the Economy.

Institutions that lend money, such as banks, hate inflation. When a bank makes a loan, it charges an interest rate based on projections of future inflation, tacking on a few percentage points for profit. If inflation rises above the anticipated level, then profits are eroded or even eliminated.

Profits are hurt because of the way banks make money. Banks pay depositors interest to attract funds, which they can loan out at a higher rate. However, the rate paid to depositors adjusts more quickly to market conditions than the interest rate that banks charge borrowers. If inflation shoots upward, interest rates immediately follow. Banks are forced to quickly raise the return to depositors, while the rate on the overall portfolio of loans lags behind. Although banks are increasingly making flexible-rate loans and taking other defensive actions (such as interest rate swaps) they still prefer a low, steady, and predictable inflation rate. The three things we can conclude:

- Bank profits fall during periods of rising interest rates (caused by increased inflation);
- In general, unanticipated jumps in inflation hurt lenders while helping borrowers who pay off their debts with money, the value of which has been eroded by inflation; and
- If inflation is properly anticipated lenders can raise the interest rates that they charge borrowers in order to maintain a positive rate of return.

Later in this course we will look at the issue of interest rate determination in more detail.
Another problem caused by unanticipated inflation is for workers on fixed contracts. If a labor union makes a long-term agreement for salary increases based on the projected inflation rate, then the real wage may actually decline if the inflation rate shifts up. The definition of the real wage is:

real wage = nominal wage - inflation rate

For an example, assume the nominal wage increases at a 5% rate. If inflation is 3%, the real gain in wages is 2%. But if inflation unexpectedly jumps to 8%, the real wage gain is -3% (the real wage falls by 3%).

Other Consequences of Inflation

There are several other economic impacts to consider as a consequence of high inflation. Inflation has an impact on the output and employment decisions by firms that are altered by high inflation. Some possibilities include:

a. Inflation distorts the price mechanism by making it difficult to distinguish changes in relative prices from changes in the general price level.

Changes in relative prices may be offset by the substitution of lower price inputs used in production. If almost all prices are rising rapidly, there is little incentive to search for cheaper substitutes that could help keep production costs low.

b. Inflation creates uncertainty. If businessmen are unsure about the future level of prices, and thus of real interest rates, they will be less willing to take risks and invest, especially in long-term projects. As investment is reduced, so is the long-run growth potential of the economy.

c. There may be a redistribution of resources and production into areas less affected by high inflation rates. Inflationary hedges are used to try to keep up with the effects of inflation, possibly to the detriment of the economy. The classic inflationary hedge is gold (and other precious metals). Gold is desirable in times of high inflation because the paper currency issued by the government rapidly loses its value (purchasing power), while gold prices tend to keep pace with inflation. The reason is that inflation increases the

opportunity cost of holding paper currency (which loses its value) and gold is the closest available substitute. As the demand for gold increases, the price of gold rises (along with inflation). As savers shift their assets into gold, they reduce their holdings of stocks and bonds. This reduces the supply of funds available for businesses to borrow, raising the cost of investment (r, the interest rate). The result is less business investment and a reduction in the economic growth rate.

d. Inflationary uncertainty pushes up real interest rates, as lenders demand a bigger risk premium on their money. Longer-term interest rates are especially punished as a high inflation premium is added to account for inflationary uncertainty. As a result, the cost of borrowing by businesses and consumers increases substantially, reducing the rate of real economic growth.

e. Overall redistribution of productive and financial resources may lead to a loss in efficiency. As economic efficiency falls, so does the production of goods and services. Certain elements of the tax code are deficient in adjusting for inflation. A capital gain represents an appreciation in the price of an asset, such as real estate. The capital gain is the difference between today's price and the purchase price (assuming that the market price has increased since the date of purchase). During times of high inflation, real estate prices usually appreciate, reflecting an inflationary adjustment among other factors. When the capital gain is realized (the asset is sold) the amount of the gain is taxed. However, tax rates fail to properly adjust for the part of capital gains due to inflation. Individuals are taxed on both their real and inflationary capital gains, while optimally they should only pay a tax on their real (after- inflation) capital gain.

We can observe a positive correlation of interest rates to inflation rates. Not surprisingly, empirical evidence shows that since 1973 countries with low inflation have tended to accomplish slightly faster GNP/GDP growth than those with higher inflation levels. In addition, countries with low inflation rates enjoyed the lowest unemployment rates.

We can conclude that inflation may cause many economic distortions, including slower growth and higher unemployment. Many policymakers advocate attempting to sustain the lowest possible rate of inflation. It is argued that low inflation rates yield benefits of:

a. Making possible the fastest long-term growth.

b. Eliminating the distorting consequences of unpredicted inflation.

c. Reducing the uncertainty and inefficiency associated with inflation.

Overview - Balance of Payments (BOP)

Definition

* What the balance of payments measures, it is the inflows and outflows of a nation's currency across its national borders with the rest of the world (ROW) over some period of time, usually a year, but often calculated quarterly or even monthly.

* The balance of payment (BOP) is a comprehensive record of economic transactions of the residents of a country with the rest of the world during a given period of time.

* It is a tabulation of the credit and debit translation of a country with government about the international economic position of the country and to help it make decision about monetary and fiscal issues, on one hand, and about trade and payments on the other hand.

* Simply somewhat, the balance of payments measures what a country earns (and borrows) from the rest of the world (ROW) and what is spends (and lends) to the ROW.

* The Balance of Payments is a summary statement of a nation's financial transaction with the outside world.

* A nation's balance of Payments statement, records, all transactions which take place between its residents (including individuals, businesses, and governmental units) and the residents of all foreign nations.

Importance of BOP

Balance of payments is a complex issue. The way the nations of the world solve the problems concerning balance of payments determines the volume of trade and investment between them. The major purpose is to provide summary statistical statements of the sources and uses of foreign exchange. The countries having deficit balance of payments are the ones whose visible and invisible imports exceed their exports. The balance of payments position of a country serves as an index of its economic position.

Causes of Unfavorable BOP

Unfavorable Climatic Conditions

Pakistan's major exports comprise of agricultural goods i.e, cotton, its products and rice. If the weather conditions are favorable, the production of these commodities go up, otherwise the production of these commodities are effected heavily causes reduction in exports.

Import Oriented Industries

Most of the import substitution industries, which have been set up in Pakistan, are importing inputs and technology. The imports of industrial raw material in the aggregate import are placed at 50%, which is eating away the precious foreign exchange earnings of the country.

Competition with Developing Countries

Pakistan has to face tough competition in the international market not with developed countries but with developing countries also particularly have the value added goods has reduced the volume of trade.

Oil Imports

Pakistan is spending a huge amount on the import of oil. The country's import of petroleum and its products is a big drain on the balance of trade of the country.

Terms of Trade

The demand for Pakistani exports in the international market is elastic due to which their price index moves up slowly. On the other hand, Pakistan's demand for imports is inelastic due to which their price index is moving up fast. Hence, our commodity/barter terms of trade are deteriorating. This is important factor, which contributes in making our balance of trade unfavorable.

Unstable Prices

The frequent changes in the fiscal and monetary policies of Pakistan in the past year had distributed the level of investment, the volume of imports and exports. The volume of exports particularly of the manufactured items has restricted volume of foreign trade.

Devaluation and Delinking

The devaluation of Pakistani rupee in 1972 and delinking in 1982 had increased the import bills. The excessive rise in the prices in the foreign market has increased the value of imports and has adversely

affected the balance of trade. Although export become cheaper but volume of exports could not be increased. AT the time of devaluation of rupee in 1972 one dollar was equal to Rs.5 and at the time of delinking in 1982 dollar value was equal to Rs.10 while the present exchange rate is one dollar is equal to Rs.55.

Older Techniques of Production

The industrial sector as well as agricultural sector in country is still operation on the machinery manufactured before 1980. Especially in the public sector modernization, balancing and replacement of machinery is of question since 1972 which results a fall in production and the quality of a products, also remains low and it is not possible to increase exports and to compete even with developing countries.

Less Production of Value added Goods

The share of industry in the GDP is balanced round 20% for the last over many years. The share of value added goods must increase to earn foreign exchange and turn the trend of adverse balance of payment.

Sick Industrial Units

The number of such industrial units, mainly due to nationalization of industries has increased. It is well known that the performance of most of nationalized industrial units is not satisfactory. The decline in production of such units reduces the exportable surplus and badly affects the volume of exports.

Social Factor

Pakistani are consumption oriented by habit. Moreover, population growth rate in Pakistan is very high. So the domestic manufactured goods are consumed in the country. There remain very few goods, which can be exported, while most of the consumer goods are imported.

Political Uncertainty

The political uncertainty and labor unrest in the industrial units have considerably affected the efficiency of the industries. The fall in the volume of production, particularly in the manufacturing value added sector has reduced export earnings.

Frequently changing Policies

The frequent changes in monetary and fiscal policies have disturbed the pattern of exports and imports in terms of value. The expansionary monetary and fiscal policies, particularly under deficit financing, have created inflationary situation in the country due to which exports went down and the value of imports went up. As a natural consequence, our balance of trade became unfavorable.

Exports of Primary Commodities

Pakistan, even after five decades, is still depending upon the export of primary goods, cotton and rice to the various countries of the world. If weather is favorable, the production of agricultural goods goes up. The export of cotton and rice increases. In case, there are heavy rains and the climate is unsuitable for the growth of agricultural produce, the export drastically declines. The foreign exchange earnings are reduced.

Consumption Oriented Society

Pakistani are mostly consumption oriented. Due to rapid rise in population and increased consumption habits, the domestic manufactured goods are mostly consumed in the country. The exportable surplus is, therefore, on the decline. Rise in Freight Rates The rapid rise in the air and sea freight rates has adversely affected the trade balance.

Propaganda about Exploitation of Child Labor

The adverse propaganda about the use of child labor, anti dumping duties in the importing countries are important factors causing imbalance in the trade.

Increase in Prices of Inputs

The increase in the prices of fuel, electricity, high capital costs of imported machinery utility, rates downward exchange rate etc have inflated the costs of both imported capital goods and industrial raw material on which domestic industry is heavily dependent.

Inflation

The inflationary impact of the rise in the prices of inputs is not helping in achieving the export targets set in each financial year. The slow export performance during 1996-97 is mainly attributed to heavy fall in export of raw cotton due to decrease in production, negative growth of large scale manufacturing (-1.4%) anti dumping duties on cotton yarn, fabric and bed linen, imposition of non tariff barriers like child labor, ISO-14000, Overvaluation Pak. Rupees.

Inflationary conditions are a serious obstacle to the promotion of exports. It creates the problem of deficit in BOP by increasing imports and decreasing exports. This gives rise to many other troubles such as, shortage of foreign exchange, fall in foreign exchange reserves, increase in foreign debt and unfavourable rate of exchange.

Imports of Invisible Items

Invisible imports relates to the payments for the services like banking, insurance and shipping etc. The imports of invisible goods are not being offset by exports of invisible goods. This situation also contributes to the persistence of adverse BOP. In addition, heavy payments in foreign exchange are also to be made every year to provide education and training to Pakistan nationals abroad, for travels and pilgrimages of the people every year.

The country is lacking in technical knowledge and as such services of technical personal, experts etc., are imported every year to meet the requirements of indigenous industries, educational institutions, training centres and the development projects.

All the above activities amount to invisible imports against which invisible exports are almost insignificant. As a result, invisible imports are being offset by invisible exports and the deficiency creates adverse BOP which is clear from the reality that total receipt on invisible items amounted to Rs. 31.23 crores as against a payment Rs.167.92 crore in 1958-59. The receipt in 1967-68 amounted to Rs. 34.49 crore as against the payment of Rs. 97.91 crores

Workers' Remittances

Another cause of BOP imbalance during 1980's is the steep decline in foreign exchange remittances from abroad. The return of Pakistanies from Kuwait and Iraq due to Gulf crises has greatly reduced the foreign exchange earnings and was put pressure on the balance of payments. Decline in home remittances of workers to 1.5 billion dollars in 1991-92 from 2.88 billion dollars in 1984-85 has also affected the balance of payments

The Need for Equilibrium in BOP

Equilibrium in the BOP

The balance of payments in an accounting sense must always balance since debits must always equal credits if the entries are correctly made. There can, however, be disequilibrium (deficit or surplus) in the balance of payments when viewed from the balance of transactions on current account. A disequilibrium - surplus or deficit - in this sense shows strengthening or weakening of a country's external capital position which is measured by the balance of its external assets to liabilities, net official reserves.

Equilibrium is that state of BOP over the relevant time period which makes it possible to sustain an open economy without severe unemployment on a continuing basis.

There are two types of BOP equilibrium.

i) Static equilibrium

In static equilibrium, exports equal imports including exports and imports of services as well as goods and other items on the BOPs - short term capital, long term capital and monetary gold are on balance, zero. Not only should the BOPs be in equilibrium, but also national money, incomes should be in an equilibrium vis a vis money incomes abroad. The foreign exchange rate must also be in equilibrium.

ii) Dynamic Equilibrium

The conditions of dynamic equilibrium for short periods of time is that exports and imports differ by the amounts of short term capital movements and gold (Net) and there are no large short term capital movements. The condition for dynamic equilibrium in the long run is that exports and imports differ by the amount of long term autonomous capital movements made in a normal direction i.e from the low interest rate country to those with high rates. When the BOPs of a country is in equilibrium, the demand for domestic currency is equal to its supply. The demand and supply situation is thus neither favourable nor unfavourable. If the BOP moves against a country, adjustments must be made by encouraging exports or goods, services or other forms of exports or by discouraging imports of all kinds.

Disequilibrium in BOP

There are several variables which join together to constitute equilibrium in the international economic position of a country, viz national incomes at home and abroad, the prices of goods and factors,

the supply of money, the rate of interest etc. At the back of these variables lie the supply of factors, production functions, the state of technology, tastes, the distribution of income, the state of anticipations etc. If there is a change in any of these variables and there are no appropriate changes in other variables disequilibrium will result.

There are four main types of disequilibrium..

i) Random or Temporary Disequilibrium

Random or temporary type of factors may lead to a temporary disequilibrium in the balance of payments e.g. outbreak of war, crop failures, floods and industrial strikes etc.

ii) Cyclical Disequilibrium

Cyclical disequilibrium occurs because of two reasons: First, two countries may be passing through different paths of business cycle. Second, the countries may be following the same path but the income elasticities of demand or price elasticities of demand are different. If prices rise in prosperity and decline in depression. A country with a price elasticity for imports greater than unity will experience a tendency for decline in the value of imports in prosperity, while those for which import price elasticity is less than one will experience a tendency for increase. These tendencies may be overshadowed by the effects of income changes. Conversely, as prices decline in depression, the elastic demand will bring about an increase in imports, the inelastic, demand a decrease.

iii) Secular Disequilibrium

The secular or long run disequilibrium in BOP occur because of long run and deep seated changes in an economy as it advances from one stage of growth to another. The current account follows a varying pattern from one state to another. In the initial stages of development, domestic investment exceeds domestic savings and imports exceed exports.

Disequilibrium arises owing to lack of sufficient funds available to finance the import surplus, or the import surplus is not covered by available capital from abroad. Then comes a stage when domestic savings tend to exceed domestic investment and exports outrun imports. Disequilibrium may result, because the long term capital outflow fall short of the surplus savings or because surplus savings exceed the amount of investment opportunities abroad. At a still later stage, domestic savings tend to equal domestic investment and long term capital movements are on balance zero.

iv. Structural Disequilibrium

Structural disequilibrium has two sub types:

a) Structural disequilibrium at goods level.

b) Structural disequilibrium at factor level.

Structural disequilibrium at goods level occurs when a change in demand or supply of exports or imports alter a previously existing equilibrium, or when a change occurs in the basic circumstances under which income is earned or spent abroad in both cases without the requisite parallel changes elsewhere in the economy.

A deficit arising from a structural change can be filled by increased production or decreased expenditure, which in turn affect international transactions in increased exports or decreased imports. Actually it is not so easy, because the resources are relatively immobile and expenditure not readily compressible. Disinflation or depreciation may be called for to correct a serious disequilibrium.

Structural disequilibrium at the factor level results from factor prices which fail to reflect accurately factor endowments, i.e, when factor prices are out of line with factor endowment, distort the structure of

production from the allocation of resources which appropriate factor prices would have indicated. If, for instance, the price of labour is too high, it will be used more sporingly and the country will import goods with a higher labour content. This will lead to unemployment, upsetting the balance in the economy.

Commercial Policy

The commercial policy of every country is generally based on the encouragement of exports and discouragement of imports and its no different in Pakistan

Heberler says.

"Commercial policy means all the measures regulating the external economic relation of a country taken by the government which has power of assisting or hindering the exports or imports of goods & services".

In other words trade policy refers to the various measures taken by the government. from time to time to regulate the value, volume, and composition of the foreign trade to requirement of the economy as to accelerate her economic growth and enhance the people welfare to the increase consumption and employment level.

Basically trade policy is divided into two parts. The first part consists of objectives and second consists of how to achieve these objectives.

Objectives of Trade Policy

Following are the main objectives of trade policy.

1) Protection to infant industries

   It is also the objective of the trade policy that it should prevent the import of particular goods for giving the protection to infant industry.

2) Protection of Foreign exchange

   It is also the aim of trade policy that it should prevent the out flow of foreign exchange.

3) Increase in the Quantity of Trade

The commercial policy one of the objectives is to increase the quantity of trade with other nations.

4) To prevent the essential raw material

Commercial policy preserves the essential raw material for encouraging the development of domestic industries.

5) Import of capital goods

The commercial policy encourages the import of capital goods increase the rate of development in the country.

6) Correction of Balance of Payment

Trade policy is also very useful for the correction of balance of payment. It restricts the imports to reduce the deficit.

7) Foreign Trade stability

One objective is to enter into trade agreements, with foreign nations for stabilizing foreign trade.

8) Stable exchange rate

Its objective is to achieve the deserved rate of exchange which may ensure economic stability.

Instruments of Trade Policy

With the use of following instruments of trade policy we can achieve our objectives in day to day life.

1) Custom duty

Import and export duties are also imposed for saving revenue and to restrict the export or import of a certain commodity to achieve the economic stability in the country. Import duties are generally imposed for revenues or for protection. Custom duty may be different with respect to commodity or country.

2) Subsidies on exports

In order to increase the exports of a particular commodity, a government sometimes gives subsidy on exports. Subsidy may be direct or indirect. When the subsidy is paid in cash from the public treasury, It is called direct subsidy . When the exports are exempted from the taxes or law foreign exchange rate is charged on the goods it is called indirect subsidy.

3) Trade agreement

Any country can enter into a trade agreements with other countries for the exchange of good. The trade agreements may be bilateral of the world have made efforts to secure the general reduction of tariffs. So 49 countries have made agreement in this regard. This is called general agreement on trade and tariffs. (GATT)

4) Direct control

It means to impose restrictions on the imports and exports by directly. It has two kinds.

i) Prohibition of imports and exports.

ii) Quota system should be introduced

5) Exchange control

Government orders the people to deposit the foreign exchange in the central bank and converts it into local currency. The government uses it keeping in view the requirements of the country.

6) Stable trading

The state may undertakers the business of imports and exports the goods according to its wishes. No private importer can import the commodity.

7) Import license

Government issues the import licenses to particulars people and it can increases or decreases the quality of imports according to the needs of country.

Trade Agreements with other Countries

The government of any country enters into trade agreements with other countries to exchange goods. The trade agreement is of two types.

1) Bilateral Agreement

2) Multilateral Agreement

1) Bilateral Agreement :

When two countries make a trade agreement for the exchange of goods, the agreement is said to be bilateral.

2) Multilateral Agreement :

When more than two countries enter into trade agreement for ensuring fair and equal treatment to the imports and exports of the member countries, the agreement is called multilateral.

In recently efforts have been made by different countries of the world to secure a general reduction of tariffs. A general agreement on trade and tariff of 49 countries of the world has been reached at.

Main objectives of GATT

1) To promote economic development.
2) To help in raising standard of living.
3) To develop the resources of the world.
4) To achieve full implementation without inflation.
5) To expand production and exchange of goods.

Trade's Terms

In order to know the position of a country in international trade and balance of payments, terms of trade play an important role.

Two concepts of terms of trade are:

a) Barter terms of trade
b) Income terms of trade

a) Barter Terms:

If refers to the ratio of exports prices to import prices.

b) Income Terms of Trade:

It measures the import capacity of a country. Income terms of trade are measured as export receipts by import price index.

Chapter 2

Literature Review

Inflation

Inflation is present when the value of purchasing power is persistently running ahead of the output of goods and services so that there is a continuous tendency for prices both for commodities and factors of production to rise, because the supply of goods and services and factors of production fail to keep pace with demand for them

Balance of Payments (BOP)

Definition

* What the balance of payments measures, it is the inflows and outflows of a nation's currency across its national borders with the rest of the world (ROW) over some period of time, usually a year, but often calculated quarterly or even monthly.

* The balance of payment (BOP) is a comprehensive record of economic transactions of the residents of a country with the rest of the world during a given period of time.

* It is a tabulation of the credit and debit translation of a country with government about the international economic position of the country and to help it make decision about monetary and fiscal issues, on one hand, and about trade and payments on the other hand.

There are two types of BOP equilibrium.

i) Static equilibrium

In static equilibrium, exports equal imports including exports and imports of services as well as goods and other items on the BOPs - short term capital, long term capital and monetary gold are on balance, zero. Not only should the BOPs be in equilibrium, but also national money, incomes should be in an equilibrium vis-a-vis money incomes abroad. The foreign exchange rate must also be in equilibrium.

ii) Dynamic Equilibrium

The conditions of dynamic equilibrium for short periods of time is that exports and imports differ by the amounts of short term capital movements and gold (Net) and there are no large short term capital movements.

The condition for dynamic equilibrium in the long run is that exports and imports differ by the amount of long term autonomous capital movements made in a normal direction i.e from the low interest rate country to those with high rates. When the BOPs of a country is in equilibrium, the demand for domestic currency is equal to its supply. The demand and supply situation is thus neither favourable nor unfavourable. If the BOP moves against a country, adjustments must be made by encouraging exports or goods, services or other forms of exports or by discouraging imports of all kinds.

Disequilibrium in BOP

There are several variables which join together to constitute equilibrium in the international economic position of a country, viz national incomes at home and abroad, the prices of goods and factors, the supply of money, the rate of interest etc. At the back of these variables lie the supply of factors, production functions, the state of technology, tastes, the distribution of income, the state of anticipations etc. If there is a change in any of these variables and there are no appropriate changes in other variables disequilibrium will result.

There ar four main types of disequilibrium..

i) Random or Temporary Disequilibrium

Random or temporary type of factors may lead to a temporary disequilibrium in the balance of payments e.g. outbreak of war, crop failures, floods and industrial strikes etc.

ii) Cyclical Disequilibrium

Cyclical disequilibrium occurs because of two reasons:

First, two countries may be passing through different paths of business cycle.

Second, the countries may be following the same path but the income elasticities of demand or price elasticities of demand are different. If prices rise in prosperity and decline in depression. A country with a price elasticity for imports greater than unity will experience a tendency for decline in the value of imports in prosperity, while those for which import price elasticity is less than one will experience a tendency for increase. These tendencies may be overshadowed by the effects of

income changes. Conversely, as prices decline in depression, the elastic demand will bring about an increase in imports, the inelastic, demand a decrease.

iii) Secular Disequilibrium

The secular or long run disequilibrium in BOP occur because of long run and deep-seated changes in an economy as it advances from one stage of growth to another. The current account follows a varying pattern from one state to another. In the initial stages of development, domestic investment exceeds domestic savings and imports exceed exports.

Disequilibrium arises owing to lack of sufficient funds available to finance the import surplus, or the import surplus is not covered by available capital from abroad. Then comes a stage when domestic savings tend to exceed domestic investment and exports outrun imports. Disequilibrium may result, because the long term capital outflow fall short of the surplus savings or because surplus savings exceed the amount of investment opportunities abroad. At a still later stage, domestic savings tend to equal domestic investment and long term capital movements are on balance zero.

iv. Structural Disequilibrium

Structural disequilibrium has two sub-types:

a) Structural disequilibrium at goods level.

b) Structural disequilibrium at factor level.

Structural disequilibrium at goods level occurs when a change in demand or supply of exports or imports alter a previously existing equilibrium, or when a change occurs in the basic

circumstances under which income is earned or spent abroad in both cases without the requisite parallel changes elsewhere in the economy.

A deficit arising from a structural change can be filled by increased production or decreased expenditure, which in turn affect international transactions in increased exports or decreased imports. Actually it is not so easy, because the resources are relatively immobile and expenditure not readily compressible. Disinflation or depreciation may be called for to correct a serious disequilibrium.

Structural disequilibrium at the factor level results from factor prices which fail to reflect accurately factor endowments, i.e, when factor prices are out of line with factor endowment, distort the structure of production from the allocation of resources which appropriate factor prices would have indicated. If, for instance, the price of labour is too high, it will be used more sporingly and the country will import goods with a higher labour content. This will lead to unemployment, upsetting the balance in the economy.

Commercial Policy

The commercial policy of every country is generally based on the encouragement of exports and discouragement of imports and its no different in Pakistan

Heberler says.

"Commercial policy means all the measures regulating the external economic relation of a country taken by the government which has power of assisting or hindering the exports or imports of goods & services".

In other words trade policy refers to the various measures taken by the government. from time to time to regulate the value, volume, and composition of the foreign trade to requirement of the economy as to accelerate her economic growth and enhance the people welfare to the increase consumption and employment level.

Public Policy

A set of interrelated decisions taken by a political actor or group of actors concerning the selection of goals and the means of achieving them within a specified situation where these decisions should, in principle, be within the power of these actors to achieve.

Money Market

The money market is a subsection of the fixed income market. We generally think of the term "fixed income" as synonymous with bonds. In reality, a bond is just one type of fixed income security. The difference between the money market and the bond market is that the money market specializes in very short-term debt securities (debt that matures in less than one year). Money market investments are also called cash investments because of their short maturities.

Capital Market

Capital markets play a crucial role in mobilizing domestic and foreign resources, and channeling them to the most productive medium and long-term uses. Since these funds are not intermediated, resource allocation should be more efficient.

CHAPTER 3

Pakistan Economy -Overview

Pakistan is a poor, heavily populated country, suffering from internal political disputes, lack of foreign investment, and a costly confrontation with neighboring India. Pakistan's economic outlook has brightened in recent years in conjunction with a great improvement in its foreign exchange position, notably its current-account surplus and rapid growth in hard-currency reserves. The Pervez Musharraf government has sought, and received, debt-relief from international lenders, reducing its external debt from $32 billion to a discounted present value less than half of that. The government is using Pakistan's surplus to prepay expensive debt and replace it with commercial debt, which it has been able to obtain at low interest rates as a result of its improved credit rating. Musharraf's economic agenda includes measures to widen the tax net, privatize public sector assets, and improve its balance of trade position. Pakistan has made privatization a cornerstone of economic revival, and while it has received a positive endorsement from the World Bank, it is still having difficulty attracting new investors.

Economy - in greater depth:

Extreme poverty and underdevelopment in Pakistan, as well as fiscal mismanagement that has produced a large foreign debt, obscure the potential of a country which has the resources and entrepreneurial skill to support rapid economic growth. In fact, the economy averaged an impressive growth rate of 6 percent per year during the 1980s and early 1990s. However, the economy is extremely vulnerable to Pakistan's external and internal shocks, such as in 1992-93, when devastating floods and political uncertainty combined to depress economic growth sharply and the financial crisis in Asia which hit major markets for Pakistani textile exports. Average real GDP growth from 1992 to 1998 dipped to 4.1 percent annually.

Since the early 1980s, the government has pursued market-based economic reform policies. Market-based reforms began to take hold in 1988, when the government launched an ambitious IMF-assisted structural adjustment program in response to chronic and unsustainable fiscal and external account deficits. Since that time the government has removed barriers to foreign trade and investment, begun to reform the financial system, eased foreign exchange controls, and privatized dozens of state-owned enterprises. Pakistan continues to struggle with these reforms, having mixed success, especially in reducing its budget and current account deficits. The budget deficit in fiscal year 1996-97 was 6.4% of GDP. Initial data implied a reduction in 1997-98 to 5.4% and in 1998-99 to 4.3%, but revised data indicates that the deficit is probably still over 5.0%. In that same 2-year period, the rupee was devalued against the dollar 12% and 10.5% respectively.

Economic reform was further set back by Pakistan's nuclear tests in May 1998 and the subsequent economic sanctions imposed by the G-7. International default was narrowly averted by the partial waiver of sanctions and the subsequent reinstatement of Pakistan's IMF ESAF/EFF in early 1999, followed by Paris Club and London Club reschedulings. The Sharif government had difficulty meeting the conditionality of the IMF program, which was suspended in July 1999. The current government has announced a program of reforms and is in discussion with the IMF regarding a Poverty Reduction and Growth Facility to begin in July 2000.

With a per capita gross domestic product of about USD 441, the World Bank considers Pakistan a low-income country. No more than 39 percent of adults are literate, and life expectancy is about 62 years or less. The population, about 155 million in 2004, is growing at about 1.96%. Relatively few resources have been devoted to socio-economic development on infrastructure projects. Inadequate provision of social services and high population growth have contributed to a persistence of poverty and unequal income distribution.

Contrary to earlier fears, Pakistan's economy performed reasonably well in FY02. In particular, the tremendous improvement in Pakistan's external sector post-September 2001, either directly or indirectly, contributed to positive developments for many macroeconomic indicators during the year. The trade deficit

turned out to be much lower than in FY01 as exports recovered in the second half of FY02 to reach the preceding year's level, while imports dropped; the current account was in surplus and underpinned the unprecedented 6.7 percent appreciation of the Rupee. An upsurge in workers' remittances, increased official transfers and savings in interest payments allowed the SBP to increase foreign exchange reserves to an all-time high; the Rupee liquidity injected through the foreign exchange purchases enabled the SBP to ease its monetary policy stance; inflation was down to 3.5 percent as the appreciating Rupee lowered the cost of imported inputs; external debt restructuring and lower interest rates on domestic debt led to a reduction in debt servicing, thereby aiding the Government's effort to contain the fiscal deficit. Still, there were several negative repercussions of the September 11 events on the domestic economy; there was a lower collection of tax revenues as the tax base was eroded due to a reduced level of imports in Rupee terms; the export target of US$ 10 billion could not be achieved, foreign investors remained hesitant in making new commitments; and the law-and-order situation became difficult as action was taken against terrorist groups.

While acknowledging the salutary impact of the external account improvement, however, it is worth stressing that the trend improvement was visible well before the seminal September 11 events. Interest rates were already on the way down; foreign currency reserves were edging up; the exchange rate was relatively stable; the inflation downtrend was well defined, and the government's continuing fiscal discipline and commitment to reforms had already set the stage for the IMF PRGF, and the subsequent re-profiling of external debt. Nonetheless, the pre-existing positive trends did gain invaluable momentum in FY02, post-September 11. However, despite these major positives, the economy was not unscathed in FY02.

Real GDP grew by a reasonable 3.6 percent, but the increase was concentrated in fewer sub-sectors. A third successive year of water shortages took its toll, as major crops recorded another decline. The overall 1.4 percent agricultural growth thus owed almost entirely to yet another impressive performance by the livestock sub-sector. The manufacturing sector presented, under the circumstances, a more creditable performance. Even though the 4.4 percent FY02 growth was considerably weaker than the 7.6 percent increase recorded in FY01, it must be remembered that the economic environment was shrouded in

uncertainties through much of FY02, first due to the conflict in Afghanistan and then due to border tensions with India. While some sectors targeting the local economy (electronics, car manufacturers, sugar, etc.) performed reasonably well through most of the year, it was the increased access to key Western markets and a substantial decline in interest rates that catalyzed the textile sector recovery late in H2-FY02. As a result, it was the services sector that dominated the FY02 growth profile with a 5.1 percent growth. Yet, it is important to note that, here too, the structure of growth was highly skewed, with a single component, public administration & defense, accounting for a major portion of the total increase in sectoral value added during the year. In other words, while the growth rate recorded some improvement in FY02, the quality of growth retrained lackluster and shallow as the spread and spillovers to the rest of the economy remained highly limited. Thus the buoyancy and briskness in economic activity was not observed.

The striking improvement in the current account, and the massive Rupee liquidity injections resulting from the SBP foreign exchange purchases, also had important implications for the conduct of monetary policy. It may be recalled that a major factor behind the monetary tightening in FY01 was the need to support the Rupee. Thus, as the exchange rate stabilized, the SBP immediately signaled an easing by twice lowering the discount rate in successive months . The subsequent two, post-September, reductions however were aimed more at mitigating the impact of the prevailing uncertainties in the business environment.

The increase in Rupee liquidity fueled the exceptional 14.8 percent growth in M2. This allowed a substantial expansion of banks' deposit base, but (1) net private sector credit demand did not grow correspondingly, (2) the funding requirement of the government from scheduled banks fell due to higher availability of non-bank finance in FY02, and (3) banks' demonstrated an apparent preference for less risky assets. This allowed the government to substitute its accumulated borrowings from the SBP with higher net borrowings from scheduled banks without putting upward pressure on interest rates. Consequently, reserve money growth was contained to just 9.6 percent, as injections through SBP foreign exchange purchases were sterilized by a net retirement of SBP's government security holdings, thus avoiding an excessive rise in inflationary pressures.

Pakistan's debt profile also saw significant changes in FY02 reflecting the country's adherence to the Debt Reduction and Management Strategy (DRMS), as well as a one-off Rs 193 billion stock adjustment of the domestic debt. While the absolute decline in external debt and liabilities (EDL) was a marginal US$ 607 million, the re-profiling of Paris Club debt and the substitution of expensive commercial loans by cheaper IFI credits led to a significant drop in the net present value of outstanding EDL. Similarly, the domestic debt profile too saw a shift to longer tenors amidst a fall in interest rates. This said, it must be stressed that the changes, though welcome, only depict an improvement in the dynamics of Pakistan's debt profile; the country has still a long arduous road to travel before the debt ratios go down to international norms.

Medium-term Prospects

A significant upturn in economic performance began in the final months of the FY02, and was manifested by higher exports, accelerated workers' remittances, improved water availability, and increased capacity utilization in some key industries. This upsurge has altered the prospects for FY03. In particular, the recovery by textiles on the back of increased access to key markets January 2002 onwards, seems likely to continue into FY03, aided by sharply lower cost of funds (the favorable perceptions on the sector are reflected in the continuing high imports of textile machinery). Similarly, the considerable improvement in water availability in the last few months gives rise to hopes of a substantial recovery in agriculture, with positive knock-on effects on the services sector as well.

With prospects of a broad economic recovery looking bright, it becomes even more important that the FY02 improvements in the macroeconomic fundamentals not be frittered away. The key policy challenge for the government in FY03 therefore is to stay the course by remaining fully committed in implementing the on-going reform process, irrespective of gains such as the higher availability of external assistance, debt re-profiling, etc.

In particular, it is important to note the possibility (however modest) that the external account improvements could taper off in future; if this development emerges, it could have significant negative repercussions, not least the re-emergence of devaluation expectations and a jump in domestic interest rates. These concerns are particularly colored by the realization that domestic policy only set the enabling environment that allowed the economy to take better advantage of the positive exogenous shocks. It must be remembered that the catalyst (and, at least in part, continuing driver) for the rise in transfer payments into Pakistan was the policies of other countries, especially the international crackdown on informal flows that drove up remittances.

In fact, it is this concern that has led the SBP to opt for a gradual adjustment of its monetary and exchange rate policies despite a substantial improvement in the current account. It must also be noted that an abrupt shift in the exchange rate is not to be desired in any case, as an inadequate adjustment period for exporters could lead to the loss of hard-to-recapture export markets, and a consequent fall in economic activity and higher unemployment. Thus, the gradual adjustment policy is likely to continue. Also, despite a hardening consensus that the increase in foreign exchange in flows is probably sustainable, the SBP intends to guard against the possible re-emergence of the kerb market, by largely subsuming it into the mainstream financial system through the newly introduced exchange companies.

The outlook for inflation does not show any signs of concern despite the growth of monetary aggregates (M2) by 14.8 percent during FY02, well above the nominal growth rate. Most of the growth in M2 originated from the continuing rise in NFA and was substantially sterilized. Consequently, the reserve money growth was contained to 9.6 percent. The large FY02 increase was not too inappropriate in light of the need to support the economy during a period of considerable uncertainty. But, going forward, it will be prudent to limit reserve money growth consistent with the nominal growth rate of the economy, since excessive growth could fuel inflationary pressures. Within this constraint, however, the loose monetary posture could be extended further.

On the fiscal side, the government should see higher net tax receipts due to the impact of the recently introduced Self Assessment Scheme, lower tax refunds, an absence of a further cut in the maximum customs

duty rate, and a return to normal imports in FY03. Non-tax revenues too, should see greater stability going forward, as the re-structuring of government-controlled entities (especially WAPDA) should allow them to service their debt.

Over the last few years, revenue shortfalls (by the CBR, in particular) have traditionally resulted in a curtailment of development expenditures. In FY03, however, the government has vowed to substantially increase developmental expenditures, and to insulate this spending from below-target revenues by, (1) incremental revenue measures and (2) reductions in non-development spending. It must be noted that higher development expenditures not only increase immediate aggregate demand, but also have substantial "crowding-in" effects on private investment. For far too long, the low development spending has effectively led to a deterioration of infrastructure, reducing the economy's growth capacity (lowering future government revenues). Thus, in essence, meeting the fiscal deficit targets through low development spending was equivalent to shifting the fiscal deficit to future generations. It is therefore essential that the government's promise be kept.

It is worth noting that the positive developments in the country's economy do not appear to be fully reflected in Pakistan's current sovereign rating, possibly due to the impact of political uncertainties (general elections are scheduled for October 2002). The continuation of current economic polices (as promised by the President) would thus be expected to result in an upward re-rating, attracting greater investments.
In short, if the global economy does not see a major dip, Pakistan appears well placed to meet its economic targets in FY03. In fact, the FY02 developments provide a rare opportunity for Pakistan to accelerate the improvement in the country's economic fundamentals.

Economic Growth, Savings & Investment

Water shortages constrained the growth of the agriculture sector for the second year running. As a result, despite improved management and increased use of tube wells to alleviate the shortages, the major crops

saw a marginal decline. However, the impact of the dismal performance of the crops was greatly moderated by the positive momentum of another encouraging performance by the livestock sub-sector. This enabled agriculture to record a positive growth of 1.4 percent for FY02.

The weak performance of the manufacturing sector, especially large-scale manufacturing (LSM) was the major factor behind slower growth in industrial value added. LSM grew by only 4 percent in FY02, much lower than the 8.6 percent growth recorded in FY01; however, this was still commendable given that the business environment through most of FY02 remained uncertain. The performance of the remaining three sub-sectors i.e. mining & quarrying, construction, and electricity & gas distribution, remained subdued.

During FY02, the services sector grew by 5.1 percent, higher than the 4.8 percent seen in FY01 The emergence of the services sector has imparted resilience to the economy, particularly at times when the commodity-producing sector is struggling.

In overall terms, while the 3.6 percent FY02 growth of the economy was reasonably good, it was narrowly based on a few sub-sectors.

With regard to investment, provisional estimates for the FY02 suggest that the pace of investment has not picked up, and the declining trend witnessed over the last decade persists. This is reflected in the 5.9 percent decline in (nominal) gross fixed investment in FY02 against an increase of 7.9 percent last year. As a ratio to GNP, it declined to 12.2 percent from 14.5 percent last year. Although, overall investment fell short of the target, the growth in foreign direct investment is encouraging - it increased to US $ 484.7 million compared to US $ 322.4 million in FY01.

While the share of both the public and the private sector declined, the deceleration in the investment by the public sector was more pronounced. This is reflective of government's budgetary constraints and the increasing emphasis on the role of the private sector. As a result, the share of the private investment in total investment reached 61.5 percent in FY02.

Prices

Annual average rates of inflation in terms of all three price indices as well as the GDP deflator went down during FY02 from their levels last year. The rate of inflation in terms of the Consumer Price Index (CPI) came down to 3.5 percent in FY02 from 4.4 percent in the previous year despite the uncertainties following the September 11 events, continued border tensions and persistent drought-like situation in the country. Better availability of essential commodities due to a reasonable production of both food and non-food items, and availability of stocks from previous years had a moderating influence on inflation. The appreciation of the Rupee by 6.7 percent also helped, by reducing the cost of imports.

As the SBP was able to substantially limit the growth of reserve money, it is hoped that inflationary pressure will be contained.

Public Finance & Fiscal Policy

Introduction

In FY02, overall budget deficit swelled to 6.6 percent of GDP, significantly higher than both the budget target as well as that in the previous year. This was largely driven by increased defense spending (Rs.17.4 billion), and three one-off expenditures - a grant to CBR to clear accumulated income tax refunds (Rs.22 billion), a substantial investment in KESC to prepare it for privatization (Rs.30 billion) and a settlement of WAPDA arrears (Rs 5.billion). These FY02-specific expenditures not only pushed up the overall budget deficit, but also masked the benefits of lower interest payments realized on account of (1) rescheduling and re-profiling of external debt, and (2) low interest rates on domestic debt instruments. Adjusted for the FY02-specific spending, the "baseline" budget deficit was lower than the FY02 target.

Although total revenues posted a reasonable growth on the back of a large rise in non-tax revenues, overall tax collections were well below the FY02 target. The poor tax collections were largely attributed to a decline in imports, an appreciation of the Rupee against US Dollar, unusually high tax refunds, and a decreasing trend in domestic inflation during FY02.

Money & Credit

The easing of monetary policy in FY02 had its roots in the macroeconomic discipline achieved in FY01 and was initiated well before the post September developments took over. The monetary easing not only brought down the benchmark 6-month T-bill rates to an all-time low but also led to a 1.9 percent drop in the weighted average lending rates.

The increased external inflows, improved liquidity in the market due to SBP interbank purchases, and lower net credit requirement by the private sector brought about a change in the behavior of both, banks and the government. While banks were anxious to lock-in their funds- in government paper, anticipating further interest rate cuts, the government used this opportunity to retire its more inflationary debt from SBP 'and borrowed afresh from scheduled banks. This had two implications: (1) it helped the SBP achieve limits on its NDA targets; and (2) it effectively sterilized the effect of SBP market purchases of foreign exchange. Also, while the actual government borrowings for budgetary support stood at Rs 12.5 billion for FY02, when adjusted for the waiver given by IMF for the KESC re-capitalization and tax refunds to the banks, the borrowings are well within targets.

Higher retirements, write-offs & deletions, and availability of fund from other sources, kept the net credit to private sector figure deceptively low (gross disbursements figures in FY02, remained higher than FY01, almost throughout the year). In overall terms lower interest rates, higher refunds and better availability of internal financing, and improved access to export markets greatly mitigated the adverse impacts of the uncertain business environment during FY02.

The overall impact of monetary easing and build-up of foreign exchange reserves resulted in an exceptional growth of 14.8 percent in monetary assets, which is the highest in the last five years.

Money Market

During FY02, the money market saw a relative improvement in liquidity as reflected in a decline in the volume and frequency of banks' use of the SBP discount window. This was, in part, a result of the SBP's pro-active liquidity management.

On the other hand, as interest rates declined due to the SBP monetary easing, and deposits began rising very strongly (with a relatively lower increase in private sector demand), banks increasingly preferred to invest in government securities to lock-in assets at higher rates.

The change in the monetary stance is reflected well in the downward shifting yield curves. However, the shape of the yield curves has become steeper, depicting a relatively lower decline in returns at the longer end of the curve.

Capital Markets

During FY02, capital market exhibited better performance compared to the previous year. Although the country underwent various economic and non-economic shocks, both the equity and fixed income securities markets remained buoyant.

The benchmark KSE-100 index gained 29.5 percent, in sharp contrast to a 10.1 percent fall during the previous year. The market gained resilience from the overall betterment in economic fundamentals, a consequent improvement in corporate profitability prospects, and the financial market liquidity prevalent in the economy. Similarly the fixed income market kept the momentum generated during the previous year on the back of reforms in National Saving Schemes and the easy monetary policy of the SBP. As a result, 17 new TFC issues were launched during the FY02 as compared to 10 during the preceding year.

Banking

The main developments in the banking sector in FY02 were the remarkable growth in deposits and the substantial increase in lending of foreign currency. Both developments largely owe to the improvements in Pakistan's external account in the aftermath of 9/11. The double-digit growth of 14.0 percent in deposits would have been even higher, had FCAs not declined by 13.7 percent. The phenomenal surge in the former was on the back of Rupee injections by SBP against foreign exchange purchases and higher remittance through banking channels. The fall in the latter reflects the decreasing attractiveness of foreign exchange holdings as the Rupee appreciated.

Besides the apparently subdued growth in credit, an important development in FY02 was the US$ 338.1 million (Rs 20.1 billion) surge in foreign currency loans. Although the banks were allowed to give credit in foreign currency (for trade related activities) since the introduction of FE-25 deposits in June 1998, it was only in FY02 that banks extended large volumes of foreign currency loans. Borrowing in dollars has become increasingly attractive in view of the lower rates (which range between 2 to 5 percent) and future expectations of a stable Rupee.

Unlike FY01, lending rates declined, especially in H2 FY02. This was in line with the easing of monetary policy. A lower fall in the weighted average deposit rates resulted in a narrowing of the banking spread by 111 basis point. It is important to note that foreign currency loans are not included while computing the weighted average lending rates. Incorporating these, it is evident that weighted average lending rates, and the banking spread, would have fallen further by at least 25 basis points.

Performance indicators (based on annual audited balance sheets) in CY01 showed a mixed picture when compared with CYOO. Efforts made to improve banks' assets quality started showing progress. The pace of NPLs from fresh lending has slowed down and together with increased emphasis on recoveries, has put a

break on the growth of bad loans. In addition, to account for the historically bad portfolio (most of it in lost category) of public sector banks, the need for appropriate provisioning has been emphasized.

Balance of Payments & Exchange Rate

Although, the current account has been steadily improving over the last three years amid higher kerb purchases, FY02 surplus of US$ 2.7 billion is the first that is broad-based - all the sub-categories contributed to the out-turn.

The trade deficit narrowed mainly due to falling imports on the back of lower fuel and food imports. Also, while exports did decline in FY02, a portion of the fall is attributable to lower unit prices for Pakistani exports. The improvement in the services account reflects the receipts against logistics support for international forces in Afghanistan as well as the savings following the re-profiling of external debt. However, the most valuable improvement seems to be the sharp increase in workers remittances; FY02 receipts were more than twice the FY01 collections.

Despite lower SBP purchases from the kerb market and lesser inflows realized in resident FCAs, the current transfers registered a phenomenal growth during the current fiscal year. In this regard, the major contribution came from the workers' remittances, which registered an extraordinary growth of 129 percent (on a cash basis) during FY02. In fact, an international crackdown on hundi networks changed the dynamics of current transfers, as incentives to use the informal channels largely disappeared.

In terms of the capital account, the completion of the IMF Stand-By Arrangement not only paved the way for successful negotiations for a medium-term PRGF but also led to a higher non-food aid from the World Bank and ADB, as well as a generous re-profiling of Paris Club debt,

FY02 was also an unusual year for the foreign exchange market. The global crackdown on hundi networks led to: (1) the collapse of the kerb premium, (2) an end to market expectations for devaluation; and (3) a U-turn in the direction of exchange rate management of SBP. All of these developments provided grounds for liberalizing the foreign exchange market, particularly the removal of segmentation between the interbank and the kerb markets, which has been one of the key structural problems in Pakistan's external sector.

The pressures on the kerb market not only outweighed the traditional downward stickiness of the kerb rate, but also reversed the traditional market expectations for devaluation of the Rupee. In terms of exchange rate management, SBP net purchases from the interbank market showed a dramatic shift from negative US$ 1,126 million to positive US$ 2,483 million.

The higher purchases in FY02 were aimed at providing support to exporters who had already suffered on account of an appreciating Rupee, loss of export orders and imposition of a risk premium. In overall terms, the Rupee strengthened by 6.7 percent against the US Dollar in the interbank market during FY02.

Although at the start of the fiscal year reserves already stood at US$ 3 billion, post-September 11 developments accelerated reserve accumulation, taking Pakistan's foreign exchange reserves to US$ 6.4 billion by the end of FY02. This surge in reserves was mainly shaped by lumpy inflows from International Financial Institutions (IFIs) and SBP purchases. The build-up of reserves allowed SBP to settle expensive and short-term liabilities, which will improve the creditworthiness of the country.

Domestic and External Debt

There is a distinct improvement in Pakistan's total debt profile during FY02. Specifically, the total debt burden declined from Rs 3,866 billion to Rs 3,761 billion and debt to GDP ratio improved to 102 percent. This note worthy achievement mainly shows Pakistan's adherence to the Debt Management and Reduction Strategy (DMRS) formulated in March 2001.

On the external front, the successful completion of IMF Stand-By Arrangement (SBA) restored Pakistan's credibility with International Financial Institutions (IFIs) and reaffirmed the government's commitment to reforms. This in turn paved the way for successful negotiations for a medium-term IMF assistance program (PRGF) as well as increased aid from other IFIs. Moreover, Pakistan also obtained a stock re-profiling of bilateral debt from Paris Club creditors on very generous terms, which will result in an implied reduction in the net present value of EDL of between 28 to 44 percent, depending on the interest rate negotiations with individual creditors.

Pakistan also retired commercial debt by US$ 0.9 billion and at the same time contracted soft loans from IFIs, which improved the term structure of external debt. Furthermore, the stock of external liabilities declined significantly by US$ 1.9 billion during the course of the current fiscal year. This decline is mainly driven by the hard currency payments of FCAs (FE-45 and FE-31) and retirement of Special US Dollar bonds, NBP deposits placed with SBP and swaps.

As far as domestic debt is concerned, it also reflects similar improvement. A one-time adjustment in floating debt substantially reduced the stock of short-term debt (reducing the stream of future interest payments). Additionally, the increased long-term borrowings through PIBs and NSS instruments also facilitated the lengthening of the maturity profile. The appreciation of the Rupee also eliminated the upward pressure on interest rates considerably, which led to a sharp reduction in the cost of domestic debt.

FOREIGN TRADE - Pakistan's Performance

Performance of Pakistan's economy over the last five decades has been quite unsatisfactory external sector is a part of it. Foreign trade gap has constantly been widening and during the recent year it has crossed the three billion US$ mark. Many reasons can be forwarded for poor performance of external sector.

Pakistan's foreign trade balance has always been negative throughout its economy history except for the following years: 1947-48, 1950-51, and 1972-73. In the first year after independence the country faced huge economic problems.

AFTER 9/11

After the event of 11th September in U.S, Pakistan once again has become the front line ally of America’s coalition against terror. Pakistan raised before them its problems, the most important of which is the debt problem which Pakistan is facing. Govt. raised the issue that as repercussions of war and support provided to U.S, it has to bear the unsustainable cost, for which it needs financial assistance.

Now, it is hoped that Pakistan will not only get debts written off but also. Further inflows consist largely of grants. Now Western world including U.S is very receptive to our ideas, now it is a golden chance for Pakistan to get permanent debt reduction. At this time govt. is conducting debt relief negotiations and preparing new policies and finding out new grounds to make the debt negotiations more effective.

The latest proof of this strengthening relationship is the development on 16 June 2004 in which President George W Bush has upgraded relations with Pakistan by formally naming it as a major non-Nato ally.

The move is in recognition of Islamabad's contribution in the fight against al-Qaeda, and is being seen as Washington's way of saying thank-you.

Pakistan will now enjoy a special security and economic relationship with the US.
"I hereby designate the Islamic Republic of Pakistan as major non-Nato ally of the United States for the purposes of the Arms Export Control Act," President Bush's statement said.

It is to be kept in mind that only six years ago, Pakistan was under US sanctions after conducting nuclear tests. Pakistan now finds itself in the same exclusive club as such close American friends such as Israel and South Korea.

The impact of this announcement on economic ties between these two countries is going to be mammoth. Malaysia has very recently agreed to open up its trade with Pakistan. Similarly Singapore's Prime minister's visit to Pakistan is also being seen as a major boost for Pakistan.

According to the new situation govt. has formulated a policy. The Governor of State Bank of Pakistan explains the government's five-pronged strategy to deal with the current debt situation. According to deal with the current debt situation. According to this policy govt. seeks permanents debt reduction (which help in reducing debt service burden) and new concession loans with zero interest rate and loans with high grant element for 10 year grace period and 30 to 35 year of repayment period, this will help us to accelerate our growth rate.

This is a historic opportunity for region and us to become self-reliant our economic sovereignty by improving our economic management. But if we flounder here, relax and return to our old ways, we will end up eroding all the goodwill that the international community has for us.

Importance of Foreign Trade in Economy of Pakistan

In the economy of any country trade with other counties always play on important role.

Pakistan's trade with other countries in the form of exports and imports is more than 25% of its GNP. This shows how important is the sector of foreign trade for our economy. Growth and stability of our

national income and standard of living of our people are closely linked with our performance in foreign trade.

The main advantages of international trade to a country are as follows:

1) Quick Industrialization:

Trade with foreign countries enables a backward country to acquire skills, machinery and other capital equipment from industrially advanced countries for seeding up industrialization.

2) Large Range of Commodities

Another advantage of trade with other countries is to enjoy large range of commodities than what is otherwise open to it. The commodities which can be produced within country at relatively higher cost can be bought from the cheapest market from abroad and the resources of the country thus saved can be better employed for the production of other commodities in which it is comparatively better fitted.

3) Economy in the Use of Productive Resources

Each country tries to produce those goods in which it is best situated. As the resources of each country are fully explained, those are thus a great economy in the use of productive resources.

4) Develop Comptetion

The advantage of trade with other countries is develop competition among different countries. The producers in home country, being afraid of the foreign competition, keep the prices of their goods at reasonable level.

5) Extension of Means of Transportation:

When goods are exchanged from one country to another, it leads to an extension of the means of communication and transportation.

6) Shortage of Commodities :

If in the country there is shortage of food or other essential commodities, they can be imported from other countries and thus the country can e saved from shortage of commodities and low standard of living.

7) Economic Relations:

The advantage of trade with other countries is to facilities to the citizens of every country to come in contact with one another. It makes them realize that no country in the world is self-sufficient. It this promotes peace and goodwill among nations.

Barriers to Foreign Trade

There are a lot of barriers to foreign trade, which are discussed below.

1) Import & Export Prohibition

Any government of a country can totally control the import or export of certain commodities for reason of health or for promoting the growth of certain industry in the country.

2) Quotas System

To reduce the imports and increase exports the government of a country may restrict the total imports of a given commodity to a specified amount or specify the maximum amount of a commodity, which can be imported from each producing country. When the total amount of goods to be imported is

determined, the gore than issues licenses for their import. The device of restricting imports is applied as an alternative to custom duties.

3) Custom Duties & Tariffs

Tariffs are the oldest form of protection that are imposed on the import and export of commodities. When high tariff are imposed on the imports of commodities, they are discouraged, prices to domestic consumer rises. When high tariffs are imposed on the exports of commodities, the exports are discouraged make the goods available for home products.

Tariffs or custom duties may be specific or ad-valoram. When a tariff is based on weight, quantity or other physical characteristics of imported good, they are called specific. The duty is called ad-valorem when it is based on the value of the goods. Such a duty is fixed as percentage of the foreign or domestic valuation of imported goods.

4) Exchange of Control

Exchange control implies the govt. regulations relating to buying and selling of foreign exchange. Under the system of exchange control all exporters are required to surrender their claims on foreign exchange to the control bank of country in exchange for domestic currency at the rate fixed by the govt. The govt. then allots the foreign exchange among the licensed importers. Exchange control may be resorted for correcting an address balance of payments or for protecting home resources or for maintaining the exchange rate at a predetermined party.

Chapter 4

Findings and Analysis

Pakistan's Trade Performance Since Inception

THE EARLY YEARS: 1950 – 1960

Initial Conditions

As a result of the partition of the Indian sub-continent, Pakistan emerged as an independent sovereign State on August 14, 1947. While both India and Pakistan were underdeveloped at the time of partition, Pakistan was relatively more underdeveloped and poor. The early years of Pakistan's economic history were marked by the dominance of agriculture, absence of a well-developed industrial sector, and weak institutional and physical infrastructure. There were considerable regional disparities in the pattern of industrialization in the sub-continent, and the areas which constituted Pakistan lagged behind in industrial development.11 To make the situation worse, infrastructural facilities were extremely inadequate. With less than 25 MW of power generation, even low levels of power consumption required import from India.

Railways were particularly affected by the partition as many of the major railway lines were disrupted by the new borders. In addition, the limited handling capacity ofKarachi and Chittagong ports did not help the country's foreign trade.

The Political Framework and Economic Policies

The early death of Quaid-i-Azam Mohammad Ali Jinnah, and the assassination of Prime Minister Liaquat Ali Khan in 1951 led to considerable political instability immediately after the creation of Pakistan. There were frequent changes in the political leadership between 1951 and 1958: the country had six Prime Ministers
and three Governors-General during this period. The first constitution of Pakistan was not approved till March 1956, and this too proved short-lived as Martial Law was declared on October 7, 1958 and the constitution was abrogated. Economic policies in the early years were largely shaped by the need to establish a diversified industrial base, to build institutions, and to put into place critical infrastructure. A key aspect of economic policy in the early years was the provision of strong protection to industry after 1952 when serious shortages of foreign exchange emerged. Excessive protection to industry severely distorted economic incentives not only for agriculture but also within the industrial sector. For example, on the recommendation of the Economic Appraisal Committee, tariffs on consumer goods were set higher than the tariffs on intermediate and capital goods. This cascaded tariff structure obviously favored the consumer goods industries by restricting the import of consumer goods and hampered the establishment of capital goods and intermediate goods industries since imports of these goods were either freely allowed or were subject to low tariffs. Furthermore, the policy regime was characterized by an excessive reliance on economic controls in the form of administered prices, industrial licensing, and a host of other regulations.

While the government vigorously pursued a pro-industrial development strategy, it neglected the development of the agriculture sector. Consequently, growth in the agriculture sector could not even keep pace with the rate of population growth leading to severe food shortages. The lack of agricultural growth also exposed the limitations of the pro-industrial policies in that it led to stagnation in the domestic market

for manufactured goods. To remedy these problems, the government began to place more emphasis on the development of the agricultural sector. In 1956, the government announced a comprehensive strategy for agricultural development that envisaged provision of fertilizers at subsidized rates, distribution of better seeds, pest control schemes, and control of salinity and water-logging. However, these policies largely remained unimplemented due to the political upheavals towards the end of the decade.

Economic policies to achieve longer term goals were embedded in the first five year plan (1955-60), which aimed to develop human and physical resources, to build infrastructure, and to maximize the productive capacity of the economy. However, for various reasons, mainly political instability, the plan’s performance fell below the projected targets. Although the plan commenced in 1955, it did not get government approval until 1958. Adequate attention was not paid to its recommendations and priorities, and there was no proper coordination between planning and budgeting. Against the plan’s expectation of a 15 percent increase in national income, the actual increase was about 11 percent. The rise in per capita income also did not exceed 3 percent mainly because of the rapid growth of population.

Economic Performance

During the period 1949-50 to 1959-60, the economy grew at a moderate rate of 3.14 percent per annum. Given the predominant share of agricultural output in GDP, the growth performance was obviously influenced primarily by the agricultural sector, which grew by a modest 1.76 percent per annum. Notwithstanding an expansion in cropped area in West Pakistan, growth in agricultural output was dampened by stagnant average yields of major crops.

Owing to the low level of manufacturing activity in Pakistan at the time of partition, the manufacturing sector exhibited high growth rates during the Fifties: the growth rate in manufacturing averaged over 10 percent annually in the first half. Import substitution was the hallmark of the government's industrial policy in the early years, and protection of domestic industry provided strong impetus to the production of a broad

range of commodities including cotton textiles, sugar, vegetable ghee, and cement. Though the expansion in large-scale manufacturing did not make an appreciable contribution to the overall performance of the economy due to its small share in the gross domestic product, the creation of a more diversified economic structure than was inherited at independence was a major achievement of these early years.

The development of the industrial sector was made possible by heavy initial investments: fixed investment rate in Pakistan increased sharply from 2.8 percent of nominal GDP in 1949-50 to 9.3 percent in 1959-60. Despite a sharp increase in the price of investment goods triggered by the devaluation of the rupee in 1955, the rate of investment, especially public investment, remained upbeat primarily due to the fact that increased availability of foreign resources helped the government to meet the high cost of capital goods. Increased level of public investment in infrastructure ---electric power, ports, telecommunications, and irrigation ---- laid the basis for faster growth. Though the share of agricultural sector dropped from 52.58 percent in 1949-50 to 45.61 percent in 1959-60, the economy continued to be dominated by the agricultural sector, with an average share in GDP of around 47.70 percent. There was a considerable expansion in the manufacturing sector: its share in GDP increased from 6.39 percent in 1949-50 to 9.91 percent in 1959-60. While the services sector contributed significantly to national output (average share of 41.07 percent), there was little variation in its share over time. On the external economic front, the surge in Pakistan's export earnings led by the Korean war-related commodity boom in 1950 quickly subsided owing to at least three broad factors. First, Pakistan's decision not to follow the sterling and the Indian rupee i e output meant lack of exportable surpluses in agricultural commodities. Third, international recession weakened the commodity prices of Pakistan's exportables. Not surprisingly, therefore, there was a sharp fall in export earnings in the first half of the decade. Export performance, however, recovered in the second half, helped mainly by the devaluation of the Pakistani rupee in August 1955. On average, imports grew at an accelerated pace in the second half of the decade mainly because of the need to import large quantities of food grains. Except for the year 1950-51 when Pakistan had a surplus on its trade account, the country continued to face a growing deficit in its balance of trade.

Balance of Payments (1950-60) Table 1

(Value in Million Dollars)

				% of		
				Exports		
	%	%	Trade	Vis a Vis		
Year	Exports	Changes	Imports	Changes	Gap	Imports
1951-52	278.53	-31.3	445.28	+26.3	-166.75	62.6
1952-53	262.05	-5.9	307.33	-31.0	-45.28	85.3
1953-54	193.65	-26.1	249.03	-19.0	-55.38	77.8
1954-55	148.46	-23.3	236.57	-5.0	-88.11	62.8
1955-56	155.97	+5.1	202.62	-14.4	-46.65	77.0
1956-57	146.68	-6.0	318.50	+57.2	-171.82	46.1
1957-58	91.09	-37.9	276.12	-13.3	-185.03	33.0
1958-59	93.36	+2.5	215.25	-22.0	-121.89	43.4
1959-60	160.32	+71.8	379.35	+76.2	-219.03	42.3
1960-61	113.49	-29.2	456.57	+20.4	-343.08	24.9

The Decade of Sixties

Initial Conditions

The initial conditions of this period can be summarized as follows:

- The foundations of the industrial sector were laid.

• Administrative machinery of government as well as vital institutions such as the central bank were in place.

• Agriculture remained the dominant sector of the economy; but its growth had stagnated.

• There was a rapid expansion in the large scale manufacturing sector.

• The rate of population growth outpaced that of agricultural growth, resulting in a decline in per capita food availability.

• Per capita income was stagnant.

• There were regulations on investment, imports and exports, prices, foreign exchange and many other sectors of the economy.

The military take-over in October 1958 followed a great deal of political instability during the most part of the Fifties. To introduce some form of democracy in the country despite the promulgation of Martial Law, a 'basic democracy' program was launched. This set up allowed the military government to settle on a presidential rule, and to ignore the important
constitutional issues of representation in the federal legislature and provincial autonomy.

On the economic front, the government set out to improve economic management and to deal effectively with corruption and unfair practices by the private sector especially in industry and retail trade. Besides introducing strict price and profit controls in the form of administered prices and profit margins, it also dealt with the menaces of hoarding, black-marketing, and smuggling with an iron hand. The initial impact of these measures was favorable and the general price index registered a fall in the early months after the Martial Law. But the government soon realized that the direct controls had introduced rigidities in the

system and thus hampered the growth of the manufacturing sector.13 Within just one year of taking over, the government began to dismantle the price control system and moved towards a general policy of economic deregulation through a greater reliance on the market mechanism. Development strategy during much of the Sixties continued to be heavily biased towards promoting industrial growth in Pakistan. The government maintained an over-valued exchange rate to ensure the cheap availability of capital goods and other imported inputs to the industrial sector. Also, by keeping prices of agricultural inputs at below world market prices, it made domestic raw materials available to the industrial sector at very cheap prices. This, together with the policy of import controls and tariffs, tax concessions such as tax holidays, accelerated depreciation allowances, and loans at very low interest rates, markedly accentuated the pro-industrial bias in the growth strategy. To further help its industrialization drive, the government adopted a series of measures to promote exports of manufactured goods. The most significant measure was the introduction of Export Bonus Scheme (EBS), which subsidized manufactured goods exports through a system of bonus vouchers 14 . Furthermore, preferential access to credit and a host of fiscal incentives were part of a policy package meant to enhance export competitiveness. These policies not only led to robust growth in the exports of manufactured goods, but also helped diversify the product composition of Pakistan's exports.

The incentives provided to manufactured goods exports were partly meant to offset the anti-export bias inherent in the policy of import substituting industrialization followed during most of the decade, barring a few years when import regime was liberalized somewhat 15 . While protectionist policies did contribute to industrial diversification and growth, these had several shortcomings. In particular, protection of domestic industry through high rates of effective protection led to inefficiencies in domestic production, prevented the country to realize its full export potential, and contributed to a worsening of the country's balance of payments (mainly because of the fact that increase in machinery and raw material imports outweighed growth in exports). The neglect of agriculture in the Fifties not only resulted in food shortages but also constrained the domestic supply of agricultural raw materials to the industrial sector. These problems forced the policy makers to devise an agricultural policy aimed at achieving self sufficiency in food, increasing agricultural production, and reducing unemployment. The shift in emphasis in government policy coincided

with the advent of the so called ‘green revolution’. This revolution started with scientific and technological breakthroughs — high-yielding varieties of seeds (HYV), chemical fertilizers, pesticides etc., — and was accompanied by a greater spread of agricultural mechanization, mainly in terms of tube-wells and tractors. The government facilitated the adoption of new technology by heavily subsidizing high-tech varieties of agricultural inputs. These factors contributed to a marked improvement in the growth performance of the agricultural sector: the average annual growth rate jumped to 6 percent in the second half of the Sixties, up from 1.8 percent in the corresponding period of the Fifties. With a view to restructuring land relationships, the government introduced land reforms which prescribed ceilings of landholdings at 500 acres of irrigated land and 1000 acres of non-irrigated land. But thanks largely to political and administrative constraints, and a variety of loopholes and exemptions, these reforms resulted in only modest amounts of land being transferred to small farmers and landless labor.

The long-term development strategy pursued during the first five years of the Sixties was outlined in the Second Five-Year Plan (1960-65). The plan sought to accelerate the pace of development and overcome the inadequacies of achievement during the First Plan period, and to ensure that the stage of self-generating growth was reached within a reasonable period. In addition, the plan attempted to restore the balance between agricultural and industrial development. Consequently, the pattern of public sector expenditure was heavily concentrated in the agricultural sector mainly because of the large expenditures on the development of water resources.

The Second Plan was quite successful in fulfilling its major objectives: the increase in national income during this period was over 30 percent as against the target of 24 percent.

The Third Five-Year Plan (1965-1970) was formulated in the light of the achievements and shortfalls of the two previous plans. Its principal objectives were to attain rapid growth in national output, reduce the degree of intra and inter-regional income inequality, increase employment opportunities, strengthen the balance of payments, and improve the availability of social services like health and education. Soon after the launching of the Third Plan, it had to be revised in respect of its resources and priorities in the light of various adverse

circumstances which included increased expenditure on defense owing to the outbreak of war with India in September 1965, drastic cuts in foreign aid along with the hardening of the terms of loans and mounting repayment obligations, and successive droughts and floods leading to a rise in food imports. Not surprisingly, then, achievements in most sectors fell short of expectations. Despite rapid growth in both the industrial and the agricultural sectors, the Sixties witnessed rising economic and political tensions, not least because of a lack of interest in issues of equity and social justice which contributed to concentration of wealth in the hands of a few individuals. In addition, the suppression of provincial autonomy sowed the seeds of discontent between East and West Pakistan and there was a growing perception that the East wing was not receiving its fair share of resources. Besides regional disparities, there was a widespread feeling that income inequalities had increased in both the provinces during the Sixties. A statement by Mahbub ul Haq, then Chief Economist of the Planning Commission, that twenty-two families controlled 66 percent of the industrial wealth and 87 percent of the banking and insurance in the country, stirred up widespread disturbances in the winter of 1968 which eventually led to the downfall of the military government.

The fact that strong growth performance was not accompanied by an improvement in the living standards of the majority of population led many to question the government's economic policies in the Sixties. It must, however, be pointed out that regardless of the controversy on the overall economic policies pursued during this period, there is a broad agreement on the fact that the Sixties was a period of sound macroeconomic management which contributed to greater monetary discipline, price stability, and low budget deficits. Furthermore, in the backdrop of political instability that had characterized much of the Fifties to the detriment of economic planning and management, a major achievement of the military government was the strengthening of the administrative capacity, which greatly facilitated the formulation and implementation of policies and programs.

Economic Performance (1960s)

The country's economic performance in terms of broad macroeconomic aggregates in the Sixties is summarized in Table 3.2.1. Measured by GDP growth, economic performance in Pakistan in the Sixties clearly surpassed initial expectations: the growth rate of the economy more than doubled from 3.11 per cent per annum in the Fifties to 6.60 per cent in the Sixties. After exhibiting stagnant and even negative growth in the initial years, the agricultural sector recorded a healthy growth rate of 6.04 percent in 1961-62. Growth in the agricultural sector peaked at 11.66 percent in 1967-68, before decelerating sharply to 4.15 percent in 1968-69, and then rebounding to 9.12 percent in 1969-70. It is noteworthy that agricultural sector performed relatively well in the second half of the Sixties as compared to the first half: the average annual rate of growth in the agriculture sector climbed from 3.88 percent in the first half to 6.36 percent in the second half. Large scale manufacturing sector posted strong growth in both halves of the Sixties, though there was a marked slowdown in the second half when industrial output grew at an average annual rate of 8.11 percent, down from 11.72 percent in the first half. Several factors contributed to the impressive performance of the industrial sector in the Sixties. First, a large and lucrative market for domestic production was created by a restrictive import regime, especially for consumer goods, resulting in high profits in the industrial sector. Second, relaxation in direct controls on investment coupled with improved profitability in the industrial sector led to a substantial increase in real gross fixed investment. Third, there was cheap availability of agricultural raw materials to the industrial sector, thanks largely to export controls on these products which epressed domestic prices of these commodities relative to their world prices.

With an average share in GDP of around 41 percent, the agricultural sector continued to play a dominant role in the economy. On the other hand, while vigorous industrialization efforts helped to raise the share of manufacturing sector in GDP from 10.68 percent in 1960-61 to 13.44 percent in 1969-70, the average share of manufacturing sector remained low during the decade at about 12.41 percent. The share of services in GDP did not show much variation during the period, and its average share stood close to 42 percent. Total investment increased from Rs. 11.51 billion in 1960-61 to Rs. 23.68 billion in 1969-70, registering an

average annual growth rate of 9.20 percent. Growth in investment considerably slowed down in the second half of the decade to -0.29 percent, from 18.69 percent in the first half. On average, the share of total investment in GDP stood at 17.36 percent during the period. Contrary to the popular belief, official figures on income distribution indicate a modest improvement in the distribution of income in the Sixties. The Gini coefficient, which is a convenient summary measure of the degree of income inequality, declined from 0.39 in 1963-64 to 0.34 1969-70, indicating an improvement in the distribution of income. Another indicator of income inequality is the share of the lowest 20 percent and highest 20 percent of households in income. During the period from 1963-64 to 1969-70, the share of the lowest 20 percent of households increased from 6.4 percent to 8.0 percent, whereas the share of the highest 20 percent of households declined from 45.3 percent to 41.8 percent. Notwithstanding this, the pattern of income distribution remained skewed towards high income households, as indicated by the substantially high proportion of income accruing to households in upper income bracket.

The incidence of poverty, as measured by the headcount ratio, increased during the Sixties: the percentage of total population falling below the poverty line was 46.53 percent in 1969-70, up from 40.24 percent in 1963-64. Pakistan's exports recorded a nearly three-fold increase during the period, increasing from US$ 114 million in 1960-61 to US$ 338 million in 1969-70 with an average annual growth rate of 10.72 percent. The strong growth in exports was accompanied by rising imports, which grew at an average rate of 7.37 percent. The country's trade balance remained in deficit throughout the decade.

Balance of Payments (1960s) Table 2

(Value in Million Dollars)

Year	% Exports	% Changes	Trade	% of Exports Vis a Vis Imports	Changes	Gap	Imports
1961-62	114.05 +	0.5		469.80	+2.9	-355.75	24.3

1962-63	209.68 +	83.8	588.25	+25.2	-378.57	35.6
1963-64	225.84 +	7.7	626.39	+6.5	-400.55	36.1
1964-65	239.42 +	6.0	771.51	+23.3	-532.09	31.0
1965-66	252.84 +	5.6	605.10	-21.6	-352.26	41.8
1966-67	272.55 +	7.8	761.69	+26.0	-489.14	35.8
1967-68	345.55 +	26.8	699.00	-8.2	-353.45	49.4
1968-69	357.13 +	3.4	640.05	-8.4	-282.92	55.8
1969-70	337.93 -	5.4	690.14	+7.8	-352.21	49.0
1970-71	419.84 +	24.2	756.80	+9.7	-336.96	55.5

The Decade of Seventies

Initial Conditions

The initial conditions of this period can be summarized as follows:

• Healthy growth in the industrial sector, occasionally disrupted by the Demonstrations in late Sixties.

• Strengthening of administrative machinery and institutions.

• Agriculture remained the dominant sector of the economy, though its performance significantly lagged behind that of the manufacturing sector.

• Concern for income distribution, wage rates, and welfare was heightened.

The Political Framework and Economic Policies

After the fall of the Ayub regime, general elections were held in December 1970. These elections were the first ever held throughout the country since independence on the basis of adult franchise. Two political parties emerged as the major political forces in the country after the elections: Awami League in East Pakistan and Pakistan Peoples Party in West Pakistan. This polarity in the country's politics led to disastrous consequences including the break-up of the country in 1971. The collapse of the Yahya regime saw the advent of the Peoples Party government led by Zulfikar Ali Bhutto, who also assumed the office of Chief Martial Law Administrator – the first civilian to hold this position. Martial Law remained the source of legal authority till a new constitution was approved by the National Assembly in 1973. Following general elections in 1977, mass unrest erupted amid allegations of vote rigging, leading eventually to the military take-over on July 5, 1977. Economic management during the People's Party government was beset by a number of exogenous shocks that caused significant macroeconomic instability. Firstly, the secession of East Pakistan led to a disruption of trade relations between the two countries and deprived West Pakistan of half of its export market. Secondly, thanks to a fourfold increase in petroleum prices induced by the newly created OPEC cartel, the Seventies witnessed phenomenal increases in Pakistan's import bill alongside a slowdown in exports due to the recession in the world economy. This deterioration in terms of trade led to widening resource and trade gap. Thirdly, Pakistan's commodity exports – rice, cotton, and sugarcane – remained vulnerable to wide fluctuations in international commodity prices. Fourthly, agricultural output, especially the cotton crop, was adversely affected by flooding and pest attacks. The government of Pakistan Peoples Party embarked on its agenda of socialist oriented reforms with much enthusiasm. In 1972, the government nationalized all private banks and insurance companies, and a large number of manufacturing units with the stated objective of reducing the concentration of wealth. The government's nationalization drive is generally held responsible for the weak performance of the large-scale manufacturing sector especially in the first half of the Seventies. It must be emphasized, however, that the poor performance of the industrial sector owed as much to the policy of nationalization as to the pattern of industrialization that developed during the earlier decades. This is borne out by the fact that there were already signs of

weakening in the growth momentum of the industrial sector by the end of the Sixties; thanks largely to an inefficient allocation of resources (promoted through excessive protectionism) that eroded the capacity to sustain high growth rates in the manufacturing sector.

A key development of the Seventies was the emergence of a strong small-scale industrial sector which was ignored in the early years due to the capital-intensive bias of Pakistan's industrial regimes. Small scale industries as diverse as leather manufactures, sports goods, and surgical instruments not only helped diversify Pakistan's industrial structure, but also created employment opportunities for the country's growing labor force. A combination of exogenous and policy factors were responsible for the growth of small-scale industries. First, private investment was diverted to small-scale industrial units as a result of nationalization policies that exclusively targeted the large-scale manufacturing units. Second, trade union activities in large-scale manufacturing made investment in these units less attractive,thus contributing to the growth of smaller production units. Third, export-oriented small-scale industries such as carpets, and garments and made-up textiles received a boost owing to devaluation of the rupee. Fourth, remittances from abroad stimulated the domestic market for consumer goods, a large proportion of which were produced by the small-scale industry.

Throughout the Seventies, the agricultural sector was plagued by stagnation, owing to a combination of exogenous and policy factors. Firstly, climatic shocks and viral diseases affected the crops, with marked damage to cotton production. Secondly, there was an overall shortage of the critical imported agricultural inputs that were needed to maintain the productivity gains of the high-yielding varieties. Thirdly, despite farm mechanization in the Sixties, inadequate utilization of water and fertilizers 16 continued to constrain agricultural production. Finally, government pricing policy discriminated against the agricultural sector by setting output prices well below those in international markets. In response to the growing income inequalities especially in the rural sector, the government initiated important land reforms in 1972. However, the outcome of these reforms was not much different from the reforms of the previous decade mainly because of lax implementation and low amount of land coverage. Furthermore, the land reforms

benefited only a small number of tenants while big landlords escaped the laws through loopholes such as transfer of land to relatives. It is, therefore, not surprising that land reforms did not make any significant contribution towards reducing the inequalities in the agrarian structure. To improve the competitiveness of Pakistan's exports, the government devalued the rupee in 1972. While this bolstered Pakistan's export earnings, the country continued to face serious balance of payments difficulties, due mainly to a fourfold increase in the country's import bill in the wake of oil price shocks. The persistent deficit in the balance of payments necessitated large external loans to plug the gap in external payments and receipts, leading to mounting external debt. It must be emphasized here that the external debt problem would have been much more serious had there not been massive inflows of workers' remittances during the Seventies.

Economic Performance

The overall performance of the economy during the Seventies was rather subdued as compared with the Sixties: on average GDP grew at a rate of 4.66 percent per annum as against 6.60 percent in the previous decade. With the relatively sluggish growth rates in the commodity producing sectors (agricultural and manufacturing sectors grew at average annual rates of 2.32 percent and 5.50 percent respectively), growth in the GDP was fuelled primarily by the services sector, which grew at a healthy rate of 5.94 percent per annum. It is noteworthy that there was a sharp difference in the economic performance in the first and second halves of the Seventies, and an upturn in economic activity occurred in 1977-78 led by an impressive recovery especially in the manufacturing sector. Thanks largely to the high growth rate of agriculture and large-scale manufacturing, the commodity – producing sector exhibited a growth rate of 7.24 percent per annum in the second half, as against 4.62 percent per annum in the first half. The improvement in the performance of the commodity-producing sectors in the second half owed as much to a fuller utilization of the idle capacity in the manufacturing sector as to an unusual spell of good weather which helped recovery in the agricultural sector. While the agricultural sector continued to dominate the economy, its share in national output decreased steadily throughout the decade to 31.5 percent in 1979-80, down from 38.02

percent in 1970-71. The share of the manufacturing sector in GDP fluctuated around 14 percent throughout the decade, averaging at 13.99 percent. The Seventies saw an increasing importance of the services sector relative to the commodity-producing sectors: whereas the share of the former in the GDP increased from 41.80 percent to 46.53 percent, that of the latter fell from 58.2 percent to about 53.47 percent. Total investment grew at a rate of 7.69 percent during the Seventies, increasing from Rs. 23.57 billion in 1970-71 to Rs. 48 billion in 1979-80. Growth in total investment accelerated in the second half to 8.90 percent, up from 6.48 percent in the first half. On average, total investment accounted for 16.25 percent of GDP during the period. Despite the government's declared emphasis on social justice and equity, income inequality increased in the Seventies. The Gini coefficient increased from 0.33 in 1970-71 to 0.37 in 1979, reflecting deterioration in the distribution of income. This is also corroborated by the fact that the share of the lowest 20 percent of households in income declined from 8.4 percent to 7.4 percent, while that of the highest 20 percent of households increased from 41.5 percent to 45 percent. Total exports increased manifold in the Seventies, rising from US $ 420 million in 1970-71 to US$ 2365 million in 1979-80, registering an average annual rate of growth of 22.35 percent. 17 The growth trend in imports exhibited a similar pattern: on average, total imports grew at about 24 percent per annum, increasing from US $ 757 million in 1970-71 to US$ 4740 million in 1979-80. As in the previous decade, the country faced a growing deficit in its trade balance during the Seventies.

Sources of Growth

Growth in total factor productivity considerably slowed down in the Seventies as compared with the previous decade: it grew at 0.82 percent as against 3.39 percent in the Sixties. While TFP in the manufacturing sector grew at a modest rate of 2.01 percent, it declined in the agricultural sector at the rate of 0.77 percent. The slowdown in the TFP growth in the manufacturing sector can partly be attributed to the nationalization policies

pursued during the decade which eroded business confidence with concomitant fall in ivate investment. On the other hand, the negative TFP growth in the agricultural sector was due largely to adverse weather conditions and inadequate supplies of water and fertilizers.

Balance of Payments (1971-80) Table 3

(Value in Million Dollars)

Year	% Exports	% Trade Changes	% of Exports Vis a Vis Imports	Changes	Gap	Imports
1971-72	590.66	+40.7	638.00	-15.7	-47.34	92.6
1972-73	817.31	+38.4	796.80	+24.9	+20.51	102.6
1973-74	1026.40	+25.6	1361.54	+70.9	-335.14	75.4
1974-75	1039.02	+1.2	2113.64	+55.2	-1074.62	49.2
1975-76	1136.66	+9.4	2067.20	-2.2	-930.54	55.0
1976-77	1140.80	+0.4	2324.46	+12.5	-1183.66	49.1
1977-78	1311.15	+14.9	2809.57	+20.9	-1498.42	46.7
1978-79	1709.60	+30.4	3675.56	+30.8	-1965.96	46.5
1979-80	2364.66	+38.3	4740.32	+29.0	-2375.66	49.9
1980-81	2957.52	+25.1	5408.4 5	+14.1	-2450.93	54.7

The Eighties Decade

Initial Conditions

The initial conditions of this period can be summarized as follows:

• Weakening of growth momentum in the industrial sector.

• Enhanced role of the public sector, though in the late Seventies there were indications to reverse the trend.

• Agriculture remained the dominant sector of the economy, with a sluggish performance as compared with the manufacturing sector.

The Political Framework and Economic Policies

The military intervention in July 1977 came in the wake of strong public protests against the Bhutto regime for the alleged irregularities in the elections held in March 1977. Unlike the two previous Martial Law regimes, General Ziaul Haq did not abrogate the Constitution but suspended it, and the period of constitutional suspension continued until November 1988, when party-based general elections were held, four months after General Ziaul Haq died in a plane crash on August 17, 1988. The period from 1988 onwards witnessed the revival of democracy in Pakistan and the difficult transition to civilian rule. The Pakistan Peoples Party secured the largest number of parliamentary seats in the general elections, and c nsequently Ms. Benazir Bhutto, the head of the PPP, became the Prime Minister of Pakistan. However, owing to a lack of clear majority in the National Assembly, the PPP government could not last long: only twenty months after coming into power the National Assembly was dissolved and the Prime Minister was removed from office by a Presidential Order on August 6, 1990. The economic policies during the Eighties accorded high priority to the restoration of business confidence, which was considerably eroded in the previous decade due to the nationalization drive of the Bhutto regime. Besides denationalization of a number of public sector enterprises, the government provided a host of incentives to revive private investment. Moreover, the government initiated wide ranging structural reforms that aimed at liberalizing and deregulating the economy, and streamlining the investment licensing procedures. Though the initial

response of the private sector to the reform package was lukewarm, by the mid-Eighties there was a pick up in private investment: the share of the private sector in total investment increased from 41.39 per cent in 1980-81 to 44 per cent in 1989-90. Nevertheless, the total investment failed to rise. The agricultural sector continued to play a dominant role in the economy, despite its declining share in the GDP. The major objective of the agricultural policy during the Eighties was to revamp the agricultural sector through liberalization of agricultural markets and production. In particular, the government deregulated the sugar, pesticide, and fertilizer industries, removed the monopoly power of the Rice and Cotton Export Corporations, and lifted the ban on the private sector's import of edible oil. These measures were complemented by an agricultural pricing policy that aimed at bringing prices of critical inputs such as pesticides and fertilizers more in line with the market determined prices. In addition, the agricultural sector benefited from a large increase in bank credit as the formal lending institutions, led by the Agricultural Development Bank, paid greater attention to tackle the problem of credit shortages in the rural sector. The major breakthrough during this period was the development of a new high-yielding variety of cotton, which led to a three-fold increase in cotton production in a span of six years.

However, despite these favorable developments, growth in the agricultural sector remained depressed owing largely to the industrialization bias in the overall economic policy. The degree of industrialization bias can be gauged by the fact that while industry enjoyed high rates of effective protection, agriculture continued to have negative protection. The problems of the agricultural sector were further compounded by numerous indirect taxes --- especially export taxes on agricultural products --- and budgetary cuts on vital public services such as agricultural research and extension and irrigation. It is not surprising, then, that most of the increases in agricultural production were due to the increased utilization of land, and not to the improved crop yields, with the exception of cotton. On the macroeconomic front, the Eighties were characterized by widening fiscal deficits, which averaged 8 per cent as a proportion of GDP in the second half of the Eighties. The high budget deficit created an upward pressure on interest rates, which led to a crowding out of investment on the one hand and mounting debt servicing problems on the other. The budget deficit was largely financed by attracting private savings at higher than market interest rates (through the National

Savings Schemes), and this helped avoid the problem of monetization of the deficit, thus mitigating the inflationary consequences of higher budget deficits (inflation averaged 7.6 percent in the Eighties, in contrast to 13.9 percent in the Seventies).

A major departure in economic policy from the previous decades was the adoption of a managed floating exchange rate system. The transition to the new system led to an adjustment in the rupee which boosted Pakistan's exports: on average, total exports grew at an impressive rate of 10 percent during the decade.
Pakistan's export earnings were further helped by an upswing in world trade which contributed to rapid increases in exports of cotton, rice, carpets, and leather products. The inflow of foreign aid during the Eighties also increased substantially, not least because of the Russian invasion of Afghanistan in 1979 that prompted the international community to support Pakistan in its endeavors to promote regional security. The Eighties also witnessed a strong growth in the inflow of workers' remittances, averaging at about $3 billion per year for most of the decade. Pakistan embarked on a program of economic reforms towards the fag end of the Eighties. A key area where the government introduced reforms was the financial sector, whose performance was marred by years of excessive regulation through administered interest rates and credit ceilings. Furthermore, the government's reliance on non-bank borrowing to finance the deficit had created differential interest rate structures in the economy that led to flight of deposits from the banking system. Recognizing the importance of financial reforms in the process of economic growth, a series of measures were adopted with a view to removing various distortions in the financial system, minimizing government's interference in the banking system, and strengthening the prudential regulations. The government also allowed a freer flow of private foreign capital and permitted the opening of foreign currency accounts.

Economic Performance

Economic growth averaged 6.12 per cent per annum during the Eighties, matching the high growth performance of the Sixties. The commodity producing sectors grew at an average annual rate of 7.33 percent, whereas the services sector exhibited an average growth of 6.60 percent. The manufacturing sector showed a healthy performance during most of the decade with an average annual rate of growth of 8.21 percent. The performance of the agricultural sector improved somewhat as compared with the Seventies but growth in this sector remained rather weak averaging 4.10 percent during the Eighties. Economic growth slowed down markedly during the second half of the decade owing largely to the slow pace of growth in the manufacturing sector: growth in GDP averaged 5.60 percent in the second half, down from 6.65 percent in the first half. While the share of the agricultural sector in GDP peaked at 30.83 percent in 1980-81, it declined to 25.83 percent in 1989-90, averaging at 27.62 percent during the decade. The manufacturing sector accounted for an increasing share in GDP: its share stood at 17.59 percent in 1989-90, up from 15.11 percent in 1980-81. There was a slight shift in the relative importance of commodity producing sectors and the services sector: whereas the share of commodity producing sectors declined from 53 percent in 1980-81 to 50.85 percent in 1989-90, the share of the services sector edged Growth in total investment exceeded 5 percent in the Eighties. While investment grew at an accelerated pace in the first half, at 7.78 percent, it slowed down in the second half to 3.39 percent mainly because of a sharp fall in the growth of public investment.

Private investment registered a healthy rate of growth of over 6 percent. Private investment in the agricultural and manufacturing sectors grew respectively at 6.39 percent and 11.39 percent. In contrast to the rising income inequalities in the previous decade, there was a slight improvement in the distribution of income in the Eighties, as indicated by the fact that the Gini coefficient fell from 0.37 in 1984-85 to 0.35 in 1987-88. The share of the lowest 20 percent of households in income edged up from 7.3 percent to 8.0 percent, while that of the highest 20 percent of households declined from 45 percent to 43.7 percent. The

incidence of poverty also declined sharply during the Eighties:the percentage of total population falling below the poverty line was 17.32 percent in 1987-88, down from 24.57 percent in 1984-85. Pakistan's exports increased from US$ 2958 million in 1980-81 to US$ 4954 in 1989-90, exhibiting an average annual growth rate of 8.55 percent. As compared to the sluggish export growth (2.09 percent) in the first half of the decade, there was a marked improvement in the export performance in the second half when exports grew at an impressive rate of over 15 percent. Growth in total imports averaged 4.17 percent during the period. Despite healthy growth in exports, Pakistan faced a persistent deficit in the trade balance.

Sources of Growth

The Eighties witnessed a further decline in the overall TFP growth to 2.45
percent. The agricultural sector continued to exhibit negative TFP growth (-1.32 percent), while TFP growth in the manufacturing sector was a healthy 5.38 percent. These trends could be explained by the fact that while manufacturing sector enjoyed a host of incentives that were designed to restore business confidence, the agricultural sector continued to suffer from the pro industrial bias in economic policies.

Balance of Payments (Eighties)Table 4

(Value in Million Dollars)

Year	% Exports	% Trade Changes	% of Exports Vis a Vis Imports	Changes	Gap	Imports
1981-82	2464.30	-16.7	5622.10	+4.0	-3157.80	43.8
1982-83	2696.40	+9.4	5357.77	-4.7	-2661.37	50.3
1983-84	2768.05	+2.7	5686.19	+6.1	-2918.14	48.7
1984-85	2491.15	-10.0	5906.20	+3.9	-3415.05	42.2

1985-86	3069.80	+23.2	5634.46	-4.6	-2564.66	54.5
1986-87	3686.38	+20.1	5380.46	-4.5	-1694.08	68.5
1987-88	4454.56	+20.8	6391.38	+18.8	-1936.82	69.7
1988-89	4661.45	+4.6	7033.71	+10.1	-2372.26	66.3
1989-90	4954.27	+6.3	6934.78	-1.4	-1980.51	71.4
1990-91	6130.57	+23.8	7619.00	+9.9	-1488.43	80.5

Economy in the Nineties & Beyond

Initial Conditions

The initial conditions of this period can be summarized as follows:

• A healthy rate of economic growth.

• Very large fiscal and balance of payments deficits.

• Aid flows had started declining.

• The process of structural adjustment and economic reforms initiated in the late Eighties, and there was danger that the trend of improvement in income distribution may be reversed.

The Political Framework and Economic Policies

Pakistan entered into the Nineties amid growing political instability that followed the dismissal of the PPP government in August 1990. The political scene during this period was marred by power struggle between the major political parties, which resulted in the dismissal of four elected overnments in a period of eight and a half years. In the elections held on February 3, 1997, Muslim League secured an overwhelming victory. However, the growing political unrest following these elections culminated in the removal of the Muslim League government in a military take-over in October 1997. The Supreme Court authorized the newly-established government to stay in power for three years and mandated the holding of general elections not later than October 2002. Despite the strong political opposition between the two political parties that ruled during much of the Nineties, there was generally a consensus on basic economic policies, especially on those embodied in the Structural Adjustment and Stabilization Programs adopted in 1988. The adoption of these programs led not only to adjustments in demand management policies but also to major changes in industrial and trade policies in the form of deregulation, privatization, and trade liberalization.

One of the major objectives of the industrial policy was to address the structural weaknesses of Pakistan's industrial sector which stemmed from years of import substituting industrialization, and the nationalization policy of the Seventies. In addition, emphasis was also placed on improving the viability of Pakistan's industrial sector in an increasingly competitive international economic environment. A host of measures including fiscal incentives, tax holidays, de-licensing of investment regimes, and reduction of tariffs on capital goods were adopted to encourage private investment. Despite the fact that these incentives had a favorable impact on private investment, growth in industrial output was sluggish as compared to the previous decade, presumably reflecting a lagged effect of investment on output growth. In order to enhance the role of the private sector in the economy, and to address the problem of operational inefficiency in public sector enterprises, the government launched a privatization program in the Nineties. However, the response of the private sector to privatization was quite weak, not least because of the fears that the government might continue to meddle in the affairs of the privatized enterprises. Not surprisingly, therefore,

the pace of privatization was slower than planned and only 90 units in the public sector had been privatized by 1995, while larger units such as telecommunications are still on offer. In addition to its privatization drive, the government opened up the power sector to private investment, which led to the setting up of power generation plants by the independent power producers (IPPs). However, the performance of these privately financed projects was marred by allegations of corruption and litigation between the government and the IPPs on electricity tariffs and other issues. While the question of whether or not the independent power producers contributed to improving the supply and distribution of power in an efficient manner is debatable, the controversy surrounding these projects considerably eroded business confidence in Pakistan.

In line with the overall thrust of economic deregulation under the structural adjustment program, agricultural policy aimed at bringing input and output prices closer to their international levels, reducing public expenditure on subsidies, and enhancing the role of the private sector. Consequently, subsidies on pesticides, seeds and farm mechanization were withdrawn and a phased program of removal of fertilizer subsidy was instituted. In view of the rising input costs, prices of major agricultural commodities were periodically adjusted to reflect the cost of production. The government also remained committed to enhancing the role of the private sector in the procurement and distribution of agricultural commodities and inputs. In addition, the private sector was allowed to participate in a variety of activities including international trade in agricultural commodities, procurement of rice and cotton, and distribution of pesticides and fertilizers. It is generally agreed that the potential for higher growth in agricultural output remains unrealized despite government's endeavors to create a favorable environment for the agricultural sector. A variety of factors are believed to be responsible for impeding growth in the agricultural sector. First, agricultural production remains vulnerable to vagaries of weather and other natural calamities such as flooding and pest attacks. Second, the inefficient utilization of scarce irrigation water has prevented the realization of full growth potential in agricultural output. Third, cutbacks in public expenditure on agriculture, including investment in rural infrastructure, did not help agricultural production. Finally, outdated land tenure arrangements, inadequate agricultural research and extension, and a weak institutional support system have severely constrained the growth prospects of the agricultural sector.

On the external economic front, the government undertook significant steps to reform the foreign trade regime. The process of trade liberalization in Pakistan started in the late Eighties as part of the structural adjustment program that aimed at enhancing macroeconomic stability, reducing internal and external imbalances, modernizing the financial sector, and introducing market-oriented reforms in the major economic sectors. The key elements of the country's import policy included rationalization of the tariff structure, reduction of non-tariff barriers, and simplification of import procedures. Pakistan made major strides in reforming its tariff structure: the maximum tariff on imports came down from 225 percent in 1986-87 to 70 percent in 1994-95. Currently the maximum tariff stands at 25 percent, with a few exceptions. In the latter half of the decade, Pakistan made substantial progress in eliminating or reducing non-tariff barriers to trade: in 1999, there were only 32 products (HS 4-digit level) on the negative list, and import of 28 products was restricted for health and safety reasons. The government abolished the restricted list, which enlisted products that could only be imported through designated importers, and lifted the licensing requirements for goods outside the negative list. Prior to the broad based economic reforms, Pakistan's import regime was characterized by complexity, discretionary powers that frequently granted exemptions and concessions, and limited transparency. These issues were also addressed in the structural adjustment programs and efforts were made to phase out tariff concessions and exemptions, and to improve transparency through simplification of import procedures.

Pakistan's export policy in the Nineties was geared towards encouraging export-led growth through the development of an efficient, competitive, and diversified export sector. To stimulate export-oriented industries, the government provided a variety of incentives including income and sales tax concessions, exemption from customs duty on imported intermediate inputs and capital goods, and easy access to credit facilities. While income from a wide range of export products was entitled to income tax concessions, recent export-related income tax relief measures included a 50 percent reduction in the income tax rate (from 1 percent to 0.5 percent) on income earned from the exports of branded rice, canned and bottled fish (including seafood), and precious and semi-precious stones. In order to increase the export of services,

engineering, contracting and consultancy services were levied a one-percent income tax. Exporters were also allowed rebates on customs duty, sales tax, and surcharges through the duty drawback facility. The duty drawback rates were standardized as a percentage of the free on board value of exports or a specific amount per unit of goods exported. In addition, all direct and indirect exporters were allowed the facility to import inputs through no duty no drawback scheme, bonded warehousing facilities, and other temporary import schemes without payment of customs duty, sales tax, and withholding of income tax. Other export promotion measures included provision of loans to exporters at concessional rates of interest through the export finance scheme, and financial assistance to export-oriented industrial units seeking quality certification in respect of ISO 9000 and 14000 series certification. With a view to promoting foreign investment in the export sector, export processing zones were established at Karachi and Lahore, which offered better infrastructure facilities as well as various other incentives including tax holidays, and unrestricted repatriation of capital and profits.

Notwithstanding wide-ranging trade policy reforms, a number of factors affected the country's performance on the external economic front. First, the economy received an early setback in the Nineties: the events following the gulf war . rising international oil prices, sagging workers remittances, and loss of export markets in the gulf region . adversely affected the country's trade and capital flows. Second, the tremors of East Asian financial crises were also felt in Pakistan: while the global response to the crises adversely affected the country's foreign trade and investment flows in general, the country's exports particularly suffered on account of adjustment in the exchange rates of crisis-hit countries that weakened the competitiveness of Pakistani products in international markets. Third, the economic sanctions in the wake of nuclear blasts led to a slowdown in overall economic activity on the one hand, and necessitated measures 18 that contributed to a weakening of trade and capital flows, on the other.

Economic Performance

The Nineties were marked by a slowing down of the rate of economic growth along with rising incidence of poverty. GDP growth rate during this period averaged 4.41 percent compared to 6.12 percent per annum during the previous decade. The slowdown in the overall growth was not withstanding an acceleration in agricultural growth to 4.54 percent per annum (compared to 4.10 percent per annum during the Eighties), and mainly reflected a sharp reduction in the rate of growth in the manufacturing sector to 3.88 percent per annum from 8.21 percent annual rate in the previous decade. While the overall economic performance was quite satisfactory in the first half, there was as a deceleration in the rate of economic growth in the second half: the average annual GDP growth fell from 5.07 percent in the first half to 3.76 percent in the second half. The composition of GDP did not show much variation during the decade. On average, the agricultural sector accounted for about a quarter of GDP, whereas the share of the manufacturing sector stood at almost 18 percent. The aggregate share of the commodity-producing sectors in the GDP fell slightly from 51.55 percent in 1990-91 to 50.94 percent in 1999-2000. On the other hand, the share of the services sector edged up from 48.45 percent to 49.06 percent during the same period. While total investment grew by 4.50 percent in the first half of the Nineties, it fell by 0.29 percent in the second half. Public investment was almost stagnant, growing at only 2.90 percent. The performance of private investment was not much better; on average it grew at 3.69 percent in the Nineties. The growth performance of private investment in agricultural and manufacturing sectors exhibited a similar trend; private investment in these sectors grew respectively at -0.32 percent and 4.44 percent. Despite an increase in the share of lowest 20 percent of households in income during the period (from 5.7 percent in 1990-91 to 7 percent in 1996-97), the Gini coefficient stood at 0.40 in 1996-97 as against 0.35 in 1987-88, indicating a sharp rise in income inequality. While the share of highest 20 percent of households in income fell initially from 49.3 percent in 1990-91 to 47.20 percent in 1993-94, it rose afterwards to 49.4 percent in 1996-97. The incidence of poverty also increased sharply during the Nineties: the percentage of total population falling below the poverty line was 25.90 percent in 1998-99, up from 18.64 percent in 1990-91.

On average, the export sector performed relatively well during the first half of the Nineties when exports grew at an average annual rate of 10.90 percent, as against a meager 1.32 percent in the second half. The annual rate of growth of total imports peaked at 21.4 percent in 1991-92, and decelerated from 1994-95 onwards. The slowdown in the rate of growth of total imports partly reflects a relative slump in economic activity during the latter half of the Nineties. Deficit in the trade balance widened in the first half of the Nineties, increasing from US$ 1488 million in 1990-91 to US$ 3574 million in 1996-97. However, the deterioration in the trade balance reversed in 1997-98, when the deficit fell by more than half from the previous year to around US$ 1490 million in 1998-99.

Sources of Growth

The deceleration in the overall TFP growth continued in the Nineties: total factor productivity for the whole economy grew at only 0.78 percent. Thanks largely to market-oriented reforms in the agricultural sector, TFP growth in the agricultural sector recovered to 1.52 percent. While the manufacturing sector recorded an impressive growth in TFP in the Eighties, it dropped to 1.64 percent during the Nineties.

Balance of Payments (90s & Beyond) Table 5

(Value in Million Dollars)

	%		%	Trade	% of Exports Vis-a-Vis

Year	Exports	Changes	Imports	Changes	Gap	Imports
1994-95	6904.02	+ 12.6	9252.31	+ 21.4	- 2348.29	74.6
1995-96	6813.47	- 1.3	9941.02	+ 7.4	- 3127.55	68.5
1996-97	6802.51	- 0.16	8548.67	- 14.0	- 1746.16	79.6
1997-98	8137.17	+ 19.6	10395.82	+ 21.6	- 2258.65	78.3
1998-99	8707.07	+ 7.0	11804.90	+ 13.5	- 3097.83	73.8
1999-00	8320.30	- 4.4	11894.20	+ 0.8	- 3573.90	70.0
2000-01	8627.66	+ 3.7	10118.02	- 14.9	- 1490.36	85.3
2001-02	7717.79	- 10.55	9287.26	- 8.21	- 1569.47	83.1

BOP 1998 & Beyond Table 6

Year/Month		Export	Re-export	Import	Re-Import	Balance of Payments
1998-99		390342.2	3500.8	465964.0	681.2	-72802.2
1999-00		443678.3	3474.0	533791.5	940.5	-87579.7
2000-01		539370.1	3711.1	627000.0	745.3	-84964.1
2001-02		560946.7	4306.9	634630.3	688.5	-70065.2
2002-03		652293.8	2943.5	714371.9	342.0	-59476.6
2003	Apr.	57210.5	244.2	61702.7	7.3	-4255.3
	May	60593.0	260.0	55989.8	17.2	4846.0
	Jun.	73011.0	292.7	66554.3	30.8	6718.6
	Jul.	51401.4	300.6	57729.1	37.8	-6064.9
	Aug.	60022.7	719.9	59817.2	374.7	550.7
	Sep.	60053.3	494.4	62294.2	40.6	-1787.1
	Oct.	57940.1	394.7	67721.8	17.2	-9404.2
	Nov.	49401.4	349.1	56850.7	17.8	-7118.0
	Dec.	59986.8	1108.7	75979.1	16.2	-14899.8
2004	Jan.	62793.8	540.3	77239.5	113.9	-14019.3
	Feb.	51980.8	301.6	65355.7	29.2	-13102.5

Mar.	58826.5	2261.5	80893.2	51.5	-19856.7
Apr.	62967.5	679.7	86689.6	79.1	-23121.5

Chapter 5

Major Exports & Imports Trends

Pakistan's Major Exports & Export Markets

Cotton has been the single most dominant export commodity of Pakistan ever since it was created .It has been able to main its lion's share in the export sector although other commodities like Leather, sports goods ,rice and synthetic .Textiles have show little or no growth at all. Surprisingly United states is Pakistan's largest export market although Pakistan has huge possible export markets in its neighbors in the shape of China and India but due to strange policies Pakistan has preferred to trade with the US. Exports are targeted to increase by 8.4 percent to $ 12.1 billion in the fiscal year 2003-04 – indicating a net increase of $ 940 million over last year's export earnings of $ 11.160 billion. During July-April 2003-04 this number grew by 13.1 percent and stood at $ 10001.0 million as against $ 8846.3 million for the same period last year. Given this trend in export growth the target set for the current year is likely to surpass. Some of the main factors contributing to this resurgent export growth include higher unit values export, deeper penetration into the European and US markets, a sharp reduction in the refinance rate in accordance with the Export Finance Scheme and a stable currency environment. The export performance (July-April) reveals that the textile manufactures, covering 65.4 percent of total exports, registered a significant growth of 14.3 percent amounting to $ 6535.4 million. All the major textile items with the exception of readymade garments and synthetic textiles showed increases ranging from 9.9 percent (Bed wear) to 28.5 percent (cotton cloth). This could be attributed to higher average unit prices and a substantial increase in quantity ranging from 3.3 percent (towels) to 26.3 percent (knitwear). The other manufactures exports (17.3% of total exports) registered a moderate growth rate of 2.9 percent with petroleum products, leather garments and Engineering goods showing healthy increases. On the other hand the exports of petroleum crude, sports goods and surgical instruments declined. Primary commodities, with an 8.2 percent share in total exports, declined by 1.5 percent due to a steep fall in the export of wheat which fell from $ 110.5 million to $ 6.0 million. This was due to the depletion in the Carryover

exportable stock of crop. However, within this group the export value of rice, fish & fish preparation, fruits and tobacco was significantly higher, showing a cumulative increase of $ 90.1 million but this was completely offset by a decline of $ 104.5 million in the export value of wheat alone. Pakistan's Exports to USA have more than doubled in the last 10-12 years and ts major reason is Pakistan's brave decision to support the US against the war on terror especially when they had to take on their own creation Taliban. Pakistan's export with Dubai has also increased over the last 10 years but the real untapped market for Pakistan is India and China.

Pakistan Major Export Commodities (%age share)Table 7

Commodity	**90-91**	**92-93**	**94-95**	**96-97**	**98-99**	**99-00**	**00-01**	**01-02**	**02-03**	**03-04**
Cotton	61.0	59.8	58.7	61.3	59.1	61.0	58.9	59.4	63.3	62.5
Leather	9.1	9.3	8.0	7.7	6.9	6.3	7.5	6.8	6.2	5.3
Rice	5.6	4.7	5.6	5.6	6.9	6.3	5.7	4.9	5.0	5.2
Synthetic Textiles	5.7	7.4	7.1	6.1	5.1	5.3	5.9	4.5	5.1	4.2

Sports Goods	2.2	1.9	3.2	3.7	3.3	3.3	2.9	3.3	3.0	2.6
Sub-Total	83.6	83.1	82.6	84.4	81.3	82.2	80.9	78.9	82.6	79.2
Others	16.4	16.9	17.4	15.6	18.7	17.8	19.2	21.1	17.4	20.2
Total	100	100	100	100	100	100	100	100	100	100

Major Exports Market (%age share)

Table 8

Country	**90-91**	**92-93**	**94-95**	**96-97**	**98-99**	**99-00**	**00-01**	**01-02**	**02-03**	**03-04**
USA	10.8	13.9	16.2	17.7	21.8	24.8	24.4	24.7	23.5	23.6
Germany	8.9	7.8	7.0	7.5	6.6	6.0	5.3	4.9	5.2	5.0
Japan	8.3	6.8	6.7	5.7	3.5	3.1	2.1	1.8	1.3	1.1

Uk	7.3	7.1	7.1	7.2	6.6	6.8	6.3	7.2	7.1	7.5
Hongkong	6.0	6.6	6.6	9.4	7.1	6.1	5.5	4.8	4.6	4.9
Dubai	2.8	5.9	4.0	4.6	5.4	5.7	5.3	7.9	9.0	7.7
Saudi Arabia	3.6	4.7	2.7	2.6	2.4	2.5	2.9	3.6	4.3	3.0
Sub Total	47.7	52.8	50.3	54.6	53.4	55.0	51.8	54.9	55.0	52.8
Other Countries	52.3	47.2	49.7	45.3	46.6	45.0	48.2	45.9	45.0	47.2
Total	100	100	100	100	100	100	100.0	100	100.0	100.0

Cumulative Exports by Major Countries Table 9

Cumulative Exports by Major Countries Table 9

(Million Rs.)

	Countries	Jul. - Apr., 2004		Jul. - Apr., 2003	
		Value	% Share	Value	% Share
	Total	575,374.17	100.00	518,689.75	100.00
1	U.S.A.	135,901.72	23.62	122,273.20	23.57
2	United Kingdom	43,735.98	7.60	37,235.18	7.18

3	Dubai	42,682.22	7.42	45,823.74	8.83
4	Germany	29,171.91	5.07	26,316.72	5.07
5	Hong Kong	28,071.20	4.88	25,292.37	4.88
6	Italy	20,547.47	3.57	15,625.30	3.01
7	Afghanistan	19,164.45	3.33	11,863.97	2.29
8	Saudi Arabia	17,049.74	2.96	21,890.81	4.22
9	Netherlands	16,007.44	2.78	13,564.53	2.62
10	France	15,392.80	2.68	13,196.94	2.54
11	China	14,070.58	2.45	11,552.14	2.23
12	Spain	13,773.92	2.39	10,406.86	2.01
13	Belgium	12,723.79	2.21	11,372.38	2.19
14	Turkey	10,713.89	1.86	6,355.56	1.23
15	Rep. of Korea	10,342.02	1.80	10,960.25	2.11
16	Bangladesh	9,140.65	1.64	5,318.85	1.03
17	Canada	8,532.88	1.48	9,692.93	1.87
18	Japan	6,535.10	1.14	7,026.91	1.35
19	Singapore	6,445.70	1.12	3,207.45	0.62
20	Australia	6,357.76	1.10	5,889.40	1.14
	Others	108,742.96	18.90	103,824.27	20.02

Pakistan's Major Imports & Import Markets

Imports are targeted to increase by 4.8 percent to $ 12.8 billion in the fiscal year 2003-04 – indicating a net increase of $ 580 million over last year's import bill of $ 12.220 billion. During July-April, 2003-04 this figure grew by 19.0 percent and stood at $ 12012.4 million as against $ 10097.8 million during the same period last year. Further analysis reveals that the Food Group components, which accounts for 7.2 percent of total imports, grew by 4.5 percent – primarily on account of a combined increase of $ 78.8 million imports in palm oil and tea for domestic consumption. Machinery, with a 23.5 percent share of total imports, was up by 22.5 percent to $ 2820.7 million, indicating a further pick up in domestic economic activity. Despite higher international POL prices, the imports under the Petroleum Group declined by 7.7 percent due to a substantial fall of 42.2 percent in the quantity of imports of Petroleum Products, thereby saving $ 208.0 million. A continuing surge in POL output by local refineries, an increased use of gas in industries and electricity generation and lesser reliance on fuel oil-based thermal electricity owing to higher electricity generation through hydel helped Pakistan rely on lesser imports of POL products. The higher unit values together with the increased domestic demand for insecticides. The Metal Group imports increased by 33.3 percent or $ 133.8 million while the non-food and non-oil imports, representing the imports of machinery, raw materials and capital goods registered an increase of 31.7 percent during this period. The exceptionally strong growth in non-food non-oil imports is typically a leading indicator of surge in economic activity. Imports during the first ten months (July-April) of the current fiscal year increased in absolute terms by $ 1914.6 million over the same period last year.

The major contributors to this additional import bill have been the Machinery group ($ 518.3 million or 27.1%) followed by the Agricultural/Chemicals Group ($ 421.5 million or 22.0%) and the Metal Group ($ 133.8 million or 7.0%). The imports under the Petroleum group have declined by $ 208.0 million resulting in a negative contribution of 10.9 percent to the increased import bill. All the major imports have remained stagnant or declined during the last 10 years except Chemicals whose share has increased from 12.6 % to 16.6 %. Whereas Pakistan has significantly reduced its imports of Tea and Fertilizers. Petroleum products have been the major import of Pakistan over the last

decade or so. Recent trends over the years have tended to change over the last year or so. Saudi Arabia has become the largest importing partner. To have a better idea of import trends of the past couple of years a comparison of July2002 to April 2003 with July 2003 to April 2004 is also given. Pakistan has reduced its dependence on USA for imports during the last 10 years from 11.8 % in 1990 to almost 6 % in 2003-04 and Japan from 13.4 % to almost 6.4 % in 2003-04.Imports from Kuwait have increased drastically from less than 1 % in 1990 to more than 6 % today .Similarly imports from Saudi Arabia have also almost doubled in the last decade.

Pakistan's major imports come from a select few countries. About one-half of them continue to originate from just seven nations namely, the USA, Japan, Kuwait, Saudi Arabia, Germany, the UK and Malaysia. By and large, the relative shares of imports have remained almost the same during 2002-03. The shares of the USA and Japan, with some fluctuations, exhibited a declining trend because of the shift in the import of machinery/capital goods and raw materials to other sources. On the other hand, the share of Pakistan's imports from Saudi Arabia has been rising due to higher imports of POL products. Malaysia's share has shown rising, as well as, falling trends over the years mainly on account of fluctuations in palm oil prices. The same trends with some fluctuations continued during 2003-04 (July-March)

Pakistan's Major Imports (Percentage Share) Table 10

Commodities	90-91	92-93	94-95	96-97	98-99	99-00	00-01	01-02	02-03	03-04
Machinery	20.5	24.3	22.8	23.1	17.9	13.9	19.3	17.1	18.5	18.2
Petroleum & Products	22.2	15.5	15.3	19.0	15.5	27.2	31.3	27.1	25.1	20.1
Chemicals	12.8	12.5	14.0	13.4	16.6	17.5	20.0	15.9	15.1	16.6
Transport Equipments	6.7	12.5	5.9	4.7	5.7	5.5	4.0	4.8	5.6	5.6

Edible oil	5.3	5.9	9.6	5.1	8.7	4.0	3.1	3.8	4.8	4.7
Iron & Steel	3.3	3.2	3.6	3.9	3.1	3.0	2.6	3.3	3.3	3.4
Fertilizer	3.5	2.5	1.2	3.2	2.8	1.9	1.6	1.7	2.1	1.7
Teal	2.2	2.1	1.8	1.1	2.4	2.0	1.9	1.5	1.4	1.4
Sub total	76.5	78.5	74.2	73.5	72.7	75.0	83.8	75.2	75.9	71.7
Others	23.5	21.5	25.8	26.5	27.3	25.5	16.2	24.3	24.1	28.3
Total	100	100	100	100.0	100	100	100	100	100	100

Major Imports Market (%age share) Table11

Commodities	**90-91**	**92-93**	**94-95**	**96-97**	**98-99**	**99-00**	**00-01**	**01-02**	**02-03**	**03-04**
USA	11.8	9.4	9.4	12.0	7.7	6.3	5.3	6.7	6.0	6.3
Japan	13.0	15.9	9.6	8.6	8.3	6.3	5.3	5.0	6.6	6.4

Cumulative Imports by Major Countries *table 12*

(Million Rs.)

Countries	Jul. - Apr., 2004	Jul. 2002 - Apr., 2003

Kuwait	0.7	3.3	5.8	6.9	5.9	12.0	8.9	7.1	6.6	6.7
Saudi Arabia	6.2	5.4	4.9	6.0	6.8	9.0	11.7	11.6	10.7	11.5
Germany	7.3	7.4	6.8	5.6	4.1	4.1	3.5	4.3	4.6	4.0
U.K	4.9	5.2	5.1	5.0	4.3	3.4	3.2	3.4	2.9	3.1
Malaysia	4.0	5.1	8.8	4.7	6.7	4.3	3.9	4.4	4.6	4.2
Sub Total	47.9	51.7	50.4	48.8	43.8	45.4	41.8	42.5	42.0	42.2
Other Countries	52.1	48.3	49.6	51.2	56.2	54.6	58.2	57.5	58.0	57.8
Total	100	100	100	100	100	100	100	100	100	100

		Value	% Share	Value	% Share
	Total	**690,570.06**	**100.00**	**591,827.78**	**100.00**
1	Saudi Arabia	80,589.62	11.67	67,007.64	11.32
2	China	52,112.62	7.55	38,669.48	6.53
3	Kuwait	46,613.23	6.75	40,387.16	6.82
4	Dubai	45,568.39	6.58	53,368.10	9.02
5	Japan	44,198.57	6.40	38,278.67	6.47
6	U.S.A.	43,953.98	6.36	35,710.95	6.03
7	Malaysia	28,188.87	4.08	26,800.03	4.53
8	Germany	27,796.45	4.03	27,226.88	4.60
9	Singapore	25,109.75	3.64	19,038.94	3.22
10	United Kingdom	20,523.45	2.97	16,664.08	2.82
11	India	18,394.30	2.66	7,729.37	1.31
13	Rep. of Korea	17,209.89	2.49	15,651.43	2.64
15	Abu Dhabi	16,078.72	2.33	13,475.85	2.28
12	Indonesia	15,958.14	2.31	13,028.08	2.20
14	Switzerland	15,763.39	2.28	8,677.16	1.47
17	Australia	15,223.65	2.20	10,424.06	1.76
16	Italy	14,642.13	2.12	12,099.31	2.04
19	Belgium	13,173.02	1.91	14,643.27	2.47
18	Iran (Islamic Rep.)	13,029.58	1.89	13,876.09	2.34
20	Thailand	12,401.07	1.80	10,936.68	1.85
	Others	124,141.23	17.98	108,134.55	18.27

Chapter 6

INFLATION in Pakistan

Introduction

Price stability has always been of primary importance in formulating and devising macro economic goals. With this in view, fiscal and monetary policies are designed to ensure stable prices and to maintain a high growth rate. The most visible impact of inflation in recent times is its effect on real output, relative prices, taxes and interest rates. It also discourages saving and promotes consumption. The effect of inflation severity is more social than economic due to the uncertainty of losing the real value of money.

Because of the cost of inflation, several policy measures such as the control of the budget deficit through appropriate fiscal and monetary policies, the improvement of agricultural productivity, the fostering of investment to stimulate output and the constant vigilance on the market situation to ensure the adequate availability of consumer goods to the common man at a reasonable price have been taken to bring inflation down to a tolerable level. As result, there has been considerable price stability in the country over the years 1999–2004. The inflation rate during the period averaged 3.7 percent with the lowest 3.1 percent in 2002-03.The recent strategy of containing inflation intends to alleviate poverty on the onehand and safeguard the average consumer against the hardships of rising prices on the other.

Inflationary Trends (% change) *Table 13*

C P I

Year	Overall Inflation (Headline Inflation)	Food Inflation	Non Food Inflation	Non-food Non-energy inflation (Core Inflation)	WPI	SPI
1990-91	12.7	12.9	12.4	12.6	11.7	12.6
1991-92	10.6	10.6	10.5	10.5	9.8	10.5
1992-93	9.8	11.9	8.6	9.0	7.4	10.7
1993-94	11.3	11.3	11.2	10.6	16.4	11.1
1994-95	13.0	16.5	10.2	11.1	16.0	15.0
1995-96	10.8	10.1	11.3	10.8	11.1	10.7
1996-97	11.8	11.9	11.7	11.7	13.0	12.5
1997-98	7.8	7.7	8.0	7.1	6.6	7.4
1998-99	5.7	5.9	5.6	6.2	6.4	6.4
1999-00	3.6	2.2	4.7	4.4	1.8	1.8
2000-01	4.4	3.6	5.1	4.2	6.2	4.8
2001-02	3.5	2.5	4.3	3.6	2.1	3.4
2002-03	3.1	2.9	3.2	2.6	5.9	3.6
2003-04(July)	3.9	4.9	3.3	3.3	7.1	5.8
Average 1990s	9.7	10.1	9.3	8.4	10.0	9.9
Average 1990-97	11.4	12.2	10.7	9.5	12.2	12.0
Average 1998-00	5.7	5.3	6.1	6.0	4.9	5.2
Average 2000-04	3.7	3.5	4.0	3.4	5.1	4.3

Price Indices

Four different price indices are published in Pakistan: the consumer price index (CPI), the wholesale price index (WPI), the sensitive price index (SPI) and the GDP deflator. The CPI covers the retail prices of 375 items in 35 major cities and reflects roughly the cost of living in the urban areas. The WPI is used to measure the price movement of selected items in the primary and wholesale markets. The items covered under the WPI are those which are offered in lots for sale. The WPI covers the wholesale price of 425 items prevailing in the city of origin of the commodities. The SPI covers prices of 53 essential items consumed by those households whose monthly income ranges from Rs.3000 to Rs.12000 per month. In most countries, the main focus for assessing inflationary trends is placed on the CPI, because it most closely represents the cost of living. In Pakistan, the main focus is placed on the CPI as a measure of inflation as it is more representative with a wider coverage of 375 items in 71 markets of 35 cities around the country.

Prices of essential Commodities (Rs)   table 14

Items	Unit	2001=02	2002-03	July 2003	April 2004	% Change Apr 04/Jul 03
Wheat	Kg	8.3	8.7	8.7	10.3	18.5
Wheat Flour	Kg	9.7	10.1	10.2	12.8	18.0
Rice Irri-6	Kg	11.6	12.2	12.4	14.1	13.2
Masur Pulse	Kg	38.4	35.4	34.3	35.9	4.4
Moong Pulse	Kg	34.4	30.5	29.1	27.3	-6.1
Mash Pulse	Kg	44.3	37.6	34.8	35.6	2.2

Gram Pulse	Kg	34.9	31.2	25.1	24.2	-3.5
Beef	Kg	55.2	61.2	68.3	81.6	19.5
Mutton	Kg	111.5	124.9	135.8	174.9	28.9
Sugar	Kg	22.9	20.0	19.3	18.4	-6.4
Milk Fresh	Ltr	17.9	18.4	18.7	19.9	6.9
Milk Powder	400 Gm	116.1	95.9	88.2	99.0	12.2
Veg.Ghee(Loose)	Kg	49.2	55.2	55.6	62.7	12.8
Cooking Oil	2.5 Ltr	171.0	199.6	202.6	205.0	1.2
Tea	250 Gm	57.0	61.5	66.0	62.7	-5.0
Chicken (Farm)	Kg	52.0	54.0	56.7	57.1	0.7
Eggs (Farm)	Dozen	28.9	30.6	28.8	24.2	-15.7
Red Chillies	Kg	78.3	75.9	68.0	75.4	10.9
Onion	Kg	9.6	8.7	6.5	9.0	38.6
Potatoes	Kg	11.4	9.5	9.3	7.5	-19.6

Inflation during the 1990s

Prices remained volatile during the decade of the 1990s, ranging between 5.7 percent and 13.0 percent mainly because of decelerating economic growth, expansionary monetary policies, output set-backs, higher duties and taxes, a depreciating Pak Rupee, frequent adjustments in the administered prices of gas, electricity and POL products, etc. The changes introduced in the economy added a major element of distortion in economic relations with an inevitable pressure on prices, GDP growth and the performance of the large-scale industrial sector. The pressure on prices intensified in 1994-95 when inflation went up to 13 percent. Both the food and non-food inflation contributed to the persistence of double digit inflation, averaging 12.2 and 10.7 percent respectively against the overall CPI inflation of 11.4 percent during 1990-97. However, the inflation rate has started to

decline over the last three years (1998-2000) because of an improved supply position, strict budgetary measures and depressed international market prices. The inflation rate which was at 5.7 percent in 1998-99, has been reduced to 3.6 percent in 1999-2000 and further to 3.1 percent in 2002-03 (the lowest in the last three decades). This low level of inflation has been achieved as a result of strict fiscal discipline, the lower monetization of the budget deficit, an output recovery, a reduction in duties and taxes, and appreciation of exchange rate.

Inflation during 2003-04

The inflation rate based on the Consumer Price Index (CPI) for the first ten months of the current fiscal year (July- April) 2003-04 has averaged 3.9 percent against 3.3 percent for a comparable period last year. The food price inflation has increased by 4.9% and non-food by 3.3% as against 3.1 percent and 3.4 percent during same period last year. The analysis of headline inflation (overall increase in CPI) bifurcated into food, non-food and non-food non- energy indicates that the overall inflation is still low but a significant increase in food inflation is the major factor that has forced headline inflation to move up. The non-food non-energy inflation which is also known as core inflation remained quite subdued owing to the pursuance of prudent fiscal, monetary and exchange rate policies. The Central Banks around the world tend to focus on core inflation that exclude the impact of food and energy prices. Core inflation basically represents policy (fiscal, monetary, exchange rate polices) induced inflation. They do this, not because food and energy are not important, but to extract a better predictor of the underlining tendency of inflation. Food and energy price changes are subject to considerable random noise. For example, tomatoes crop was damaged by excessive rains in Sindh causing its price to rise substantially. An initial spike in tomatoes prices were reversed when the new crop came to the market. Similarly, oil prices in international market is unusually high because of the winter demands and a rebounding global economy, particularly in United States and Asia. The oil price is likely to revert back towards OPEC’s target range of $24-30 per

barrel from the current level of over $40 per barrel. With reversal of oil prices to the OPEC's price target, the energy prices will come down. The central banks, therefore, focuses on core inflation rather than overall inflation. Much of the surge in food price inflation over the last year has been the result of an increase in the price of wheat, wheat flour, rice, meat, edible oil and onions. The increase in the prices of these items has been due to several factors, some of which are discussed below. The supply shortage of wheat in the market caused by: (i) a 16.7 percent increase in support price of wheat for the Year 2004 crop; (ii) below target production in the Year 2003; (iii) delay in import of wheat; (iv) depletion of stocks due to exports in the preceding two years; and (v) withholding wheat supply by hoarders and speculators. The increase in edible oil prices in the local market can be linked to a 31 percent increase in palm oil prices in the world market due to tight global supply. The damages to the onion crop in Sindh by heavy rains and supply gaps pushed onion prices up in the local market. The prices of mutton and beef increased owing to their greater demand on account of the bird flu virus. The items contributing to an increase in food inflation have been listed in Table. The prices of 14 items have increased in the range of 0.7% (chicken farm) to 38.7% (onions). At the same time the prices of 6 items including sugar, tea, eggs, potatoes, moong and gram pulses have decreased in the range of 3.5%(gram pulse) to 20% (potato). Based on the trend of the prices of these items, the contribution of food inflation to the overall inflation has been estimated at 50% against 38% for the same period last year The analysis of the inflation rate on a month-to-month basis for the period July-April 2003-04 indicates that barring February, the overall inflation continued to rise. This was mainly driven by the increase in food price inflation. The food inflation since October 2003 till April 2004 increased at a much higher rate against non-food and overall CPI inflation because of an unusual rise in the prices of the principal food items like wheat flour, meat and fresh vegetables. The moderation in the non-food inflation during this period was the result of a lower increase in the price of fuel, energy and transportation.

Inflation by Income Groups

The study of the income and consumption behaviour of different parts of society and their abilities to afford the consequences is of great importance as inflation effects the purchasing power of different income groups differently. An analysis of the ten month (July-April) inflationary trend across the four income groups indicates that people in the lower income group, upto Rs.3000, have experienced a relatively higher inflation (4.5%) compared to those in higher income groups (3.7%). This is because of higher food inflation as the poor spend a larger part of their income on food items.

Inflation Rate by Income Groups

Table 15

Period	Overall CPI	Up to Rs3000	Up to Rs 3001-5000	Up to Rs. 5001-12000	Above 12000
1995-96	10.8	10.6	10.7	10.8	11.3
1996-97	11.8	11.7	11.9	11.8	11.6
1997-98	7.8	7.9	7.8	7.9	8.0

1998-99	5.7	5.6	5.6	5.9	6.2
1999-00	3.6	3.2	3.4	3.8	4.5
2000-01	4.4	4.5	4.3	4.5	4.7
2001-02	3.5	3.0	4.9	3.4	3.6
2002-03	3.1	2.9	1.8	3.1	3.1
2003-04 (July-April)	3.9	4.5	4.4	4.1	3.7

Wholesale Price Index (WPI)

The WPI has recorded an upward trend during 2003-04. It increased at a rate of 7.1 percent during (Jul-Apr) 2003-04 against an increase of 5.8 percent in the same period of last year. Significant features of wholesale price behaviour indicate that prices of building materials, raw materials and manufacturing items have increased substantially while prices of fuel, lighting and lubricants have decreased over the last year. The higher increase in building materials (21.9%) against 1.4% last year was due to an increase in the prices of iron bar and sheet and cement owing to the greater demand because of increased construction activities. The increase in raw materials (17.6%) over an increase of 13.1% last year was mainly due to an increase in the domestic and international market prices of cotton and cotton related items. The increase in manufacturing items prices (8.0%) over an increase of 1.4% was due to an increase in the prices of cotton yarn, nylon yarn, fertilizer and chemicals. The trend in WPI and the contribution of individual groups toward the overall increase in the index re given in the table

Sensitive Price Indicator (SPI)

The SPI is based on the prices of 53 essential items has increased by 5.8 percent during the first ten months of the current fiscal year (July-April) 2003-04 over 3.7 percent in the comparable period last year. During this period the prices of 21 items in the food group have increased with significant rises in price of wheat (18.5%), wheat flour (18.0%), rice irri-6 (13.2%), beef (19.5%), mutton (28.9%), onion (38.6%), vegetable ghee loose (12.8%), red chillies (10.9%), cooking oil (1.2%) and milk fresh (6.9%). At the same time, the prices of some basic items like sugar; tea, moong and gram pulse and eggs have declined because of sufficient supply and easy availability of these items in the market. However, most of the items under the non-food group of the SPI with the exception of a few either declined or remained unchanged

Headline and Core Inflation

	Indices				Headline And Core Inflation			
Year	**General**	**Food**	**Non Food**	**Non Food Non Energy**	**General**	**Food**	**Non Food**	**Non Food Non Energy**
1991-92	47.41	46.33	48.52	48.84	10.58	10.64	10.52	10.52

1992-93	52.07	51.84	52.31	53.26	9.83	11.74	7.81	9.05
1993-94	57.94	57.72	58.18	58.97	11.27	11.34	11.22	10.72
1994-95	65.48	67.24	64.09	65.49	13.02	16.67	10.17	11.06
1995-96	72.55	74.05	71.36	72.59	10.79	10.13	11.34	10.84
1996-97	81.11	82.86	79.73	81.07	11.8	11.89	11.73	11.68
1997-98	87.45	89.20	86.07	86.82	7.81	7.65	7.94	7.09
1998-99	92.46	94.46	90.89	82.15	5.74	5.9	5.61	6.14
1999-00	95.78	96.56	95.16	96.16	3.58	2.23	4.69	4.35
2000-01	100.00	100.00	100.00	100.00	4.41	3.56	5.09	3.99
2001-02	103.54	102.50	104.28	103.59	3.54	2.44	4.28	3.59
2002-03	106.75	105.40	107.66	106.25	3.10	2.89	3.24	2.56
2003-04 July-April	110.89	110.75	110.98	109.56	3.93	4.89	3.29	3.31

Price Stabilization Measures

Containing prices within limits is a prime target of the government's economic policy. However, due to economic integration and the free interplay of market dynamics, the safeguard and protection of the poor segments of society from the hardship of rising prices and the burden of poverty has become increasingly important. Through a series of policy measures, the Government has succeeded in keeping inflation low. These include the creation of a stable macro-economic environment by keeping a check on budgetary

expenditure and the stimulation of growth in the commodity producing sector. Some major steps taken to bring stability in prices are as follows:

i. The Import policy of essential items has continued to build up stock to meet the dearth of essential items to prevent a price hike.

ii. The Cabinet Committee now called Sensitive Items Prices Committee (SIPC) keeps a close watch on the price situation of essential items through its weekly meetings.

iii. Efforts have beenmade to counter the impact of the easy monetary stance on prices.
iv. The functioning of the USC has been strengthened qualitatively through the timely distribution of essential items.

v. Wheat export has been disallowed to meet the domestic requirement, import of 1.0 million tons of wheat to build strategic reserves has been announced, and to discourage private sector to hoard wheat the SBP has
imposed cash margin of 50 percent for borrowing for the wheat procurement and retire the borrowed amount by September 30, 2004. These measures are likely to reduce the prices of wheat and flour in the

Chapter 7

Review of Previous Trade Policies(1995-2004)

Like any other less developed country, Pakistan too has to rely on the imports in order to maintain its pace of economic development. Historical trends have proved that whenever there is a decrease or set back in imports, there is a decrease in the growth rate of the economy. Therefore Pakistan has to rely on the imports of industrial raw materials, machinery and equipment, etc. from abroad that results in increase in balance of payment deficit. On the other hand Pakistani exports mainly consist of agricultural products that are very low as compared to imports resulting a huge balance of trade deficits.

In such circumstances the Trade Policies that are presented in every financial year become very important and leave long-term effects on the economy.

The trade policies of Govt. of Pakistan had been changed accommodating different circumstances from time to time. The Pak. Govt. had taken various policy measure to overcome its problem relating to international trade of Pakistan.

Some of the Trade policies of the last five years are concisely reviewed in the following lines.

Trade Policy 1995-96

The trade policy 1995-96 was perceived as a liberalized policy. In this policy the Govt. has adopted a strategy to decrease the tariff, customs duty, regulatory duty, non-tariff trade barriers, and etc. as committed by it in the GATT.

Following are various features of import policy 1995-96.

a) To ensure uninterrupted supply of raw material to the industries set up in the country.

b) Liberalize imports of machinery for industrial development.

c) Availability of essential commodities to general consumers.

d) Reduction of distortion from over regulation.

e) Reduction of smuggling through providing a measure of competition.

f) Provision of relief to domestic consumers from over protection of domestic industry.

g) To facilitate inflow of new technology in the country.

h) Increase in the efficiency of domestic industry by gradually exporting it the foreign competition.

i) Simplification of import and export procedures.

j) Announcement of personal baggage and export credit guarantee scheme.

k) Freight subsidy on export of jersey sheets.

The expected exports for the FY 1995-96 were $9.206 billion (i.e. increase of 16.5%) as government perceived an increase in the prices of its exportable products in the international markets. But actual exports were only $8.71 billion. On the hand the imports were estimated at a level of $10.94 billion but actual imports were $11.80 billion resulting at trade deficit of $3.09 billion.

Trade Policy 1996-97

Minister of finance commerce Mr. Ch. Ahmad Mukhtar announced trade Policy for 1996-97.

Following were the salient feature of this policy.

a) Liberalization of tariff and non-tariff trade barriers.

b) Diversification of exports.

c) Increase in the value addition exports.

d) Performance based reward schemes for exporters.

e) Canning of food products, manufacturing of audio-video cassettes, floppy diskettes, kitchen utensils and other products of plastic materials on a temporary basis, provided these are subsequently exported are allowed to import.

f) Import of factory ships and fishing vessels for processing and preserving fishery products will be allowed at a reduction in import duty of 10%.

g) The Department of Explosives is making used CNG and LPG cylinders importable subject to the safety certificate.

h) The import of sugar-cane seeds and banana suckers will be subjects to prior approval of the Department of Plant Protection.

i) The authorized customs authority will now deal with applications for permission to re-export frustrated cargo.

The project exports were $10.00 billion and projected imports were $11.00 billion. But actual exports were amounted to $11.63 billion and Export were only $8.26 billion during FY 1996-97 thereby resulting a deficit of $3.37 billion.

Trade Policy 1997-98

The Minister for Commerce Mr. Sartaj Aziz announced the trade policy for the FY 1997-98. Following are some highlighters of that policy:-

a) Customs duty on wet blue hides reduced to 0%

b) Import of raw material for manufacturing engineering goods for export has been liberalized.

c) Duty free import allowed for machines, tools, equipment and other items required by gems and jeweler industry.

d) Supplies against international tenders exempted from sales tax on imported raw materials.

e) Import of textile designs, at work and transparencies used by the Garments industry exempted from customs duty 0.5% of the value of exports by actual exporters in the immediately preceding financial year.

f) Duty free import of raw sugar for re-export after refining permitted.

g) Import of special labels, special buttons and special brand tags used in making ready-made garments will be allowed and its procedure streamlined.

h) For encouraging the toys industry, import procedure for the import of their raw materials to be streamlined.

i) Import of gold and silver presently confined only to three companies has been further liberalized.

j) Import of certain 2nd hand specialized medical equipment allowed.

The projection for the FY 1997-98 about imports was $11.90 billion. While exports were projected at the level of $9.57 billion resulting a trade deficit of $2.33 billion, which was decreased by $1.04 billion. But actual targets attained were quite low i.e. exports were only $8.667 (i.e. increase of 4%) and imports were at the level of $11.00 billion resulting a trade deficit of $2.33 billion.

Trade Policy 1998-99

The trade policy of 1998-99 was up to some extent a progressive document towards some various issues related to the imports and exports. Given below are some important features of it.

a) All pending cases of refund of sales tax and customs duty will be settled within 30 days.

b) Export processing units (EPUs), which export at least 70% of their production, will be allowed to import goods without payment of customs duty and sales tax.

c) To enhance the exports of higher value-added textiles items and leather garments, it has been decided to increase the duty free and tax free imports of accessories by these industries form 0.5% to 5% of the FOB value of export of these items.

d) Duty free import of 2nd hand and re-conditioned computers, which are not more than three years old, has been allowed to the importers who import these goods from their own foreign exchange.

e) Secondhand machinery such as sugar plants, cement plants, oil refining, chemical plants, thermal power plants, cranes, road rollers, and machine tools etc. that are locally manufactured will not be importable.

Trade Policy 2003-2004

Following are the important features of the trade policy 2003-2004 announced by the Trade Minister Mr. Hamayun Akhtar.

Objectives Of Trade Policy 2003-2004

Our exports this year, at about $ 8.5 billion, are going to be about 11% higher than last year. While it is a satisfactory growth rate, we are painfully conscious of the fact that given the proper environment our potential is much greater. The objective that we have set ourselves are as follows:-

A) targeting export at US$ ten billion in 2003-2004,

b) achievement of sustainable and consistent growth in export earnings,

c) Diversification of our export base,

d) Achievement of greater value-addition in the goods and services being exported by us.

Strategy to Achieve Objectives

The target of exports is 10 billion dollars, which is 17% more than the previous target. In order to achieve this target, the following would be our strategy. The salient features of our strategy to achieve the above objectives are:

Firstly, the enhancement of our world market shares of our top ten textile and non-textile categories, and Secondly, to concentrate on selected non-traditional items such as software, engineering goods, chemicals, fruits and vegetables etc. Detailed plans are being developed.

Corrective measures

Trade policy 2003-2004 shall lay the framework for the next three years. Such corrective measures as become necessary will be taken immediately rather than held back for the annual trade policy statement

* Policies shall be driven by market forces, with only such Governmental intervention as is required to `level the playing field', to remove obstacles, or to

guide investments to the more productive sector. Emphasis shall be on rewarding efficiency and good performance.

* Stakeholder participation shall continue to be the basis of policy formulation.
• Anti export bias shall be reduced through trade and tariff liberalization, a more open competition, and a marked improvement in the export infrastructure. The exchange and interest rate instruments shall provide the underpinning for the export strategy. I am glad to be able to announce that henceforth the exchange rate mechanism will be responsive to the trade imperatives.

Imports

Let us first look at the import side of our trade policy. Some of the more significant changes that government of Pakistan has brought about are:

* Requirement of opening of Letter of Credit before shipment done away with.
* Actual users can now import any importable item up to the limit of US$ 5,000/- per annum.
* Advance payment facility extended to all importable goods, subject to a maximum of US $ 5,000/-. For industrial users this limit has been enhanced to US$ 15,000 in case of air-freighted spares / machinery.
* Shelf life and other labeling requirements for edible products have been simplified.
* Procedures for import of Ozone Depleting Substances made more transparent.
* EPZ units are being allowed to sell/export to the tariff area (a) `waste', upto 3% of FOB value of exports, (b) vehicles not less than five years old, and (c) imported goods in same state subject to the provisions of the Import Trade and Procedures Order.
* Procedural requirements in respect of certain restricted goods have been simplified so that an importer does not have to obtain NOC's from several government offices.
* Car (gift and baggage) rules have been simplified.

Government of Pakistan is convinced that a restrictive import regime and export growth can not co-exist. With this dismantling of the import restrictions we are confident

that not only will increased competition lead to significant quality and productivity gains, it will also catalyze exports.

Export side of Pakistan's trade policy

How do we propose to approach this ten billion dollar target? In keeping with the Export Strategy it is proposed to particularly focus on the export of certain selected sectors during 2003-04. Following are the specific measures being taken in support of these sectors:

1) Textile

Textile is the most important sector of our economy and has been under special focus through Vision 2005 analysis. If our industry has to become internationally competitive it has to begin in this sector. Textile Vision 2005 (covering improvement of cotton quality, project finance, promotional measures, marketing strategies and quota policy) is in the final stages. In the meanwhile following measures have already been announced.

* Cotton policy that, among other things, allows export of raw cotton right from the beginning of the season.
* Setting up of Ginning Research Institute
* Reduction of Customs Duty on import of saw gins
* Amendment in KCA bylaws to permit shift from varieties to grades
* Grading by PCSI at Ginneries (w.e.f. 1st July)
* Withdrawal of Excise Duty on import of raw cotton. Under the restructuring and redirection envisaged in Vision 2005, and in order for the focus to shift to the higher value added sector, it has been decided to withdraw with immediate effect the export finance facility for yarn and grey cloth.

2) Fisheries

Already considerable work has been done in support of the legal, administrative, marketing and supply-chain framework. The task ahead is to

* Concentrate on the supply-chain development and marketing of nine varieties that have been identified.
* Minimize "post harvest" losses.
* Improve quality.
* Develop downstream products (canned, analogue etc.).

The following specific measures are being taken for this sector:

a. Fishing/catching stage operators are being given the status of indirect exporters to facilitate duty free import of machinery and equipment, like navigational equipment, fish finders, storage and handling equipment etc.
b. A committee of the stakeholders is being set up to pursue the commercial plans developed by EPB, inclusive of the recommendations for the Fisheries Policy.
c. To promote aqua culture suitable land, next to sea, is to be made available.
d. Duty free import of shrimp meal and baby shrimp will be allowed.

To promote export of seafood products (as against `commodity') lowest withholding tax i.e. 0.75% will apply for fish and fisheries products packed in retail packs 500g to 2 kg.

3) Fruits & Vegetables

Following measures are being taken:

a. Quality certification system under Agricultural Produce (Quality & Grading) Act to be redesigned by EPB in consultation with exporters and MINFAL. Export on consignment basis will be allowed.
b. For valuation purposes the wholesale prices reported by Bureau of Supplies may be used as a benchmark.
c. Fruit and vegetable processors will be treated as indirect exporters to allow them duty free import of machinery and equipment.
d. One window facility is being set up at Karachi airport to facilitate export of Fruits & Vegetables.
d. Export of fruit and vegetables, will be allowed freely, and on a regular basis, with no minimum export price or the requirement of registration with EPB.

4) Rice

We are going to:

a. Allow import of par boiling plants from India.

b. Reduce port handling charges. A committee headed by Minister of Communications and consisting of Chairman KPT, EPB, and Rice Exporters Association is being set up to review port charges, including `by road labor'.

c. Improve yields and quality (lower percentage of broken by making available improved quality of Irri seeds on an emergency basis.

d. Ensure greater market penetration in Indonesia, Iran, Iraq, Philippines, Kenya, Zimbabwe, and South Africa through active Governmental support.

e. Encourage Brand development.

5) Gems & Jewelary

Following measures are being taken:-

a. amend SRO's 131 and 592 to make exports easier and less prone to misuse,

b. amend policy for licensing of gold imports,

c. duty on import of diamonds and rough gemstones is being reduced. A specific rate of duty, corresponding to around 2% ad val, shall be fixed,

d. the value addition requirement for export of bangles is being reduced to 5%,

e. a jewelry design institute is being set up on a priority basis,

f. EPB and the jewelers association will collaborate on an extensive advertising campaign to promote hand-made jewelry from Pakistan,

6) Software

The package already developed by the IT Division is going to make a major contribution - especially in the fields of training, reduction in the cost of internet use, and the setting up of I.T. parks and incubators. In the budget measures have already been announced to encourage I.T. exports. We consider these measures to be sufficient for the time being.

7) Leather Garments & Products

The following measures are being taken:

a. Import of following products from India is being allowed. Plastic shoe lasts. Shoe adhesives. Toe puff material. Thermoplastic rubber. Shoe reinforcement tapes.Rubber master batch.

b. Overseas experts (designer, pattern master etc.) are being obtained. They will be attached to the National Institute of Leather Technology (NILT).

c. Leather Products Development Center is being put under the operational control of NILT to facilitate better skill development.

d. We will work actively with the Provincial governments to improve the quality of livestock, so that better raw materials become available to the leather sector.

In addition to these sector specific promotional measures further export liberalization actions have been agreed. Some of these are:-

a. Ban on export of wheat to be removed. Ministry of Food & Agriculture shall lay down the export procedures, and conditions.

b. Registration of contracts with EPB in respect of agricultural and livestock products is being done away with, except the following:

- Cotton
- Rice
- Urea

c. Requirement of NOC from department of Archaeology for the export of used copper and brass utensils will not be required any longer.

d. Requirement of NOC from Wildlife Council for export of birds is to be done away with, except for species covered by the Convention on International Trade in Endangered species.

e. Requirement of NOC from Ministry of Petroleum and Natural Resources for export of lubricants, naphtha etc. to be removed.

f. Permissible limit for (export of) samples enhanced to $ 5,000 and for gift parcels to Rs.10,000 It has also been decided to be removed. This measure will not only contribute to greater economic activity but also introduce Pakistani products abroad in the most cost-effective manner possible

Other Export Measures:

a. Exports by land route to and through Afghanistan to Central Asian Republics do not provide full duty drawback and sales tax refunds, even where payment is received in foreign exchange as this facility is prone to misuse. However, it is felt that an export opportunity, with considerable growth potential should not be compromised. It has accordingly been agreed that export of 'selected products' (i.e. that can not be easily smuggled back and in respect of which adequate safeguards have been built) be allowed through land route, with usual refund facilities.

b. To facilitate ISO certification Government has been providing a subsidy (Rs.150,000) to enterprises. This programme ends in December this year. It is being extended to 30-06-2004. It is also proposed top cover QS 9000 under this scheme.

c. Last year's trade policy had allowed full drawbacks on exports through parcel/courier service. However, in actual practice drawbacks have been capped at 5%. It has been decided to remove this cap.

d. SRO.593 allowing import of duty free machinery by an engineering unit for export production is being extended until 30-06-2004.

e. SRO.818, allowing import of raw materials for exports, is being amended to include textile made ups.

Skill Development

One of the most critical areas of concern for growth of export is the paucity of skilled man power, that spills over, equally, to managerial and marketing talent. With EDF funding we have setup several training institutes in collaboration with the respective trade bodies. However, much greater and a much more focused effort is required to derive optimum results. In order to ensure this, and obtain synergetic results, it is proposed to set up a Skill Development Council that will function as an umbrella organization for the existing institutes and also develop new ones. This Council will also complement the National Productivity Council.

To supplement these promotional measures it is necessary to improve upon Export facilitation. Two critical areas here are Missions abroad and the Export Promotion Bureau.

Mission abroad

The President of Pakistan has given clear categoric instructions to the Foreign Office that the primary function of our embassies shall be trade promotion. The Foreign Office is accordingly installing systems to monitor, on a regular basis, the trade promotional performance of our missions. I am confident our exporters will in future find our embassies to be a friendly place with proactive export assistance. I urge upon our exporters to have a greater liaison with the embassies and keep them informed of their marketing endeavors to enable them to play a more supportive role.

Export Promotion Bureau

Export plans for various countries will be developed and communicated by EPB to the respective missions. Ambassadors will communicate with EPB on all commercial matters.

Export Promotion Bureau, that is the lynchpin of our facilitation process, is being given a new look; indeed, my feedback from the exporters is that already they are beginning to feel the difference. We are going to provide greater and better human and financial resource to the Export Promotion Bureau. We are going to empower them further so that EPB is more than a trade fairs and delegations authority. Any exporter who has a complaint - whether against a bank, a port official, or another government functionary - will seek EPB's immediate intervention on such matters, and EPB shall have the requisite authority to take prompt remedial measures.

Additional Export Facilities

Sea freight rates from Pakistan are significantly higher (42% to 950%) compared to Bombay & Dubai) and add considerably to the cost of our exports. It is critically

important for the sea freight rates to be competitive. Ministry of Communications has accordingly been asked to

a. Benchmark port charges and other related costs with other ports in the region, and

b. Revise KPT and PQA charges to make them more competitive

c. Devise suitable measures to make freights ex-Karachi more competitive.

Phase I of the Karachi Exhibition complex is near completion. For its efficient management a company, in the private sector is being set up. This company will also manage phase II of the complex and explore possibilities of setting up a similar complex at Lahore.

To introduce greater empathy for the cause of Exports it had been decided to setup an Export Facilitation Unit (EFU) in the CBR, for which a special post of Member (Exports) was created. It is proposed to strengthen the EFU.

Resolution of Trade Disputes

Resolution of Trade Disputes has been one of our weak areas, impinging upon Pakistanis image as a reliable trading partner. We have recently revived the Commercial Courts but weaknesses in the legislative and implementation aspects remain. We are attending to these. In the meanwhile it is proposed to give an effective.

Role of The FPCCI for Arbitration & Conciliation

It is axiomatic that a tax on imports is a tax on exports. Without losing sight of revenue and legitimate protection to industry considerations we need to review our tariffs. For this purpose a high-powered committee, including some eminent economists, is being setup. Its recommendations shall become available by October this year which shall be adopted, if necessary under a phased program. This will enable the entrepreneurs to make proper investment decisions. I must reiterate that we want to approach further liberalization in a systematic manner, with stakeholder participation, with the intent to let investors have a clear understanding of the future trend of tariff rates.

Main Enabling Measures

Duty draw back systems continue to be an area of serious concern. In its search for a system that is fair to the exporters without becoming vulnerable to abuse,

Government has provided various No duty No drawback, manufacturing in bond, temporary importation schemes and now the pass book system. Despite this array of choice I am afraid neither the Government nor the exporter is really comfortable with it.

There is no doubt that this is a complex issue, given the multiplicity of the sources of inputs as well as the category of buyers. Government is carefully studying the various options. Already, work has started on the determination of Input Output Coefficients for various industries. In the coming weeks government will devote all our energies to develop a viable system that properly addresses the concerns of the government as well as the exporters. And, of course the exporters will be closely associated in this exercise.

High Cost of capital

The high cost of capital puts us at a disadvantage against our competitors and the current Export Finance Scheme suffers from several weaknesses. The major objective is to provide greater and easier availability of export finance. We are already working with the State Bank to ensure a greater tilt towards the preferred and greater value addition sectors, easier access for the small and medium, emerging and indirect exporters, and greater availability at the pre-shipment stage.

New Export Guarantee Scheme

For a variety of reasons our banks have been less than proactive in advancing export credits. We hope to be able to make export finance a priority especially once the new Export Credit Guarantee Scheme gets operationalized.

The existing Export Credit Guarantee Scheme administered by the Pakistan Insurance Corporation has not been working. We are now launching a new scheme, with private sector management and equity funding hopefully coming from ADB, IFC, and Commercial Banks etc. The Offering Memorandum is ready. Capitalization is estimated at US$ 10 million. Besides covering the export risk at pre-shipment stage the guarantee will serve to meet the collateral requirements of the banks that will particularly benefit the small exporters. The scheme is expected to be launched before December this year. Work is also at an advanced stage for the setting up of Foreign Currency Import Facility

that will provide a "dollar window", with interest rates pegged to LIBOR, for import of inputs by the exporters.

Product Up Gradation & Market Development Fund

It had been agreed to set up a Product Up-gradation and Market Development fund. This, however, was never operationalized. It is proposed to set up this fund during the current year to finance, on a matching grant basis, exporters' endeavors aimed at product upgradation and market development, including brand development and overseas advertising support. Preference will be given to non-traditional products and new markets. It is proposed to set up this fund with an amount of Rs.1 billion from the Export Development Fund.

To mitigate the impact of certain cost penalties that are not recoverable through the drawback/refund system, as also to give recognition to those who increase their exports, it is proposed to launch a scheme that will reward eligible exporters. The rewards will be on a graduated scale corresponding to the percentage increase in the value of exports over last year. The minimum thresh-hold will be a 15% increase over last year. The scheme will not cover primary commodities.

Chapter 8

WTO : OPPORTUNITIES AND THREATS

BACKGROUND

After the World War II, the organization of General Agreement on Tariff and Trade (GATT) was established to give an early boost to trade liberalization and to begin to lessen the threats of protectionist measures, which remained in place from the early 1930s. In 1946, 23 countries started tariff negotiations. This first round of negotiations resulted in 45,000 tariff concessions affecting $10 billion (or one fifth) of world trade. The tariff concessions and rules together became known as the General Agreement on Tariffs and Trade (GATT) and entered into force in January 1948. From 1948 to 1994, GATT provided the rules for much of the world trade and presided over periods that witnessed some highest growth eras in international trade. GATT helped in establishing a strong and prosperous multilateral trading system that became more liberal through many rounds of trade negotiations.

In the retrospect of WTO , two prominent trade rounds are worth mentioning as an attempt to harmonize the international trade. The first one is the 'first Tokyo round', and the other, the most popular, is the last Uruguay round. During 1970s, the Tokyo round was the first major attempt to tackle trade barriers that did not take the form of tariffs, and to improve the system. The Tokyo round lasted from 1973 to 1979 among 102 member countries. This continued GATT's efforts to progressively reduce tariffs. As a result of continuous efforts, the average tariff on industrial products in nine major industrial countries has decreased to 4.7%. In the ministerial meeting of GATT members in Geneva, in November 1982, it was decided that GATT will be replaced with WTO , and in 1994 Uruguay round, WTO was formally established. The principle objective of WTO is to ensure trade liberalization through involving its members in trade negotiation and setting down trade related disputes between nations. At present, 145 countries are member of WTO . Pakistan joined WTO on January

EFFECTS OF WTO ON PAKISTAN ECONOMY

Future WTO Agreements

In the final Doha Ministerial Declaration, Ministers agreed, on all four issues (investment, competition, transparency in government procurement, and trade facilitation), that negotiations would take place after the Fifth Ministerial Conference (scheduled in Sept 2003) on the basis of a decision to be taken by explicit consensus at that Session on modalities of negotiations. This implies that a decision has already been taken in principle to start negotiations towards new agreements, and only the modalities of the negotiations have to be agreed to. To one's knowledge, in WTO , the term "negotiation" especially applied to "new issues" implies that a commitment has been made to establish new rules or agreements. Historical record shows that during the negotiations, the developed countries have tremendous advantages to shape the agenda, principles and provisions of the issue and the agreement, and that the final outcome may not be in the interests of developing countries. Several developing countries objected to this. In result, as a compromise, the conference chairman read out a "Chairman's understanding" that in relation to the four issues, a decision would indeed need to be taken at the Fifth Ministerial Conference by explicit consensus, before negotiations could proceed on the four issues. He also clarified that this would give each member the right to take a position on modalities that would prevent negotiations from proceeding until that member is prepared to join in an explicit consensus. This statement gave greater protection to developing countries that did not want to commit to negotiations.

1. Agreement on Trade and Investment

The main proponents of an investment agreement would mean international binding rules that allow freedom of foreign investors the rights to enter countries without conditions and regulations, and to operate in the host countries without most conditions existing now, and be granted "national treatment" and Most Favored Nation (MFN) status. Performance requirements (e.g., equity ownership restrictions, obligations on technology transfer, export orientation, geographical location, etc) and restrictions on movements of

funds would be prohibited and investment incentives may also be disciplined. There would also be strict standards of protection for investors' rights, for example in relation to "expropriation" of property. Expropriation includes government policies such as health or environmental measures that affect the future earnings and profits of an investor; full compensation to the investor is required. North American Free Trade Agreement (NAFTA) is experience expropriation.

An international agreement on investment rules of this type is ultimately designed to maximize foreign investors' rights whilst minimizing the authority, rights and policy space of governments and developing countries. This has serious consequences in terms of policy making in economic, social and political spheres, affecting ability to plan in relation to local participation and ownership, balancing of equity shares between foreign and locals and between local communities, the ability to build capacity of local firms and entrepreneurs, and the need for protecting the balance of payments and the level of foreign reserves. It would also weaken the bargaining position of government vis-à-vis foreign investors including portfolio investors, and creditors.

2. Agreement on Trade and Competition Policy

Agreement on Trade and Competition proposal is to have multilateral rules that instruct member countries to establish national competition law and policy. These laws/policies should incorporate the "core principles of WTO ", defined as transparency, nondiscrimination (MFN and national treatment). Competition law and policy, in appropriate forms, are beneficial, even for poor countries. However each country must have full flexibility to choose a model which is suitable, and which can also change through time to suit changing conditions. Having an appropriate model is important in the context of globalization and liberalization where local firms are already facing intense foreign competition. In particular, developing countries must have the flexibility to choose the paradigm of competition and competition policy/law that is deemed to be more suitable to their level of development and their development interests. For instance, the EU proposal for competition policy to provide "effective opportunity for competition"

in the local market for foreign firms, and thus to apply the WTO "core principles" to competition law/policy would affect the needed flexibility for the country to have its own appropriate model or models of competition law/policy.

Competition can be viewed from many perspectives. From the developing countries' perspective, it is important to curb the mega-mergers and acquisitions taking place, which threaten the competitive position of local firms in these countries. Also, the abuse of anti-dumping actions in the developed countries is anticompetitive against developing countries' products. The restrictive business practices of large firms also hinder competition. However these issues are unlikely to find favor with the major countries, especially the USA, which wants to continue use of anti-dumping actions as a protectionist device. If negotiations begin, the EU interpretation of competition; i.e., the need for foreign firms to have national treatment and a free competition environment in the host country, could well prevail, especially given the unequal negotiating strength which works against the developing countries. The likely result is that developing countries would have to establish national competition laws and policies that are inappropriate for their conditions. This would curb the right of governments to provide advantages to local firms, and local firms themselves may be restricted from practices, which are to their advantage.

3. Transparency in Government Procurement

The Singapore WTO Conference (1996) agreed "to establish a working group to conduct a study on transparency in government procurement practices, taking into account national policies, and based on this study, to develop elements for inclusion in an appropriate agreement". The decision does not specify that there must result an agreement; it only commits that members set up a working group to study the subject of transparency and based on this study to develop the elements to include in an appropriate agreement. It is thus important to see what an appropriate agreement, if any, should be like, from the perspective of the interests of developing countries and also their need for policy flexibility.

The study in the working group, and the agreement, is only mandated to cover transparency (and not the practices themselves), and the Doha Declaration has reaffirmed this limited scope, in 2001. However, the major countries advocating this issue had made clear their ultimate goal to fully integrate the large worldwide government procurement market into the WTO rules and system. At present, WTO members are allowed to exempt government procurement from WTO market access rules. The exceptions are those countries that have joined the WTO 's plurilateral agreement on government procurement. Hardly any developing country is a member of this plurilateral agreement. Since developing countries have found it unacceptable to integrate government procurement and its market access aspect into the WTO , the major developed countries devised the tactic of a two stage process: firstly, to draw in all members into an agreement on transparency; and secondly, to then extend the scope from transparency to other areas (for example, due process) and then to the ultimate areas of market access, MFN, and national treatment for foreign firms.

If the integration of procurement into WTO eventually takes place (as is clearly the aim of the major developed countries), governments in future will not be allowed to give preferences to local companies for the supply of goods and services and for the granting of or concessions for implementing projects. The effects on developing countries would be severe. Government procurement and policies related to it have very important economic, social and even political roles:

- The level of expenditure, and the attempt to direct the expenditure to locally produced materials, is a major macroeconomic instrument, especially during recessionary periods, to the counter economic downturn.
- There are national policies to give preference to local firms, suppliers and contractors, in order to boost the domestic economy and participation of local firms in economic development and benefits.
- There is specification that certain groups or communities, especially those that are under-represented in economic standing, be given preference.
- For procurement or concessions where foreign firms are invited to bid, there could be a preference to give the award to firms from particular countries (e.g.

other developing countries, or particular developed countries, with which there is a special commercial or political relationship).

In case, the government procurement is opened up through the national treatment and MFN principles, the scope and space for a government to use procurement, as an instrument for development would suffer. For instance:

- If the foreign share increases, there would be a "leakage" in government attempts to boost the economy through increased spending, during a downturn.
- The ability to assist local companies, and particular socio-economic groups or ethnic communities would be seriously curtailed.
- The ability to give preferences to certain foreign countries would similarly be curtailed.

Given the great importance of government procurement policy as an important tool required for economic and social development, and nation building, it is imperative that developing countries retain the right to have full autonomy and flexibility over its procurement policy. The attempts to draw this issue into the WTO are thus of grave concern.

Given the ambitions of the major countries, it is realistic to anticipate that following the establishment of an agreement on transparency, there will be strong pressures to extend its scope to also cover market access, or the rights of foreign companies to compete on a "national treatment" basis for the procurement business. Thus, the discussions on "transparency" and on a "transparency agreement" should be seen in the light of the strategic objective of the majors to draw in the developing countries into the real goal of market access and full integration of procurement practices. Therefore if there is an agreement on transparency, it is likely to be the start of a slippery slope that could lead, in years ahead, to a full market-access agreement.

4. Trade Facilitation

In the fifth Ministerial meeting, issue of trade facilitation in the WTO will be discussed. However, it is not confirmed that whether there will be negotiations on this issue or not. The main objective of the proponents is to have the rules and procedures similar to those adopted by the developing countries. It ignores the wide difference in the administrative,

financial and human resources between the developed countries and developing countries. Also it does not give weightage to the wide difference in social and working environment. For instance, it may be proposed that physical examination of goods by the customs authorities should only be in a small number of cases selected on a random basis to improve the flow of goods through the customs barrier. But this increases the risk of avoidance of payment of adequate custom duties. Such a practice may be appropriate for the major developed countries where the chances of leakage is negligible, but it may not be appropriate for the developing countries where leakage is higher.

Suggestions for the upcoming agreements

The common theme of the first three issues is an attempt to maximize the rights of foreign enterprises to have market access to developing countries through their products and investment; to reduce to a minimum the rights of the host government to regulate foreign investors; and to prohibit government from measures that support or encourage local enterprises. If these agreements come into the WTO , poor countries will find it increasingly difficult to devise their own policies for development and for the building up of their local enterprises to be competitive. Now the attempt is being made by persuading under developing countries to accept bringing these topics into WTO as "negotiating issues". Because, in the negotiations, it will be argued that the "national treatment" principle of WTO should be applied to these products. The developed countries will then use the means at their disposal to have new agreements reflecting their interests but which may become major obstacles to development or to survival and viability of local firms. Pakistan, along with other developing countries, should comprehend the issues like investment, competition, and government procurement before agreeing to include them in negotiation rounds. Following are some of the suggestions that the government should consider in order to shield against the harm effects of these possible agreements.

1. An investment agreement in WTO is most likely to be damaging to development options and interests. The argument that should be taken in the WTO is that investment is not a trade issue, and thus bringing it within the ambit of WTO would be an aberration and could cause distortion to the trade system. Moreover, it is not clear that the principles

of WTO (including national treatment, MFN) that apply to trade in goods apply to investment or, if they were applicable, would they benefit countries like Pakistan. Traditionally, developing countries have had the freedom and right to regulate the entry and conditions of establishment and operation of foreign investments; restricting their rights could cause adverse repercussions.

Furthermore, it can be argued that neither there is consensus on modalities of negotiations, nor even on the principle of whether there should be an agreement in WTO , and that therefore there should not be a decision to start negotiations at the Fifth Ministerial meeting of 2003.

2. In competition regulation scenario, what is required is a paradigm to view competition from an economic development perspective. Competition law/ policy should complement other national objectives and policies (such as industrial policy) and the need for local firms and sectors to be able to successfully compete, including in the context of increased liberalization. From a development perspective, a competition and development framework requires that local industrial and services firms and agricultural farms must build up the capacity to become more and more capable of competing successfully, starting with the local market, and then if possible internationally. This requires a long time frame, and cannot be done in a short while. It also requires a vital role for the state, which has to play the role of nurturing, subsidizing, encouraging the local firms. The build up of local capacity to remain competitive and become more competitive also requires protection from the "free" and full force of the world market for the time it takes for the local capacity to build up. This means that economic development strategy has to be at the center, and competition as well as competition policy has to be approached to meet the central development needs and strategy. Therefore some of the conventional models of competition may not be appropriate for a developing country like Pakistan. On the other hand, other models may be more appropriate, but their adoption may be hindered or prohibited by a WTO agreement on competition that is based on the "core principles of WTO ."

There is not a convincing case for a multilateral set of binding rules to govern the competition policies and laws of countries; and there are especially justified grounds for

serious concern if such an agreement were to be located within the WTO , as it is likely to be skewed in a way that is inappropriate for the development interests of developing countries as a result of the attempt by proponents to apply the "core principles" of WTO to the issue and to the agreement. The governments should take a strong stance on this issue. Furthermore, if a multilateral approach is needed, there are other venues that are more suitable; for example, United Nations Conference on trade and Development (UNCTAD) already has a Set of Principles on Restrictive Business Practices. Moreover, if the objective is to arrange for cooperation among competition authorities of countries, then it is unnecessary and inappropriate for the WTO to be the venue.

3. Regarding governmental procurement agreement, a major strategic decision should be taken to prevent the issue of government procurement from entering the WTO as a negotiating topic. Rather a transparency agreement should not be welcomed. It should be recognized that the existence of a transparency agreement would make an eventual market-access agreement very difficult to stop.

4. Negotiations should not start on trade facilitation after the Fifth Ministerial meeting. Clarification and improvement of the rules in these areas will add to the commitments of the developing countries in the WTO , adding new burdens and may have adverse implications too. Improvements in trade facilitation should be made through national efforts aided by technical assistance, rather than through imposing additional obligations in the WTO .

In short, the government should register its concerns on these issues that they do not belong to the WTO , as these are not directly trade issues. The application of "national treatment" to the issues is inappropriate as it would prevent or hinder governments from adopting policies and measures needed for development and other national goals such as nation building and harmony among ethnic communities. Pakistan should take clear national position strategically to prevent these issues from being made "negotiation issues" and thus to prevent the establishment of new agreements on these issues. It is thus important to prevent issues that are not appropriate from coming under a decision to start negotiations.

Chapter 9

Conclusion and Recommendations

Strategies for the future:

Some of the best strategies to survive during periods of high INFLATION include. Borrow as much as you can while restricting your lending to short-term and only at rates that far exceed the prevailing rate of inflation (interest rates in the open market have already shot up to 24% to 36% per year). Park most of your wealth in real assets, do not get into long-term debt securities what so ever; do not hold cash balances; but, if you on, in favour of dollar; and speculate, if you have the means, in favour of rupee's depreciation.

1. Make exports more elastic as to reduce the rate of inflation.
2. The imports of luxury items need drastic reduction.
3. The import of raw material which are available in the country may be disallowed.
4. The export surplus can be increased by greater production.
5. The existing trade gap with other countries can be reduced by increasing bilateral trade.
6. High quality exportable goods should be produced at competitive cost for capturing foreign market.
7. Reduction in export duties, allowing incentives to the exporters on non-traditional goods, payment of export rebates can boost our exports substantially.
8. Reducing the balance of payment deficit depends on our repaid industrial production and the quality of our products. We need to fully utilize the idle capacity of our engineering industries. For Modern technology in industrial production is of paramount importance.
9. The system of floating exchange rates can also correct the adverse balance of payments, because they automatically change in such a way as to correct a balance of payments disequilibrium. Since flatting rates are determined by the factors of supply and demand they can restore equilibrium by taking advantage of the comparative cost of production of the goods traded. Due to cheap rate of

Pakistani exportable goods, foreign buyers will preferably purchase Pakistani products creating a favourable balance of payments.

10. Increasing the exports of agricultural and other local products can open new doors of employment. We can import advanced technology for increasing home production. Even joint ventures with friendly countries can prove very effective in bringing more economic benefits. There is need to realize that can export potential must assimilate advanced technology form the west.
11. Pakistan should encourage the exports of engineering industries. This is possible if the raw materials imported by the export oriented industries are exempted from sales and excise duties, exporter are given more tax concession and allocation of important inputs are allowed on concessional rates. The restrictions of quota system in respect of cotton textiles must be abolished as they hinder our export promotional efforts, inside and outside the country.
12. An aggressive marketing strategy of reaching out to the potential investors through media, written material, personal contacts, conferences, exchange of delegations etc. should be established.
13. The BOI (Board of Investment) should use powerful International Financial Media, like Wall street Journal, The economist Euromoney, Financial Times, New York Times. Time (Weekly) international Herald Tribune, New Strait Time etc. to project Pakistanis liberal economic environment and investor friendly investment policies.
14. To sustain regular dialogue with investor investment conferences in capital and technology rich countries should be organized Chief Executives of multinational and large business group which are already operating in Pakistan should be invited. They should highlight the success stories of their companies operations in Pakistan. CEO's and decision making level executives of multinational should be invited in these conferences in order to attract them to make investment in Pakistan.
15. The investment promotional material should also be printed in Japanese, Chinese and Arabic languages. in this way much large number of investors in these countries will know about Pakistan.

16. Provide effective help to investors at provincial level in removing their difficulties and identifying new investment opportunities committees of investment should be made.
17. Visa policy for the investors and business executives coming from major investing countries should be relaxed.
18. The anti-inflationary policy combined with a flexible exchange rate resigme would be pursued vigorously to provide more stable condition for restoring an overall balance in external payments conditions.
19. The cropping pattern has also to be determined with a view to maximizing the value added in agriculture in terms of the border prices and not in terms of domestic prices which are subject to numerous distortions. This would generate the maximum export surplus in value terms at world market prices. The procurement prices for agricultural produce and the prices for agriculture inputs have also to be fixed with a view to encourage a cropping pattern which maximizes export value.
20. The import and export tariffs need a thorough revision from the point of view of minimizing the tax element in the cost of production. The approach should be to tax consumption but not production.
21. The trade barriers raised by developed countries against the import of manufactures from the developing countries is one of the important factors preventing greater production and export by some industries in Pakistan. Particularly the cotton textile industry. The dismantling of these barriers through North-South negotiations can go a long way in increasing Pakistanis exports of manufactured goods.
22. The tax element in the cost of production of export commodities needed to be eliminated except where it was desired to tax exports.
23. Deflation is another important weapon which is used to correct the unfavourable balance of payments. The currency authority may try to lower the prices by reducing the quantity of money in circulation. If the country succeeds in bringing down the prices, it then becomes a good market to buy from and a bad market to

sell in. Exports are encouraged and imports fall an thus the deficit gap is greatly reduced. This method when adopted is full of dangers. If by contracting supply of money, the prices are lowered, the rigid costs may not be brought down. Labour may oppose the reduction in the wages. This can lead to depression and un employment in the country which may prove very dangerous.

24. Pakistan should prefer the labour intensive industries. Because labour is cheap as compared to the machinery. It can reduce the import of machines and can reduce the cost of production. The demand of cheap goods can increase.

25. We should increase the small scale industry like Korea, Taiwan and Hong Kong. We can increase our production and exports with small capital. We can increase the exports of sports and carpets. Pakistan can not afford to import the heavy machinery

Annex:

The Country that is PAKISTAN- Some Statistics

Aid (% of GDP):
1.1% [84th of 133]

Source: calculated on the basis of data on ODA from OECD (Organisation for Economic Co-operation and Development), Development Assistance Committee. 2002. DAC Online. Database. Paris.; and data on GDP from World Bank. 2002. World Development Indicators 2002. CD-R

Budget (expenditures):
$14.8 billion, including capital expenditures of $NA (FY02/03 est.)
[51st of 226]

(per $ GDP):
$5.01 per $100 [179th of 218]

(per capita):
$98.21 per person [186th of 226]

Source: CIA World Factbook, December 2003

Budget (revenues):
$12.6 billion [52nd of 226]

(per $ GDP):
$4.26 per $100 [180th of 218]

(per capita):

$83.61 per person [187th of 226]

Source: CIA World Factbook, December 2003

Currency:

Pakistani rupee (PKR)

Source: CIA World Factbook, December 2003

Currency code:

PKR

Source: CIA World Factbook, December 2003

Current account balance:

-$1.4 billion (2002E)

(per $ GDP):

$0 per $100

(per capita):

$0 per person

Source: Energy Information Administration, US Department of Energy

Debt - external:

$32.3 billion (2002 est.) [26th of 198]

(per $ GDP):

$10.93 per $100 [134th of 195]

(per capita):

$214.34 per person [160th of 198]

Source: CIA World Factbook, December 2003

Debt service:

25.76% (2001)[24th of 149]

Source:

Distribution of family income - Gini index:

41 (FY98/99) [40th of 112]

Source: CIA World Factbook, December 2003

Economic aid - recipient:

$2.4 billion (FY01/02) [8th of 179]

(per $ GDP):

$0.81 per $100 [87th of 173]

(per capita):

$15.92 per person [108th of 179]

Source: CIA World Factbook, December 2003

Economic freedom:

1.7 (2003) [102nd of 161]

Source: The Heritage Foundation

Source: CIA World Factbook, December 2003

Exchange rates:

Pakistani rupees per US dollar - 59.72 (2002), 61.93 (2001), 53.65 (2000), 49.12 (1999), 44.94 (1998)

Source: CIA World Factbook, December 2003

Exports:

$9.8 billion f.o.b. (FY02/03 est.) [63rd of 225]

(per $ GDP):

$3.31 per $100 [189th of 221]

(per capita):

$65.03 per person [184th of 225]

Source: CIA World Factbook, December 2003

Exports - commodities:

textiles (garments, cotton cloth, and yarn), rice, leather, sports goods, and carpets and rugs

Source: CIA World Factbook, December 2003

Exports - goods and services:

16% [137th of 163]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.;

Exports - manufactured:

85% [16th of 130]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.;

Exports - partners:
US 24.5%, UAE 8.5%, UK 7.2%, Germany 4.9%, Hong Kong 4.8% (2002)
Source: CIA World Factbook, December 2003

Exports - primary:
15% [92nd of 122]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.;

Exports of goods and services (% of GDP):
18.01% (2001)[137th of 196]

Source:

Exports to US:
$557900000 [53rd of 246]

(per $ GDP):
$0.18 per $100 [124th of 213]

(per capita):
$3.70 per person [148th of 222]

Source: US Census Bureau

Fiscal year:

1 July - 30 June [0th of 233]

Source: CIA World Factbook, December 2003

GDP:

$295.3 billion (2002 est.) [27th of 229]

(per capita):

$1959.59 per person [167th of 236]

Source: CIA World Factbook, December 2003

GDP (PPP):

$266.2 billion [26th of 165]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.;

GDP - composition by sector (agriculture):

24% [61st of 206]

Source: CIA World Factbook, December 2003

GDP - composition by sector (industry):

25% [110th of 205]

Source: CIA World Factbook, December 2003

GDP - composition by sector (services):

51% (FY01/02 est.) [127th of 206]

Source: CIA World Factbook, December 2003

GDP - real growth rate:
4.4% (FY01/02 est.) [63rd of 211]

Source: CIA World Factbook, December 2003

GDP growth (1975-2000):
2.8% [30th of 156]

Source: World Bank. 2002. Correspondence on GDP per capita annual growth rates. March. Washington, DC.

GDP growth (1980-2000):
63% [21st of 110]

Source: Per Capita GDP Growth IMF

GDP per capita in 1820:
$531 [23rd of 26]

Source: Angus Maddison

GDP per capita in 1900:
$687 [36th of 42]

Source: Angus Maddison

GDP per capita in 1950:
$650 [47th of 56]

Source: Angus Maddison

GDP per capita in 1973:
$981 [49th of 56]

Source: Angus Maddison

Gross National Income:
$60.04729 billion (2001) [39th of 205]

(per $ GDP):
$20.33 per $100 [136th of 170]

(per capita):
$398.46 per person [131st of 172]

Source:

Human Development Index:
0.499 [132nd of 173]

Source: Human Development Reports, United Nations 2002

Imports:
$11.1 billion f.o.b. (FY02/03 est.) [55th of 225]

(per $ GDP):

$3.75 per $100 [205th of 221]

(per capita):

$73.65 per person [194th of 225]

Source: CIA World Factbook, December 2003

Imports - commodities:

petroleum, petroleum products, machinery, chemicals, transportation equipment, edible oils, pulses, iron an steel, tea

Source: CIA World Factbook, December 2003

Imports - goods and services:

19% [145th of 163]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.;

Imports - partners:

UAE 11.7%, Saudi Arabia 11.7%, Kuwait 6.7%, US 6.4%, China 6.2%, Japan 6%, Malaysia 4.5%, Germany 4.4% (2002)

Source: CIA World Factbook, December 2003

Imports from US:

$174300000 [63rd of 246]

(per $ GDP):

$0.05 per $100 [158th of 213]

(per capita):

$1.15 per person [167th of 222]

Source: US Census Bureau

Imports of goods and services (% of GDP):
19.35% (2001)[152nd of 196]

Source:

Income category:
Low income
Source:

Income distribution (poorest 10%):
4.1% (consumption) [9th of 116]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.

Income distribution (poorest 20%):
9.4% (consumption) [13rd of 116]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.

Income distribution (richest 10%):
27.6% (consumption) [75th of 116]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.

Income distribution (richest 20%):
41.1% (consumption) [81st of 116]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.

Industrial production growth rate:
2.4% (FY01/02 est.) [100th of 162]

Source: CIA World Factbook, December 2003

Industries:
textiles, and apparel, food processing, beverages, construction materials, paper products, fertilizer, shrimp
Source: CIA World Factbook, December 2003

Industry - Value added:
22.94 (2001) [0th of 185]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.

Industry - Value added (% of GDP):
22.94% (2001)[0th of 185]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.

Inflation (1990-2000):
9.7% [63rd of 158]

Source: calculated for the Human Development Report Office by the World Bank on the basis of data on the consumer price index from World Bank (2002b);

Inflation rate (consumer prices):
3.9% (2002 est.) [89th of 219]

Source: CIA World Factbook, December 2003

Informal economy:
36.8 [42nd of 111]

Source:

Net foreign investment:
0.5% [110th of 133]

Source: calculated on the basis of data on foreign direct investment and GDP from World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.; aggregates calculated for the Human Development Report Office by the World Bank.

Population below poverty line:
35% (2001 est.) [66th of 117]

Source: CIA World Factbook, December 2003

Population under $1 a day:

31.0% [21st of 60]

Source: World Bank 2002b via backone.pdf

Population under $2 a day:
84.6% [7th of 60]

Source: World Bank 2002b via backone.pdf

Research and development personnel:
78 per million people [78th of 91]

Source: World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC; aggregates calculated for the Human Development Report Office by the World Bank.

Share of household income (highest 10%):
27.6% (1996-97) [74th of 114]

Source: CIA World Factbook, December 2003

Share of household income (lowest 10%):
4.1% [11st of 114]

Source: CIA World Factbook, December 2003

Technological achievement:
0.17 (circa 2000) [61st of 68]

Source: United Nations Development Program. Human Development Report 2001. New York: Oxford University Press,2001, Table A2.1. via ciesin.org

Terms of trade:
107 [27th of 108]

Source: calculated on the basis of data on terms of trade from World Bank. 2002. World Development Indicators 2002. CD-ROM. Washington, DC.

Tourist arrivals:
375,000 (1997) [77th of 153]

(per capita):
2.48 per 1000 people [142nd of 152]

Source: United Nations World Statistics Pocketbook and Statistical Yearbook

Trade balance with US:
$-383600000 [186th of 246]

(per $ GDP):
$-0.12 per $100 [134th of 213]

(per capita):
$-2.54 per person [128th of 222]

Source: US Census Bureau

Trade in goods:
33.85% (2001)[145th of 197]

Source:

Transnational corporations (affiliates):

644 [53rd of 188]

(per capita):

4.27 per 1 million people [117th of 162]

Source: World Investment Report 2001, United Nations Conference on Trade and Development (UNCTAD)

Transnational corporations (parents):

59 [34th of 59]

(per capita):

0.39 per 1 million people [39th of 44]

Source: World Investment Report 2001, United Nations Conference on Trade and Development (UNCTAD)

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Research Methodology

For the completion of this thesis I had to really look extensively into the Record of balance of payments of Pakistan since 1947 to date and discover the myth behind the ever increasing inflationary trend prevalent in Pakistan .Although the records gathered from multiple sources like ministry of Economics , Federal Bureau of Statistics and from "The Economist" were more or less the same yet there were conflicting views as to what were the basic reasons behind the economic conditions for that particular economics time frame . These views seemed to be politically influenced and subjective.

Therefore I had to interview **Mr. Chaudhray Masood Ahmad** Joint Chief Economist Ministry of Planning, Government of Pakistan who helped a lot in clearing my mind of many ambiguities that i previously had .It was very kind on his part to take some time out of his very busy schedule to meet me 4 times for almost more than 1 hour each visit .

To get another point of view as well I interviewed Dr M.Aslam (former head of Department of economics , Quaid e Azam University Islamabad. I have had the privilege of studying under the guidance of Mr Aslam during my first semester at NIMS and he proved a great helping hand just like the very authority he is in the field of economics

Apart from that I had to search thoroughly through the internet and newspapers to find the relevant facts. I had to look into many books written on economics by local authors and to get a more balanced point of view i also went through books written by foreign authors.

I had to interview many people from business community and the working community as well to get their valuable comments and insights into the general rising prices and balance of payments.To get the view points of the common man on these issues was paramount for the completion of this research study. I can say with confidence that all the limitations I expected to face were cleared away by Mr Masood Ahmad who used his authority and links as well as his knowledge to my fullest of use