ECONOMY OF TOMORROW

FRIEDRICH EBERT STIFTUNG

ECONOMY OF TOMORROW:
Case Study of Pakistan

By: Dr. Hafiz A Pasha April 2014

- During a decade of high economic growth rates in Asia, Pakistan has not been able to profit from its changing political environment since the restoration of democracy in 2008. Its external and internal political conflicts in combination with the weak institutional framework have resulted in setting other priorities than focusing on economic policy reforms. Consequently, low rates of saving and investment, both from private and public sector, in infrastructure, industry, agriculture and human development have not created sufficient economic growth.

- In absence of a comprehensive industrial policy, the export-oriented sectors have not been able to provide the needed quantity and quality of employment opportunities for the young generations. Due to trade policies that failed to promote diversification, pressing macro-economic imbalances have been created. For the first time in its history, Pakistan has experienced a period of stagflation – low growth rates combined with high inflation.

- This country study analyses the social, financial and environmental challenges for economic policy making on the way to the "Economy of Tomorrow". It argues that Pakistan is currently standing on the "knife edge" which could go either way. But it also identifies the most important factors for change, with the objective to promote a debate about more inclusive and sustainable economic policies.

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ACRONYMS

AIT	Agricultural Income Tax
BISP	Benazir Income Support Programme
BoP	Balance of Payments
CCP	Competition Commission of Pakistan
CNG	Compressed Natural Gas
CO2	Carbon dioxide
CPI	Consumer Price Index
CSF	Coalition Support Fund
DDMA	District Disaster Management Authority
DISCOs	Power Distribution Company
ECP	Election Commission of Pakistan
EFF	Extended Fund Facility
EOBI	Employees Old-Age Benefits Institution
EPI	Environmental Performance Index
EPZ	Export Processing Zone
ERRA	Earthquake Reconstruction & Rehabilitation Authority
EU	European Union
FBR	Federal Board of Revenue
FCAs	Foreign Currency Accounts
FDI	Foreign Direct Investment
FES	Friedrich-Ebert-Stiftung
FTA	Free Trade Agreement
FWB	First Women Bank
GDI	Gender Development Index
GDP	Gross Domestic Product
GENCOs	Power Generation Companies
GESCO	Gujranwala Electricity Supply Company
GIC	Growth Incidence Curve
GoP	Government of Pakistan
GST	General Sales Tax
HIES	Household Integrated and Economic Survey
HKH	Hindukush – Karokaram – Himalayan
IESCO	Islamabad Electricity Supply Company
IMF	International Monetary Fund
IPP	Institute of Public Policy
K-PK	Khyber Pakhtunkhwa
KPT	Karachi Port Trust
MAF	Million Acre Feet
MFN	Most Favoured Nation
MOC	Ministry of Commerce
MOF	Ministry of Finance Planning
MOP	Minister of Finance
MW	Mega Watt
NBP	National Bank of Pakistan
NDMA	National Disaster Management Authority
NEPRA	National Electric Power Regulatory Authority

NHA	National Highways Authority
NIT	National Investment Trust
O&M	Operation and Maintenance
OGDC	Oil and Gas Development Company
OGRA	Oil and Gas Regulatory Authority
PARL	Pak-Arab Refinery Limited
PASMIC	Pakistan Steel Mills Corporation
PBS	Pakistan Bureau of Statistics
PDMA	Provincial Disaster Management Authority
PES	Pakistan Economic Survey
PFC	Provincial Finance Commission
PIA	Pakistan International Airlines
PML-N	Pakistan Muslim League-Nawaz
PPAF	Pakistan Poverty Alleviation Fund
PPL	Pakistan Petroleum Ltd
PQA	Port Qasim Authority
PR	Pakistan Railways
PRSP	Punjab Rural Support Program
PSO	Pakistan State Oil
PTI	Pakistan Tehrik-e-Insaf
SAFTA	South Asian Free Trade Area
SBF	Standby Facility
SBP	State Bank of Pakistan
SECP	Securities and Exchange Commission of Pakistan
SLIC	State Life Insurance Corporation
SNGPL	Sui Northern Gas Pipeline Ltd
SPDC	Social Policy and Development Centre
SROs	Statutory Regulatory Orders
SSGCL	Sui Southern Gas Company Ltd
SUPARCO	Space and Upper Atmospheric Research Commission
TDAP	Trade and Development Authority of Pakistan
TDS	Tariff Differential Subsidy
TMA	Tehsil Municipal Administration
UAE	United Arab Emirates
UIPT	Urban Immoveable Property Tax
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
USA	United States of America
USAID	United States Agency for International Development
VAT	Value Added Tax
VIPs	Very Important Persons
WAPDA	Water and Power Development Authority
WDI	World Development Indicator
WTO	World Trade Organization
XEN	Executive Engineer

Foreword

The Economy of Tomorrow: constructing alternative models, creating innovative alliances

The global financial and economic crises of recent years – with its multiple implications in the industrialized world, but now also increasingly visible in emerging and developing economies – are of political nature. The banking crisis in the US, which extended into Europe and triggered the Euro crisis, is a product of financial deregulation, but also of accumulation of public and private debts over the last three decades. The social consequences of the crises in countries like Greece, Portugal and Spain have been severed by Germany-driven austerity policies. In order to overcome the economic crises and dangerous national fragmentations within Europe, more coordinated and consolidated financial, economic and fiscal policies would be needed. Again, the problem derives from the lacking capability and will of the political sphere, mostly in the hand of the nation-states, to deal with a deregulated capitalism.

At the same time, politics have been driven by a permanent obsession to follow the assumed needs of the markets. In Southern Europe, democratically elected national governments are being undermined by international technocrats dictating economic reform packages, instead of searching for a broad-based consensus for reforms, including the majority of the population. When criticized, the most prominent discourse from technocrats and European politicians has been: "There is no alternative" (TINA). Those simple words are proving that politics have become subordinate to financial markets, and democratic principles are only suitable if they serve capitalism. But the old paradigms are coming to an end, and the new power struggles have just started. The recent government shutdown in the US could be an example of how much political decision-making over economic policies might become ideological.

Beyond the lacking political capacities and the existing public discourses lies a crisis of economic thinking and understanding. The majority of influential economic thinkers, largely following a neo-classical school of thought, have not been able to prevent or even predict the ongoing financial and economic crises. Most of the countries on the globe are now sharing similar challenges, despite very different starting points: to find ways to build up a socially inclusive, financially stable and ecologically dynamic economy. Hence, new economic concepts are urgently needed, in order to define policy instruments oriented towards the needs of a growing global population. Ultimately, the economies should create full opportunities for all, making the economic and financial markets an instrument of policy making rather than a goal in itself.

In order to achieve forward-looking economic models, one has to understand the political economy of reforms, in every specific context. Very often the coalitions maintaining the status quo have built up very powerful networks with direct or indirect influence on the processes of policy-making. For the purpose of change, platforms for the discussion of reform agendas have to be established; new alliances including diverse stakeholders have to be created. Alternative narratives and long-term visions with the ability to convince different groups of society are needed for winning public debates and building up political pressure on decision-makers. In the end, the way towards the Economy of Tomorrow is a political struggle.

This case study on Pakistan within the Economy of Tomorrow (EoT) project marks the beginning of a new working line established by the FES Pakistan office in 2013. I am extremely thankful to Dr. Hafiz Pasha for accepting to author this country study and for convening the EoT Pakistan panel at various occasions. I also want to express my gratitude to all the members of the Pakistan Panel on the Economy of Tomorrow, who have discussed the different chapters extensively in various meetings over the last few months and contributed enormously to the high quality of this case study. This is not the end of the project but rather the beginning of a working line, in which we want to continue discussing more specific economic policy questions and develop recommendations for policy making in a constructive manner. Furthermore, I want to thankfully acknowledge the role of Abdul Qadir, Programme Coordinator of FES, in composing the Pakistan EoT panel and establishing the new FES Pakistan working line on the Economy of Tomorrow, as well as of Abdullah Dayo, Project Officer of FES, and Shoukat Ali, Secretary of FES, in overviewing the process of lay-outing and designing of this study.

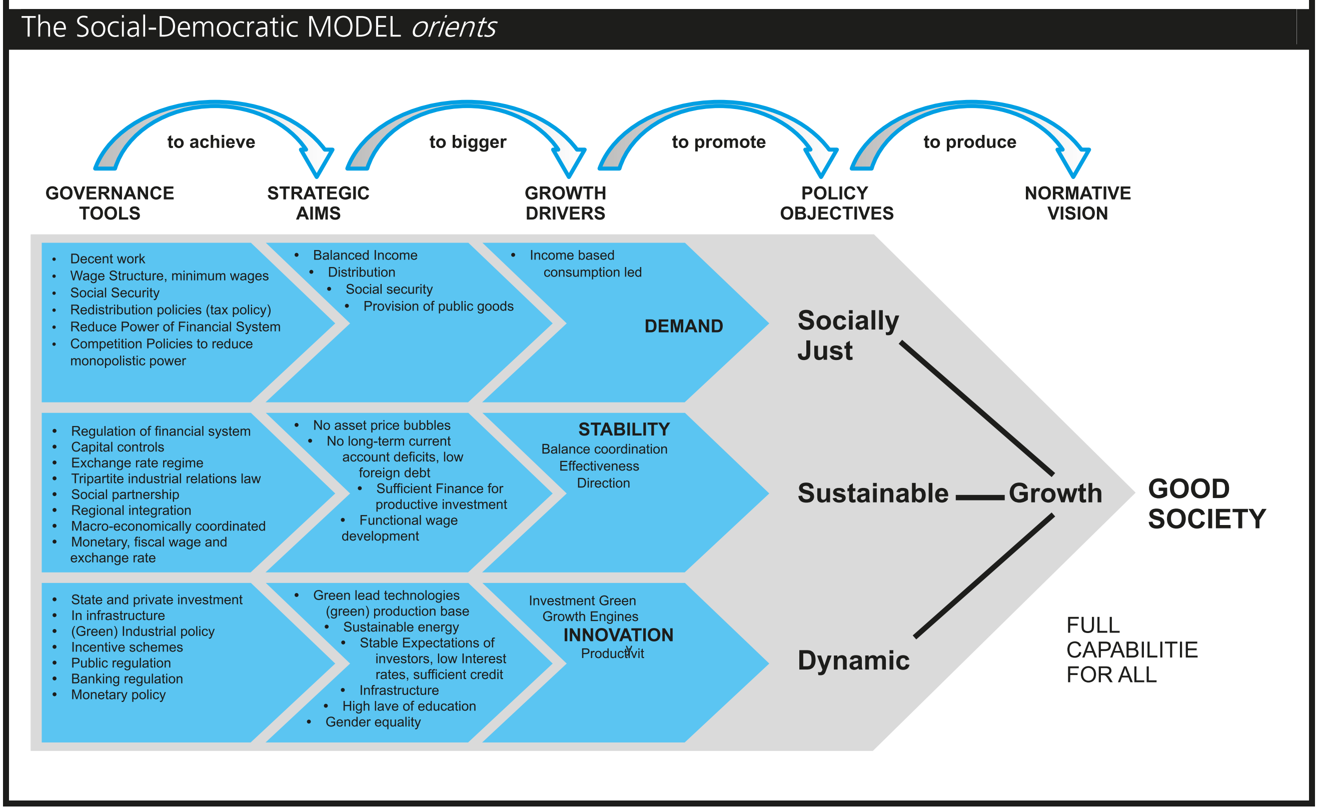
Philipp Kauppert
Resident Director
FES Pakistan
Islamabad, May 2014

Introduction

The new development paradigm focuses on growth which is inclusive, sustainable and resilient. While Asia has demonstrated the ability to grow fast it has a vulnerability to financial crisis, as in 1997. Also, inequalities have increased in most countries and the region has suffered severe damage due to mega natural disasters. More recently, the blow to the global economy in 2009 has highlighted the interdependence of regions in an increasingly globalized world. While the financial crises originated in the USA and Europe, the contagion effects have been felt by most countries of Asia.

Against this background the Friedrich-Ebert-Stiftung (FES) is determined to establish a dialogue between Asia and Europe on a new development paradigm and establish a network of progressive European and Asian economists. As a first step it is proposed to undertake country studies in European and Asian countries to see how these countries are situated in terms of a 'good society'.

Figure 1.1
Basic structure of a "Good Society" development model



A 'Good' Society

The basic structure of a 'good society', as developed by FES is given in Figure 1.1. It combines social justice with participation, sustainability and high productivity increases. The aim is to achieve a 'good society' with full capabilities for all.

This report entitled 'Economy of Tomorrow' is a case study of Pakistan. The first task undertaken is to adapt the generic structure of a 'good society' to the Pakistani context, in Chart 1.1.

The adaptation of the framework to the Pakistani setting adds the dimensions of social policy, governance, institutions and the legal framework. It focuses, as in Figure 1.1, on governance tools, strategic aims/objectives and on the normative vision.

Report Contents

There are five substantive chapters in the report as follows:

Chapter 1: General Macroeconomic Review
Chapter 2: Income Distribution, Consumption Demand and Inclusive Development
Chapter 3: World Market Strategy and Protection from External Shocks
Chapter 4: Green New Deal and Benefits of an Ecological Focus
Chapter 5: General Evaluation

Chart 1.1
Structure of the 'Good Society' Model for Pakistan

TOOLS	AIMS	OBJECTIVES
Governance		
• Develop a National Security Policy	Tackle Militancy and Terrorism	
• Strengthen Security and Law Enforcing Apparatus	Improve Law and Order Situation	
• Focus on Human Rights Laws and Implementation	Improve status of Women and Minorities	
• Establish Third Tier (Local) of Government	Promote participative democracy	
• Establish Accountability and Transparency Laws and Mechanisms	Reduce Corruption	
Infrastructure		
• Rehabilitate and Expand Capacity of Power Sector	Remove power-loadshedding and make sector financially viable	**FASTER GROWTH**
• Rehabilitate and Expand the Irrigation System	Increase agricultural output	
Fiscal Policy		
• Tax Reforms	Raise the Tax-to-GDP ratio and make the tax burden more progressive	
• Provision of Public Goods	Increase Productive Capacity	**SUSTAINABILITY**
• Program of Social Protection	Support Poor and Disadvantaged Groups	
Monetary Policy		
• Level of Interest Rates	Manage Aggregate Demand	
• Allocation of Credit	Divert credit to priority sectors like SMEs, agriculture, etc.	
• Exchange Rate Regime • Capital Controls	Management of External Balance of Payments	**SOCIAL JUSTICE (INCLUSIVENESS)**
• Banking Regulation	Ensure viability of Commercial Banks	
Trade and industrial Policy		
• Import Tariffs	Protect Domestic Industry	**RESILIENCE**
• Export Incentives	Promote Exports	**A 'GOOD' SOCIETY**
• Regional Integration	Diversification of Export Markets	
Social Policy		
• Provision of Education and Health	Promote Human Development	
• Gender Laws and Mainstreaming	Promote Gender Equality	
• Develop Social Partnerships	Achieve Greater Social Mobilisation	
Labour		
• Labour Laws	Increase 'Decent' Employment	
• Minimum Wages	Protect unskilled workers	
• Wage structure	Promote functional Wage Development	
• Social Security System	Pensions for retired workers	
Environment		
• (Green) Industry	'Green' Technologies like alternate (renewable) energy sources	
• Enforcement of Environment Protection Laws by Strengthening Relevant Institutions	Minimise Environmental Damage	
Market Regulation		
• Competition Laws and Implementation	Prevent Monopolies and Restrictive Practices	
• Establish Specialised Regulatory Agencies	Management of Natural Monopolies, Public Utilities	
• Local Supervision of Markets	Ensure 'fair' prices	
Policy Coordination		
• Ensure Stable and Business Friendly Environment	Promotion of Growth	

Chapter 1: GENERAL MACROECONOMIC OVERVIEW

1.1 Past Development of the Key Macroeconomic Indicators

1.1.1. Growth

The new millennium started with Pakistan in the midst of sanctions imposed by the international community following the nuclear tests which constrained growth to the low rate of 2 percent per annum. Soon after, with Pakistan becoming an ally in the global 'war-on-terror' the economic situation changed for the better with large aid inflows. The growth rate rose to reach a maximum of 9 percent (see Table 1.1.). This was accomplished because of a boost in all sectors-industry, agriculture and services. Investment (both public and private) as a percentage of GDP, showed a big increase, being stagnant in the early years of the new millennium.

Table 1.1
Key Macro Economic Indicators

	Unit	Indicator	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13(P)
Agriculture	%	Real Growth Rate	-2.2	0.1	4.2	2.4	6.5	6.3	3.4	1.8	3.5	0.2	2.0	3.5	3.4
Industry	%	Real Growth Rate	4.1	2.7	4.2	16.3	12.1	4.1	7.7	8.5	-5.2	3.4	4.7	2.7	3.5
Services	%	Real Growth Rate	3.1	4.8	5.2	5.8	8.5	6.5	5.6	4.9	1.3	3.2	3.9	5.3	3.7
GDP	%	Real Growth Rate	2.0	3.1	4.7	7.5	9.0	5.8	5.5	5.0	0.4	2.6	3.7	4.4	3.6
Total Investment	%	as a percentage of GDP	14.9	14.5	14.6	14.3	16.7	19.3	18.8	19.2	17.5	15.8	14.1	14.9	14.2
Fixed Investment	%	as a percentage of GDP	13.7	13.4	13.2	13.0	15.3	17.7	17.2	17.6	15.9	14.2	12.5	13.3	12.6
Public Investment	%	as a percentage of GDP	4.9	3.6	3.5	3.5	3.8	4.2	4.6	4.8	4.3	3.7	3.2	3.7	3.9
Private Investment	%	as a percentage of GDP	8.8	9.8	9.8	9.4	11.4	13.5	12.6	12.8	11.7	10.5	9.3	9.6	8.7
National Savings	%	as a percentage of GDP	14.3	16.1	17.9	15.5	15.3	15.2	14.0	11.0	12.0	13.6	14.2	12.8	13.5
Inflation	%		4.4	2.5	3.1	4.6	9.3	7.9	7.8	12.0	20.8	10.1	13.7	11.0	7.4
Money Supply	%	Growth Rate	9.0	15.4	18.0	19.6	19.3	14.9	19.3	15.3	9.6	12.5	15.9	14.1	15.9

(P) = Provisional
Source: PES

The high growth in Pakistan coincided with economic boom in most Asian economies, with one major difference. While growth spurt in the emerging economies continued, more or less, unabated, growth in Pakistan could not be sustained. In fact it was followed by a period of near stagflation. For the last five years GDP growth has averaged barely 3 percent per annum. Deep rooted economic issues have constrained high and sustained growth in Pakistan including: high levels of power outages, low rate of savings and consequently inadequate investment not only by the private sector but also the public sector in infrastructure, industry, agriculture and human capital; a weak industrial and export structure, dominated by cotton based exports, due to trade policies that failed to promote diversification; an ambivalent attitude towards the private sector; ineffective governance structure with weak public institutions and rule of law, lack of accountability, high level of bureaucratic red-tapism and rampant corruption.

Table 1.2
Gross Capital Formation, Total (Public + Private) by Sector as % of GDP

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13 (P)
Agriculture	3.67	2.97	2.91	2.89	2.68	3.83	3.30	3.21	2.93	2.97	3.11	3.04	3.28
Mining & Quarrying	0.28	0.46	0.64	0.92	0.19	0.30	0.38	0.45	0.31	0.37	0.41	0.24	0.25
Manufacturing	3.53	3.43	3.61	3.15	3.29	3.36	3.72	3.08	3.01	2.83	1.90	1.47	1.43
Large Scale	3.49	3.39	3.56	3.09	3.23	3.29	3.65	3.00	2.94	2.75	1.81	1.38	1.34
Small Scale	0.05	0.05	0.05	0.05	0.06	0.07	0.08	0.08	0.07	0.08	0.08	0.09	0.09
Electricity and Gas Distribution	1.39	1.27	1.01	0.93	0.35	0.48	0.71	0.54	0.62	0.81	0.68	0.73	0.68
Construction	0.32	0.26	0.27	0.12	0.14	0.22	0.27	0.29	0.28	0.29	0.17	0.09	0.13
Transport, Storage & Communication	1.57	1.86	1.45	1.28	1.98	2.57	3.82	3.61	3.53	2.14	2.10	1.43	1.23
Wholesale & Retail Trade	0.14	0.15	0.18	0.19	0.23	0.24	0.29	0.29	0.30	0.29	0.29	0.29	0.30
Finance & Insurance	0.14	0.07	0.13	0.26	0.27	0.27	0.29	0.33	0.34	0.28	0.22	0.16	0.20
Ownership of Dwellings	2.58	2.63	2.49	2.37	2.48	2.49	2.46	2.28	2.45	2.30	2.00	1.93	2.11
Other	0.86	0.83	0.83	0.76	0.89	1.01	1.08	1.07	1.05	1.06	1.08	1.04	1.12
GFCF	**13.28**	**13.19**	**12.85**	**12.50**	**11.98**	**14.01**	**16.31**	**15.13**	**14.82**	**13.33**	**11.96**	**10.45**	**10.72**

(P) = Projected
Source: PES

Real gross fixed investment has fallen steadily, showing a decline of over 30 percent over the period 2008-12 to 10.8 percent of GDP–again the lowest on record in more than half a century (see Table 1.2). The decline in investment in industry, especially large-scale manufacturing, is worrying.

It appears that consumption demand has significantly contributed to economic activity; the official statistics indicate a growth in overall private consumption of 3.7 percent over 2006-13 (See Table 1.3).

Table 1.3
GDP by Expenditure (as a Percentage of GDP) 1999-00 to 2012-13

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13 (P)
Private Consumption Expenditure	77.8	78.6	77.2	76.3	76.6	79.3	77.6	77.9	81.9	79.2	79.7	81.2	82.5	81.0
General Government Current Consumption Exp.	8.3	7.5	8.4	8.5	7.9	7.6	10.4	9.9	9.7	10.5	10.3	9.7	10.5	10.8
Gross Domestic Fixed Capital Formation	13.7	13.5	13.2	13.0	12.9	15.1	17.7	17.2	17.6	15.9	14.2	12.5	13.3	12.6
Change in Stocks	1.4	1.3	1.3	1.7	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Export of Goods and Non-Factor Services	12.5	13.6	14.1	15.5	14.5	14.6	14.1	13.2	12.4	12.4	13.5	14.0	12.3	12.7
Less Imports of Goods and Non-Factor Services	13.6	14.6	14.2	15.0	13.6	18.2	21.5	19.8	23.2	19.7	19.4	19.0	20.3	18.8
Expenditure on GDP at Market Prices	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

(P) = Projected

Growth Rate and Share in Growth of Different Components of Aggregate Demand

	Share (%) 2005-06*	Growth Rate (%) 2005-06 to 2012-13	Contribution to Growth (%)	Share in Growth (%)
Private Consumption Expenditure	78.0	3.3	2.6	76.5
Government Consumption Expenditure	10.2	3.7	0.4	11.8
Gross Fixed Capital Formation	17.4	-0.8	-0.1	-2.9
Change in Inventories	1.6	3.3	0.0	0.0
Exports of Goods and Services**	13.9	0.8	0.1	2.9
Imports of Goods and Services**	-21.2	-2.5	0.5	14.7
GDP at Market Prices	100.0	3.4	3.4	100.0

*
**
Source: PES

Important impediments to the revival in investment are the energy crisis along with the security situation. These two factors have pulled back Pakistan's economic growth rate by about 2.5 percentage points annually. Power outages have imposed a heavy cost on the economy of Rs.1400 billion in 2011-12, equivalent to almost 7 percent of the GDP (see Table 1.4) as estimated by IPP. This implies that the growth rate of the economy could have been significantly higher in the absence of power load shedding.

Similarly, Pakistan has had to not only suffer total fatalities of over 31000 persons over the period 2003-2010, but the economy has suffered a loss of over Rs 900 billion in 2010-11 due to the direct and indirect costs of terrorism, as quantified by IPP. These costs have increased from Rs 380 billion in 2007-08. Cumulatively, it is estimated that terrorism has cost Pakistan over $ 90 billion, more than three times the support received from the USA and the rest of the international community.

Table 1.4
Costs of Loadshedding

	National Outage Cost (Rs in Billion)	Outage Cost per Kwh	
		(in Rupees)	(in cents*)
I. DIRECT COSTS			
A. Domestic Consumers	**240**	**23**	**23**
Urban Consumers	196	24	24
Rural Consumers	44	18	18
B. Commercial Consumers	**472**	**68**	**69**
C. Industry	**314**	**53**	**54**
Large-scale*	231	54	55
Small-Scale	83	51	52
D. Agriculture	**89**	**29**	**30**
Total	**1115**	**37****	**38**
II. INDIRECT COSTS***	**324**		
TOTAL NATIONAL COSTS OF POWER OUTAGES	**1439**		
GDP 2011-12	20091		
As % of GDP	***7.2***		

*estimated from the earlier IPP study; **weighted by level of consumption; ***estimated at 37% of the costs to the productive sectors
Source: USAID Loadshedding Project IPP (2009)

1.1.2. Macroeconomic Imbalances

Slow economic growth over the last decade has been accompanied by large and growing macroeconomic imbalances, and Pakistan for the first time in its history has experienced stagflation with low growth combined with high inflation. Public finances have deteriorated very significantly and external finances are largely being kept afloat as a result of very large worker remittances. However, today the balance of payments position of Pakistan is precarious.

Driven by a falling tax-to-GDP ratio, mounting public enterprise losses, and persistent subsidies for the power sector, the overall fiscal deficit has increased to an average of 6.5 percent of GDP over the last five years (See Table 1.5). The problem, however, is not only the large size of the deficit but what the deficit finances and how it is financed. Because of the low tax-to-GDP ratio of around 10 percent, government revenues do not cover current expenditures; the revenue account deficit–negative savings on general government account–have averaged 3.5 percent of GDP in the three years 2009-10 to 2011-2 and have been responsible for half of the overall fiscal deficit.

Table 1.5
Summary of (Consolidated) Public Finances of Pakistan (as a % of GDP)**

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Total Revenues	12.2	13.0	13.7	13.3	12.8	13.1	14.0	14.1	14.0	14.0	12.4	12.8	13.0
Tax Revenues	9.7	10.0	10.6	10.2	9.4	9.8	9.6	9.9	9.1	10.1	9.3	10.3	9.6
Non-Tax Revenues	2.5	3.0	3.1	3.1	3.4	3.3	4.4	4.2	4.9	3.9	3.0	2.4	3.4
Total Expenditures	15.8	17.2	17.1	15.5	15.9	17.1	19.5	21.4	19.2	20.2	18.9	21.3	21.0
Current Expenditures	14.2	14.6	15.1	12.6	12.3	12.6	14.9	17.4	15.5	16.7	15.9	17.7	16.0
Development (PSDP)	2.0	2.6	2.5	2.6	3.3	4.4	4.7	4.2	3.6	3.5	2.8	3.6	3.4
Net Lending to PSE's	-0.4	0.0	-0.4	0.3	0.4	0.0	-0.1	-0.3	0.1	0.3	0.0	0.1	1.6
Overall Deficit	4.0	4.0	3.4	2.2	3.1	4.0	4.1	7.3	5.2	6.2	6.5	8.5	8.0

* July to March
**figures for 2012-13 given in Table 1.12.

Source: Fiscal Operations, MOF

The financing of the overall fiscal deficit has relied heavily on what are essentially inflationary means. Total bank financing during 2011-12 averaged over 3.5 percent of GDP, more than half of the fiscal deficit. In 2012-13, bank financing of Rs 1545 billion met nearly 76 percent of the budget deficit. The direct financing of the fiscal deficit by the central bank has been curtailed, but large commercial banks' financing of the government operations has been possible only through large liquidity infusion by OMOs to them by the State bank of Pakistan (SBP). This has resulted in significant monetary expansion. More recently, greater reliance is being placed on deficit financing by the SBP.

1.1.3. Inflation

Consequently, consumer price inflation averaged 12 percent annually during the three years, 2009-10 to 2011-12 (See Table 1.1). However, consumer inflation moderated to 11 percent in 2011-12 and further dropped to 7.4 percent in 2012-13, (in part due to a change in base year of CPI from 2000-01 to 2007-08, with under-reporting in the inflation of house rent and gas prices). The overall public debt which was brought down to 53 percent of the GDP in 2005-06 from a high of 74 percent has again shot up to over 63 percent by 2011-12 (see Table 1.6).

Table 1.6
Composition and Level of Public Debt (% of GDP)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13*
Domestic Debt	36.7	35.8	33.1	31.1	28.4	28.3	30.8	29.2	32.9	34.1	39.2	40.6
External Debt	37.4	33.7	29.7	27.3	24.8	23.8	26.1	28.6	28.7	25.6	25.3	22.1
Total	74.1	69.5	62.8	58.4	53.3	52.1	56.9	57.9	61.6	59.7	64.5	62.7

* July to March
Source: MOF

Table 1.7
Summary of the Balance of Payments of Pakistan

(in Million $)

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Exports	10,397	11,167	13,686	15,103	17,801	20,322	21,418	24,016	23,227	24,902	31124	29731	31364
Exports % of GDP	*13.39*	*14.29*	*15.24*	*14.30*	*15.08*	*14.81*	*14.06*	*14.12*	*13.81*	*14.04*	*14.55*	*13.21*	*13.17*
Imports	14,808	14,078	16,535	17,698	25,557	33,193	45,518	35,299	39,234	38,128	43,580	48,688	47,559
Imports % of GDP	*19.1*	*18.0*	*18.4*	*16.8*	*21.7*	*24.2*	*29.9*	*20.8*	*23.3*	*21.5*	*20.4*	*21.6*	*20.0*
Workers' Remittances	1,087	2,389	4,237	3,872	4,169	4,600	5,494	6,451	7,811	8,906	11,201	13,187	13,920
Workers' Remittances % of GDP	*1.40*	*3.06*	*4.72*	*3.67*	*3.53*	*3.35*	*3.61*	*3.79*	*4.65*	*5.02*	*5.24*	*5.86*	*5.84*
Current Account Balance	-513	1,338	4,070	1,811	-1,534	-4,990	-6,878	-13,874	-9,261	-3,946	214	-4,658	-2,299
Current Account Balance % of GDP	*-0.66*	*1.71*	*4.53*	*1.72*	*-1.30*	*-3.64*	*-4.51*	*-8.16*	*-5.51*	*-2.22*	*0.10*	*-2.07*	*-0.97*
Direct Investment Abroad	322	485	798	949	1,524	3,521	5,140	5,410	3,720	2,201	1,635	821	1,447
Direct Investment Abroad % of GDP	*0.42*	*0.62*	*0.89*	*0.90*	*1.29*	*2.57*	*3.37*	*3.18*	*2.21*	*1.24*	*0.76*	*0.36*	*0.61*
Reserves Million $	1,689	4,337	9,529	10,564	9,805	10,765	13,345	8,577	9,118	12,958	14,784	10,803	6,008
Reserves Million $ % of GDP	*2.18*	*5.55*	*10.61*	*10.00*	*8.31*	*7.84*	*8.76*	*5.04*	*5.42*	*7.30*	*6.91*	*4.80*	*2.52*
Import Cover ratio	1.37	3.70	6.92	7.16	4.60	3.89	3.52	2.92	2.79	4.08	4.07	2.66	1.52

Source: SBP

While the large fiscal imbalances have persisted, the foreign exchange position is an area of great concern. The current account deficit in the balance of payments deficit shot up to $13.8 billion or 8 percent of GDP primarily because of the 'oil shock' in 2007-08, necessitating resort to the IMF Standby Facility (SBF) of $11 billion. Stagnancy in exports and unsustainable imports due to an overvalued exchange rate upto 2008-09 (as indicated by the REER in Table 1.8) put Pakistan's current account under stress, despite the continued growth in worker remittances and disbursements from the Coalition Support Fund (CSF).

Table 1.8
Nominal Exchange Rate* of Pakistan With Respect to the US $ and Euro

Years	US $	% Change	EURO	% Change
2000-01	64.0891		54.4583	
2001-02	60.0729	-6.27	59.484	9.23
2002-03	57.809	-3.77	66.1351	11.18
2003-04	58.1566	0.60	70.2176	6.17
2004-05	59.6738	2.61	72.1451	2.75
2005-06	60.1765	0.84	76.4654	5.99
2006-07	60.4381	0.43	81.8061	6.98
2007-08	68.1684	12.79	107.5847	31.51
2008-09	81.2551	19.20	114.6507	6.57
2009-10	85.3343	5.02	104.1677	-9.14
2010-11	85.9411	0.71	124.5756	19.59
2011-12	94.4204	9.87	118.6534	-4.75

*At the end of period. **October 7, 2013
Source: SBP

The more serious and urgent problem is that the financial account of the balance of payments is coming increasingly under pressure. Due to a decline in direct foreign investment to $800 million from a peak of $5410 million in 2007-08, and tapering off of inflows of long term loans and assistance, the financial account turned negative for the first time in 2012-13. Liquid foreign exchange reserves held by the SBP declined to $ 6 billion by end June 2013, enough to cover only 1.5 months of imports. Pakistan has entered into an agreement with IMF for a 'bail out' through EFF, to sustain the ability to make the large repayments due to the Fund (see at later section)

1.1.4. Employment

The macroeconomic challenges will have to be surmounted if the GDP is to be put back on a high growth trajectory of at least 6 percent, if Pakistan is to absorb productively its labour force, which is increasing at almost 3 percent per annum (see Table 1.9). Currently 3.5 million workers are unemployed. Given the demographic profile, Pakistan is witnessing a youth bulge; 230 million people are projected to be looking for work by the end of 2050. If this youth is not gainfully employed, the 'demographic dividend' for Pakistan has the danger of becoming a 'demographic curse', given the rise of militancy and extremism.

Table 1.9
Labour Participation, Growth Rate of Employment, Unemployment Rate by Gender and Total

Years	Total Population			Labour Force			Unemployed			Employed people		
	Both	Male	Female	Both	Male	Female	Both	Male	Female	Both	Male	Female
2001-02	146.0	75.7	70.33	43.3	36.4	6.9	3.6	2.4	1.1	39.7	33.9	5.8
2002-03	149.3	77.4	71.93	45.0	37.4	7.5	3.6	2.5	1.1	41.4	35.0	6.5
2003-04	152.7	79.1	73.57	46.8	38.6	8.2	3.6	2.5	1.0	43.2	36.0	7.2
2004-05	156.0	80.8	75.21	49.2	40.0	9.2	3.4	2.4	1.0	45.8	37.6	8.2
2005-06	159.5	82.6	76.88	51.7	41.5	10.2	3.2	2.3	1.0	48.5	39.3	9.3
2006-07	162.9	84.3	78.57	52.1	41.4	10.6	2.8	1.9	0.9	49.3	39.6	9.7
2007-08	166.4	86.1	80.28	53.7	42.5	11.2	2.8	1.8	1.0	51.0	40.7	10.3
2008-09	170.0	87.9	82.01	55.9	43.6	12.2	3.0	1.9	1.1	52.8	41.7	11.1
2009-10	173.5	89.8	83.75	57.4	44.4	12.9	3.2	2.0	1.2	54.2	42.5	11.7
2010-11	177.1	91.6	85.51	58.5	45.1	13.3	3.5	2.3	1.2	55.0	42.8	12.2
Average Annual Growth from 2001-02 to 2010-11	**2.17**	**2.14**	**2.20**	**3.39**	**2.43**	**7.54**	**-0.33**	**-0.68**	**0.39**	**3.68**	**2.62**	**8.59**

Source: LFS, PBS

Opportunities also have to be created for women who are in a majority in Pakistan. Furthermore, more education and training opportunities need to be developed to enhance labour productivity, which over the last decade increased by only about 10 percent (see Table 1.10). The overall average real wage increased by only about 3 percent per annum during this period, with wages of a semi-skilled/skilled worker increasing marginally (see Table 1.11). A significant part, over 22 million, of the labour force is in the informal sector, (excluding agriculture) increasing at a rate of 4.6 percent annually.

Table 1.10
Trend in Labour Productivity

	GDP (millions) (at constant prices)	Employment (millions)	Labour Productivity (Rs)
1999-00	-	-	-
2000-01	-	-	-
2001-02	5,945,199	39.7	149,681
2002-03	6,226,156	41.4	150,367
2003-04	6,692,079	43.2	154,994
2004-05	7,291,537	45.8	159,280
2005-06	7,715,777	48.5	158,980
2006-07	8,142,969	49.3	165,149
2007-08	8,549,148	51.0	167,782
2008-09	8,579,987	52.8	162,445
2009-10	8,801,394	54.2	162,348
2010-11	9,123,771	55.0	165,933

Source: PES

Table 1.11
Nominal and Real wages of Different Type of Workers

Years	Nominal Wage			Real Wage Index* At base 2007-08		
	Carpenter	Mason (Raj)	Labour	Carpenter	Mason (Raj)	Labour
2001	252	252	127	71.8	69.5	68.3
2002	252	252	130	69.3	67.1	67.5
2003	264	258	132	70.3	66.6	66.2
2004	293	305	164	74.7	75.3	78.7
2005	329	346	193	76.8	78.2	84.8
2006	384	399	238	83.1	83.6	96.7
2007	448	473	265	89.8	92.0	100.1
2008	558	576	297	100.0	100.0	100.0
2009	570	588	315	87.3	87.2	90.7
2010	596	643	350	83.0	86.6	91.6
2011	656	706	402	80.3	83.6	92.5
2012	703	780	450	77.5	83.2	93.3
Average annual Growth Rate of Real Wage				***0.7***	***1.6***	***2.9***

*Real Wage =Nominal Wage/CPI
Source = PES

1.2 Present Macroeconomic Problems

1.2.1. Balance of Payments

Three issues dominate Pakistan's economic scenario- the fragile external account situation, the burgeoning fiscal deficit and the severe energy shortage. There is need to avoid a type of the financial crisis like 2008 when the 'oil price shock' led to a haemorrhaging of the current account and a rapid depletion of foreign exchange reserves. The currency depreciated sharply from Rs 60 to 80 per dollar and stability was restored only after the release of a large tranche over $3 billion by the IMF under a new Standby Facility in November 2008.

Currently some warning signals are visible. Though the current account was in surplus in the first quarter, July to September of 2012-13, primarily due to a surplus in the services account arising from the large payment from the CSF by the USA. The deficit rose precipitously to $2.3 billion in the next three quarters of 2012-2013. This is not due to any worsening in the trade balance but to the emergence of a deficit in services and a visible fall in home remittances. In the first two quarter of 2013-14, the current account deficit has approached $1.5 billion.

The financial account has been variable in character with a small positive balance except in the month of January 2013. It is noticeable that net inflows of direct foreign investment have turned negative in January and February 2013 indicating some flight of capital from Pakistan. Foreign aid inflows in net terms have been small in magnitude and negative in some months. During the quarter, October to December 2012, there was a large negative outflow, largely of non-resident FCAs from banks.

However, in the first two months of 2013-14, there was a surplus in the financial account of $401 million, but the overall balance of payments was in deficit of $614 million.

Overall, the balance of payments has been in deficit in 2012-13, with a tendency for the deficit to rise in recent months. The deterioration has been exacerbated by repayment of debt to the IMF of $2162 million during the year. Consequently, foreign exchange reserves have fallen by $4596 million. In 2013-14 the repayment to IMF reaches the peak level of $ 3236 million. Thereafter, the burden falls sharply to $1271 million in 2014-15. Projection of the level of foreign exchange reserves in the 'business as usual' scenario (without a new IMF program) shows a fall of reserves to $3.5 billion by September 2013, representing an import (of goods and services) cover of under one month and by December 2013 to $2.5 billion. This explains why Pakistan has finalized a new programme with the IMF.

1.2.2. The Fiscal Position

Turning next to the fiscal position, in 2012-13 the fiscal deficit has been high at 8.0 percent of the GDP, as massive subsidies have had to be given to tackle the problem of exploding circular debt in the power sector. Another major development is the drying up of external resources to finance the deficit and increasingly heavy reliance on domestic borrowing including deficit financing (printing of money) by the SBP. Tax revenues have shown a very low buoyancy with a growth rate of 3 percent. Expenditure growth has been high at 24 percent.

The Federal budget for 2013-14 targets to bring the deficit down to 6.3 percent of the GDP (an adjustment of 2.5 percent of the GDP). This is to be accomplished through an increase in tax revenues from Rs 2007 billion to Rs 2475 billion and a curtailment of current expenditures. However, these are already some worrying developments: 1) tax revenues which materialized in 2012-13 have a shortfall of Rs 65 billion compared to the assumed amount (Rs 1937 billion instead of Rs 2007 billion); 2) salary increase announced for all federal government employees is likely to cost an additional Rs 40 billion; and 3) deficit provincial budgets in 2013-14. These negative factors will imply a higher deficit (around 7.3 percent of the GDP), unless development expenditure is curtailed severely once again, thereby jeopardizing the process of revival of the economy (see Chapter 5).

1.2.3. The Energy Sector

The new government has come up with a new Energy Policy. It has retired circular debt of Rs 480 billion to improve the rate of capacity utilization, and is taking punitive action against theft of electricity to reduce losses. Also, the Prime Minister has undertaken a successful visit of China and has got positive response on infrastructure investments. These investments are necessary for the up gradation of existing plants, conversion to more economical and sustainable fuel mix (currently more than half is on thermal), and investment in additional generation capacity, especially renewable energy. However, important issues in the power sector relating to financing of investments, regulatory framework, pricing policy and distribution policy and curtailment of losses remain unaddressed which can dampen the effectiveness of the energy policy to adequately tackle the shortage.

1.3 The IMF Program

1.3.1. The Extended Fund Facility

The IMF was approached almost immediately by the newly inducted government of PML (N) in view of the low foreign exchange reserves of $6 billion (less than one month's cover) on the 30th of June 2013.

These reserves had fallen by $4.8 billion in 2012-13. Given pending large debt-servicing obligations, especially to the IMF of over $3.2 billion, there was the danger that the country could move sooner or later to a situation of debt default, with major negative consequences on the economy. Therefore, the Government essentially adopted quickly the strategy of 'taking a new loan to repay an old loan'.

The new loan was negotiated with the IMF in July 2013 as part of the Extended Fund Facility (EFF). This facility focuses more on structural reforms and has better repayment terms than the Standby Loan contracted in 2008.

Under the EFF, Pakistan has been given access over a three year period to 425 percent of its SDR quota with the Fund, equivalent to $ 6.6 billion. There were five tough prior actions that had to be taken before the facility became operative, including a heavy dose of taxation in the Budget of 2013-14, hike in power and gas tariffs and a big cut in development expenditure.

The initial release in September was of $544 million. It is envisaged that releases will be made in quarterly instalments following a successful review each time. There are five performance criteria and eleven structural benchmarks in the original letter of intent signed by the Government of Pakistan. Nine of the eleven structural benchmarks are to be met by June 2014. Therefore, while the actions are front loaded, the releases are more back loaded.

The basic strategy in the Program is 'Stabilize first; Revive Later'. As such, ambitious targets have been set, as follows:

(i) Raise foreign exchange reserves from $6 billion at the start of 2013-14 to $9.6 billion by end of the year
(ii) Reduce the fiscal deficit from 8 percent of the GDP last year to 5.8 percent of the GDP in 2013-14.

For stabilization of the balance of payments the principal instrument proposed is depreciation of the rupee, such that the REER falls by 8 percent by end-June 2014. Interest rates are expected to rise in line with any increase in the rate of inflation.

On the fiscal side, the Budget of 2013-14 incorporated taxation proposals expected to increase revenues by almost Rs 200 billion. This included a hike in the GST standard rate (16 to 17 percent, levy of new withholding income taxes and enhancement in direct tax rates. In addition, power tariffs have been enhanced for industrial and commercial consumers by 35 percent on the average in order to reduce the tariff differential subsidy to the power sector. More recently, power tariffs have also been raised for domestic consumers by about 30 percent, except for life-line consumption of up to 200 kwh per month.

1.3.2. Economic Performance under Program

Five months have elapsed since the signing of the agreement and two reviews have been completed. The performance of the economy under the aegis of the Program has been mixed.

At the end of the first quarter of 2013-14, there has been a shortfall in achievement of the foreign exchange reserves target by over $1 billion. Exports have not grown as fast as anticipated and foreign direct investment (FDI) has declined sharply. Inflows from donors have been substantially lower than expected (see Table 1.12). It appears that the presence of the Fund program has not contributed sufficiently to bolstering confidence in the markets.

By end December, foreign exchange reserves have fallen further to only $3.4 billion (less than one month cover) as compared to the original IMF projection of $5.3 billion. It appears that even in the presence of the Fund program, Pakistan continues to move to an increasingly precarious position in its external balance of payments.

In the first review, the Fund Staff determined that one of the performance criteria related to the net international reserves (NIR) had not been met. A waiver was granted by the Executive Board and Pakistan received the second instalment in September.

The second review took place in February in Dubai. Here again, Pakistan has failed to meet two performance criteria relating to the level of borrowing from SBP and the level of swap/forward operations of the Central Bank. The third release of funds depends upon waivers to be granted by the Executive Board, which will meet in end-March.

Table 1.12
Original* Balance of Payments Projections by the IMF and Actual

($ Million)

	1st Half (July – December)			2nd Half (January – June)	
	IMF Projections	Actual	Difference	IMF Projections	Difference**
Current Account	**-1898**	**-1589**	**309**	**290**	**1879**
Exports	13146	12543	-603	14083	1540
Imports	21120	20896	-224	21777	881
Trade Deficit	-7974	-8353	-379	-7694	659
Services (net)	-1127	-1383	-256	239	1622[a]
Remittances	7064	7790	726	7214	-576
Capital Account	**157**	**135**	**-22**	**322**	**187**
Financial Account* **	**1388**	**-408**	**-1796**	**5477**	**5885**
General Government	-225	-366	-141	2061	2427[b]
FDI + FPI	1155	518	-637	2761	2243[c]
Others	458	-560	-1048	655	1215[d]
Balance of Payments	**-351**	**-1862**	**-1511**	**6089**	**7951**
End Period Foreign Exchange Reserves	**5328**	**3478**	**-1850**	**9436**	**5958**

*as contained in the September 12, 2013, IMF Report | **2nd half Projection minus 1st half actual | ***including errors and omissions

[a] receipt of CSF money
[b] higher programme assistance from World Bank, ADB, etc.
[c] privatization receipts + auction of 3G licence
[d] possibility of Eurobond flotation

Source: IMF, SBP

A number of questions arise about the on-going Fund Program: Why has it failed to produce the desired results upto now? What is the economic outlook for the rest of 2013-14? What impact is the stabilization process under the Program having on the poorer segments of Pakistani society?

1.3.3. Risk Factors

The reasons why the Program has failed to achieve the results with regard to the build-up of the foreign exchange reserves lie primarily in the net inflows into the financial account of the BOP. The net inflow was projected at $1.4 billion; instead there has been a net inflow of $0.4 billion (see Table 1.12). This is due primarily to a substantial lower level of foreign direct and portfolio investment and aid from donors. Clearly, the worsening of security conditions has had an impact despite the presence of a business-friendly government in Islamabad.

As opposed to this, the current account of the BOP has performed well. Imports have been lower, while remittances have been substantially higher by over $0.7 billion.

The economic outlook for the second half for 2013-14 looks even more optimistic and unrealistic as implied by the IMF projections. The following improvements are expected:

(i) Exports are expected to be over 12 percent higher than the level attained in the first half of the year.

(ii) As opposed to a deficit of $1.4 billion in the services account the next six months are projected to show a surplus of $0.2 billion, primarily due to inflow of CSF money.

(iii) The biggest change is expected in the financial account. From a deficit of $0.4 billion in the first half of the year this account is expected to yield a massive surplus of $5.5 billion from January to June 2014. Foreign assistance is expected to lead to a net inflow of over $2 billion as compared to net repayment of $0.4 billion from July to December 2013. Similarly, foreign direct and portfolio investment in Pakistan is expected at $2.8 billion, 433 percent higher than in the first half of 2013-14. This is predicated on large privatization receipts and auction of the 3-G licence.

(iv) Based on the optimistic assumptions described above, foreign exchange reserves are projected to increase by almost $ 6 billion over the level in end-December 2013 and reach $9.4 billion by end June 2014. This will represent almost 2.5 months of import cover. If this happens, Pakistan will have averted a financial crisis in the presence of the Fund program.

It must be recognised that the economic outlook hinges on the following inflows from January to June 2014:

(a) CSF money of about $1.2 billion

(b) Privatization receipts of PTCL of $0.8 billion

(c) Sale of 3-G licence of $1.2 billion

(d) Resumption of program assistance of over $2 billion by donors

If one or more inflows do not materialize then the level of foreign exchange reserves will be significantly below the projected level of $9.4 billion. In the worst case scenario, reserves could even fall to below $2.5 billion by end-June 2014.

1.3.4. Impact on the Poor

We take up the issue of whether the IMF program has a 'human face'. The exclusive focus on stabilization, before economic revival, means that growth will not rise significantly above 3 percent in 2013-14. The restraint on growth is likely to be the consequence of a major cut back in the size of the national PSDP, crowding out of the private sector due to lower access to credit and higher interest rates, and the negative impact on production of the higher burden of indirect taxes. The consequence is that the growth in incomes and employment will be limited.

On top of this, the rate of inflation is projected to get back to a double-digit rate due, first, the larger depreciation of the rupee, second, the hike in electricity and gas tariffs and in POL prices and, third, the increase in GST rate. Lower growth in income, higher unemployment and rapid increase in prices, especially of food items, will have a negative impact on the level of poverty in the country.

The Program recognizes that the poor will suffer during the process of stabilization. As such, it builds an up-scaling of the size of the Benazir Income Support Program by about 50 percent to Rs 75 billion in 2013-14. Also, life-line consumption of electricity and gas has been exempted from the tariff increase. But these measures may be inadequate to prevent a rise in poverty.

1.4 Likely Future Developments

As highlighted above, the process of growth in Pakistan has been severely constrained by a number of non-economic and economic factors. Some observers have characterized this as the 'Perfect Storm'. The fundamental question is whether Pakistan can get out of this situation in the next few years.

Of immediate urgency is to manage the external payments position of the country to avoid a potential default situation. Pakistan has reached agreement with the IMF on access to the EFF over the next three years of $6.6 billion.

1.4.1. Structural Reforms

The structural reform agenda over the next three years includes the following:

- i) Restructuring of loss making public entities like PIA, Pakistan Railway, Pakistan Steel Mills (PASMIC), etc., followed in some cases by privatization
- ii) Privatization of some GENCOs and DISCOs in the power sector
- iii) Reinforcement of the autonomy of SBP and imposition of limits to borrowing from the Central Bank
- iv) Strengthening of the functions of regulatory agencies like NEPRA, OGRA, CCP, etc.,
- v) Creation of a secondary market for Government Securities
- vi) Rationalisation of the import tariff structure, with lower maximum tariff, reduction in number of slabs to possibly four and elimination of SROs
- vii) Broadening of the tax base of the Provincial Sales Tax on Services
- viii) Steps towards deregulation to reduce the costs of doing business in Pakistan
- ix) Consensus in the CCI on the generation of cash surpluses by the Provincial Governments.

As highlighted above, there is a real risk that the process of structural adjustment under the future IMF program may impose a disproportionate burden on the lower income groups and exacerbate poverty and malnutrition. If this is to be avoided then the social protection program will have to be substantially expanded.

1.4.2. Economic Outlook

The original macro economic framework for 2013-14 under the IMF program is highlighted in Table 1.13. The fund has recently revised upwards the GDP growth projection to 3.1 percent, while the average rate of inflation is expected to higher at 10 percent. A comparison between the baseline and the Program scenario reveals that in the absence of the Program Pakistan would have had difficulty in meeting its external debt obligations by end-June 2014.

Table 1.13
Macroeconomic Framework for 2013-14 in IMF Program

Variable	Unit	2012-13	2013-14		
			Baseline	Program	Difference
OUTPUT AND PRICES					
Growth of Real GDP at factor cost	%	3.6	3.3	2.5	-0.8
Inflation in Consumer Prices (Average)	%	7.4	8.2	7.9	-0.3
SAVINGS AND INVESTMENT					
Gross National Saving:	% of GDP	13.3	12.5	14.3	1.8
Government	% of GDP	-5.1	-4.5	-2.2	2.3
Private	% of GDP	18.4	16.9	16.5	-0.4
Gross Capital Formation	% of GDP	14.2	14.1	14.9	0.8
Government	% of GDP	3.3	3.3	3.3	0.0
Private	% of GDP	10.9	10.8	11.6	0.8
Balance	% of GDP	-1.0	-1.6	-0.6	1.0
BALANCE OF AYMENTS					
Current Account Balance	$ billion	-2.3	-3.8	-1.3	2.5
Net Capital Flows*	$ billion	-0.1	3.2	4.3	1.1
(FDI)	$ billion	(1.4)	(2.1)	(2.3)	(0.2)
Gross Official Reserves	$ billion	6.0	2.3	9.6	7.3
(Months of Imports)		1.4	0.5	2.2	1.7
EXTERNAL DEBT	**% of GDP**	**26.9**	**26.0**	**27.0**	**1.0**
PUBLIC FINANCES					
Revenue and Grants	% of GDP	13.2	13.0	14.4	1.4
(Tax Revenue)	% of GDP	(9.7)	(9.8)	(10.8)	(1.0)
Expenditure	% of GDP	21.7	20.8	19.9	-0.9
(Current)	% of GDP	(17.0)	(17.4)	(16.6)	(-0.8)
Development (+ Net Lending)	% of GDP	(4.7)	(3.3)	(3.3)	0.0
Primary Balance	% of GDP	-3.9	-3.0	-0.9	2.1
Overall Fiscal Balance	% of GDP	-8.0	-7.8	-5.5	2.3
PUBLIC DEBT	**% of GDP**	**66.6**	**69.2**	**66.6**	**-2.6**
TRADE					
Exports	% growth	0.2	9.6	11.4	1.8
Imports	% growth	-1.6	7.3	6.9	-
MONEY					
Broad Money	% growth	15.9	17.7	13.8	-3.9
Private Credit	% growth	-0.6	8.0	8.5	0.5
MEMO ITEMS					
REER	% change	-6.2	-4.8	-7.7	-2.9
Terms of Trade	% change	-0.4	1.0	-0.1	-1.1
Real Per Capita GDP	% change	1.5	1.3	0.5	-0.8
GDP at market prices	Rs in Billion	22909	25415	25351	-64
GDP at market prices	$ billion	236.5	235.6	229.9	-5.7
Average Exchange Rate	Rs/$	**96.87**	**107.87**	**110.26**	**2.39**
% depreciation			11.4%	13.82%	2.42
Exchange Rate	Rs/$		**111**	**113**	**2**

Source: LFS, PBS

1.5 Alternative Reforms

As highlighted above, if one or more projections of inflows do not materialize then the foreign exchange reserves position will remain vulnerable. The fund may insist on even faster deprecation of the currency, especially through larger purchases from the spot market. This increases the danger of even more inflation, putting thereby a larger burden of the adjustment process on the people.

How can this situation be avoided? The time has come to contemplate some genuine 'home grown' reforms especially as part of contingency planning. In the event, the strategy of short-term expansion of exports of goods and services fails then the alternative may have to be a policy of import compression. Already, exports in the first six months of 2013-14 have grown by only 3 percent. Reserves have fallen to $3.4 billion by the end of December 2013, over $2.6 billion less than at the start of the year.

How can import compression be achieved without affecting significantly the rate of inflation and distorting economic activity? The answer lies in protecting essential imports while achieving a significant cutback in non-essential imports. The former include items like wheat, edible oil, pulses, machinery, fertilizer, medicines and petroleum products. These items accounted for 55 percent of imports in 2012-13.

Excluding essential imports, regulatory duties may be introduced at rates of up to 10 percent. This will impact on 45 percent of the import bill. In addition, while a comprehensive review of SROs is underway, an interim measure should be adopted. In the case of items outside the list of essential imports, if the import is allowed under on SRO at a concessional duty rate more than 5 percentage points less than the statutory rate, then the difference should be restricted to 5 percentage points. On top of this, the import margin requirements on non-essential imports may be raised from 35 percent currently to 60 percent.

This battery of measures has the potential of reducing the non-essential imports bill by almost $2.5 billion. The result will not only be an improvement in the balance of trade but also in larger foreign exchange reserves. Simultaneously, with lower depreciation of the rupee, prices of essential items will rise less and insulate better the bulk of the population from the adverse consequences of the adjustment process.

The IMF generally does not like higher import tariffs and has, in fact, asked for trade liberalization later in the program by reduction in the maximum import tariff rate of 25 percent. However, regulatory duties are recognized by WTO as a legitimate measure in the event of balance of payments difficulties. These duties can be scaled down once foreign exchange reserves rise to safe levels.

The advantage of this 'home grown' package of measures is that it not only leads to an improvement in the balance of payments but also contributes to higher revenues. The suggested move, as a contingency option, could yield almost Rs 100 billion of additional customs duty revenues. On top of this the consequential effects on sales tax and presumptive income tax will yield another Rs 20 billion. Therefore, this measure could help substantially in achieving the ambitious FBR revenue target.

It is surprising that the Government did not adopt this measure in its first Budget, instead of raising the GST rate from 16 percent of 17 percent. The PLM(N) manifesto explicitly proposes the imposition of regulatory duty on non-essential imports.

All in all, the IMF Program has not contributed yet to bolstering confidence and the rupee has depreciated by over 6 percent. Pakistan has to safeguard its position and remain ready to implement 'home grown' measures of the type mentioned above if the situation arises when the targets are not achieved and more action is needed. If however, Pakistan comes close to achieve the IMF projected level of $ 9.4 billion by end June 2014, the more vigorous efforts can be made in 2014-15 to achieve a strong revival of the economy.

Chapter 2: INCOME DISTRIBUTION, CONSUMPTION DEMAND AND INCLUSIVE DEVELOPMENT

2.1 PAST DEVELOPMENTS

2.1.1. Income Distribution

The trend in the Gini Coefficient during the last decade indicates a slight worsening of the income distribution, based on the Household Integrated and Economic Surveys of the PBS (see Table 2.1). A comparison with a sample of Asian countries reveals that income inequality is relatively low in Pakistan (see Table 2.2).

Table 2.1
Trend in the Gini-Coefficient of Pakistan

Years	World Development Indicators	A.R. Kemal [PRSP]			Haroon Jamal [SPDC]		
		Rural	Urban	Total	Rural	Urban	Total
1999-2000							
2000-01							
2001-02	0.30	0.37	0.46	0.41	0.35	0.44	0.41
2002-03							
2003-04							
2004-05	0.31				0.35	0.43	0.41
2005-06	0.33						
2006-07							
2007-08	0.30						
2008-09							
2009-10							
2010-11					0.38	0.41	0.41
2011-12							
2012-13							

Sources:
WDI, World Bank
A.R. Kemal, PRSP. Background Paper, PRSP Secretariat, MoF, GoP
Haroon Jamal, Research Report No.84, SPDC, Karachi.

The Growth Incidence Curve (GIC) between 2001 and 2012 demonstrates, however, that the incremental income has been unevenly distributed, with growth rate of real per capita income in the top quintile twice that of the bottom quintile. Also, the HIES only captures about half of the national income and much of the understatement of income tends to be in the upper quintiles, which significantly understates the Gini Coefficient.

Other indicators of the upper tail of the income distribution reveal much greater concentration. For example, the top 1 percent of farmers own as much as 22 percent of farm land, 41 percent of the tractors and 28 percent of the tube wells. In urban areas, capital/unearned incomes are very unevenly distributed. The top 1 percent of the borrowers from the banking system pre-empt 83 percent of the credit. The less than one million investors in the stock market have seen the value of their shares appreciate by over 14 times since 1999-2000, much faster than the underlying rate of inflation. Dividends paid out by publicly quoted companies rose rapidly during the Musharraf era from 0.7 percent to over 1 percent of the GDP.

Table 2.2
Comparison of Income Inequality in Selected Countries

Country	Year	Gini Coefficient	Share of Top 20% to Bottom 20%
Bangladesh	2010	32.1	4.65
China	2009	42.1	10.08
India	2010	33.9	5.02
Indonesia	2011	38.1	6.30
Malaysia	2009	46.2	11.34
Pakistan	**2008**	**30.0**	**4.16**
Philippines	2009	43.0	8.31
Sri Lanka	2010	36.4	5.78
Thailand	2010	39.4	6.91
Turkey	2010	40.0	8.32
Vietnam	2008	35.6	5.84

Source: WDI, World Bank

Home remittances, foreign and domestic, are estimated currently at between 11 and 13 percent of household incomes. The evidence (see Table 2.3) is that foreign remittances are dis-equalising in character, while domestic remittances play a more equalizing role. Overall, remittances do not impact significantly on the income distribution.

2.1.2. Employment

Turning to the labour market, Pakistan is witnessing a 'youth bulge' and the labour force is expanding rapidly at over 3 percent annually. During the Musharraf period, with high economic growth, the unemployment rate fell significantly from 7.8 percent in 2011-02 to 5.2 percent. With the sharp fall in the GDP growth thereafter, the unemployment rate has risen to 6.0 percent. Youth unemployment is high at over 11 percent and this is a factor contributing to the rise of militancy and crime. It is also estimated that the percentage of the labour force with 'decent' work (remunerated employment for at least 35 hours a week) has fallen from 70 percent to 54 percent.

Table 2.3
Impact of Home Remittances on Income Inequality

	2011-12
Domestic Remittances	
Share of bottom 20%	10
Share of middle 60%	66
Share of top 20%	24
Foreign Remittances	
Share of bottom 20%	2
Share of middle 60%	48
Share of top 20%	50
Pre-Remittances Income	
Share of bottom 20%	11
Share of middle 60%	55
Share of top 20%	34
Post-Remittance Income	
Share of bottom 20%	10
Share of middle 60%	56
Share of top 20%	34

Source: HIES, PBS

The non-agricultural low-wage sectors are primarily in the informal part of the economy and include activities like wholesale and retail trade; community, personal and social services. Growth of employment in the informal sector during the Musharraf period was relatively high at almost 5.5 percent, which has since fallen to 3 percent. Wages in the informal sector are only about two thirds of the average wage in the urban economy.

The latest Labour Force Survey (LFS) of 2012-13 reveals the persistence of the following problems in the labour market:

- 'The Discouraged Worker Effect' on Males
- 'Compulsion to Work' on women even in marginal activities
- Increase in 'open' unemployment Rates
- Rapid increase in number unemployed
- Increasing 'Informalization' of the employed labour force (especially at the margin)
- Employment in agriculture continues to increase
- Extent of Underemployment has increased (in terms of hours worked)
- Share of unpaid family workers has increased (especially women)
- Serious problem in absorbing Youth
- Growing problem of 'Idle' youth
- Declining real wages
- Rising skill premium

The Labour Force Survey reveals that, between 2010-11 and 2012-13, the labour force participation rate of youth (aged from 15 to 19 years) has declined by 1.3 percentage points, highlighting the phenomenon of an increasing number of 'idle youth'. The number of unemployed has increased by 340,000 during the last two years, taking the unemployment rate to 6.2 percent in 2012-13. Underemployment has also risen. Currently, over 16 percent of the employed, work for less than 35 hours a week. Outside agriculture, almost 74 percent of the workers are engaged in the informal sector.

The skill premium in the economy is high (see Table 2.4). Professional managers earn almost three times the average wage while unskilled workers get about two thirds of the average wage. The government has recently announced an increase in the minimum monthly wage from Rs 8000 to Rs 10000 ($94).

Table 2.4
Skill Premium in Pakistan

	Ratio to Average Monthly Income 2011-12
Legislators, Senior Officials and Mangers	2.66
Professionals	2.17
Technicians and Associate Professionals	1.36
Clerks	1.44
Service, Shop and Market Sales Workers	0.88
Skilled Agricultural Workers	0.80
Craft and Related Trade Workers	0.85
Plant and Machine Operators and Assemblers	0.93
Elementary (Unskilled) Occupations	0.68

Source: LFS, PBS

2.1.3. Women's Participation in Labour Force

Table 2.5 highlights the participation rate of women not only in conventional economic activities but also in 'augmented activities'. These include inputs into subsistence agriculture, own construction of dwelling, etc. Most of these activities are home-based. The table indicates that almost 40 percent of women are engaged in 'marginal' economic activities.

Table 2.5
Participation Rates of Women

(Million)

	Population	Crude Activity Rate (%)	Female Labour Force	Augmented Activity Rate (%)	Women in Marginal Activities
TOTAL					
2001-02	70.33	-	-	-	-
2007-08	80.28	-	-	-	-
2010-11	85.51	15.6	13.34 (12.11)* (63.4)**	27.0	9.74
2012-13	89.06	15.6	13.89 (12.52)* (60.5)**	26.3	9.53
RURAL					
2001-02	45.82	-	-	-	-
2007-08	51.49	-	-	-	-
2010-11	53.46	19.4	10.37	35.4	8.55
2012-13	54.73	19.3	10.56	34.4	8.26

- Total labour force of women is 23.4 million, out of which 9.5 million, equivalent to 41 percent, are in 'marginal economic activities'
- 87 percent of the women in marginal economic activities are in the rural areas.
- The employment rate of women in the 'conventional' labour force was 9.22 percent in 2010-11, which has increased to 9.86 percent in 2012-13
- 7.68 million female workers were' contributing family workers' which has changed to 7.57 million in 2012-13

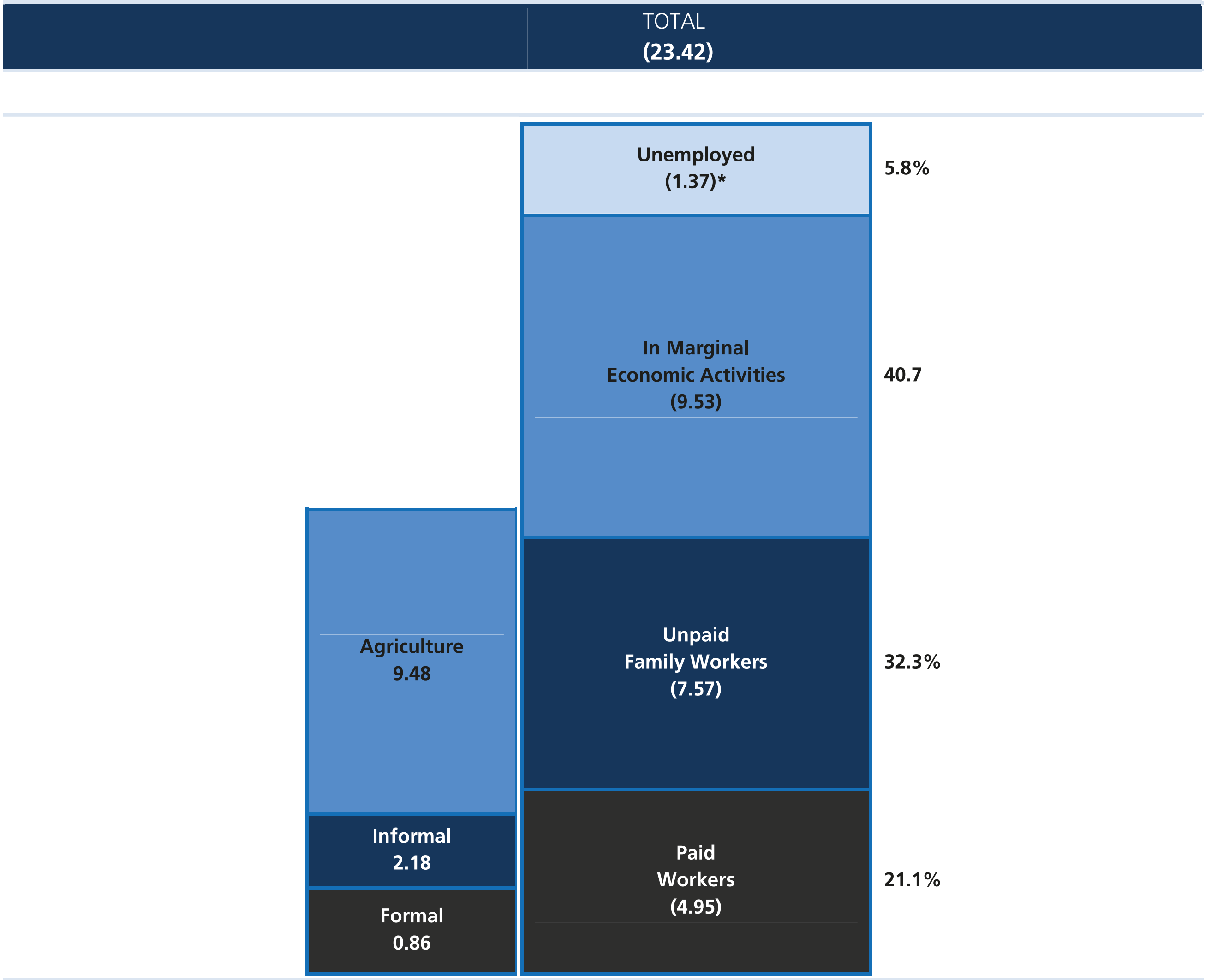
*employed | **share of unpaid family workers

Source: LFS, PBS

Overall, Chart 2.1 indicates that out of the augmented labour force of 23.4 million females in 2012-13, 9.5 million are in marginal activities, 7.6 million are unpaid family workers and only 5 million are paid workers. The unemployment rate within the conventional labour force is high, at almost 10 percent.

Overall, the survey reveals that only 21 percent of women have 'decent work' as compared to over 60 percent in the case of men. Only 4 percent, less than one million, of women have jobs in the 'formal sector'.

Chart 2.1
Distribution of Working Women
2012-13



*figures in millions

- Only 21% of working women have 'decent work' Compared to almost 60% for men
- Only 4% of women have jobs in the 'formal' sector

Source: LFS, PBS

The gender differential in wages is also large. Female workers earn only about two thirds of the income of male workers in identical occupations. The difference is even more pronounced among unskilled workers. The female labour force participation rate is exceptionally low at only 22 percent. In fact, the Gender Development Index (GDI) of the United Nations Development Programme (UNDP) places Pakistan at the bottom of a group of Asian countries, with the exception of percentage of seats in the Parliament. This is due to a measure adopted for increase in reserved seats for women by the Musharraf government.

The trend in real wages for workers of varying levels of skill was positive from 2000 to 2007, with annual increases ranging from 1 percent to 2 percent. Since then they have been declining significantly on average annually (see Table 2.6), with a larger fall in the case of skilled workers.

Table 2.6
Trend in Real Wages* (at 1999-2000 Prices)
ACGR (%)

(Rs per day)

Years	Carpenter	Mason	Unskilled labour
2000	298	298	179
2008	328	356	200
	(1.2%)**	(2.2%)	(1.4%)
2012	263	301	188
	(-5.4%)	(-4.2%)	(-1.5%)

* In Karachi
** Annual Growth Rate
Source: PES, MoF

2.1.4. Incidence of Poverty

The incidence of poverty is a key indicator of trends in the lower tail of the income distribution (see Table 2.7). Pakistan has been successful in reducing poverty rapidly from the late 80s onwards to 2008. Between 2002 and 2008 it is estimated that the incidence of poverty declined sharply. According to the World Bank almost 8 million people were taken out of poverty. Pakistan was one of the few South Asian countries on the track to achieve the Millennium Development Goal (MDG) for poverty reduction. No official estimates of the extent of poverty exist after 2008. A recent study by SPDC indicates that poverty may have risen sharply to almost 37 percent by 2010. The multidimensional poverty index of UNDP reveals that Pakistan is somewhat better placed than India and Bangladesh (See Table 2.8) in overall terms, but behind in education.

Table 2.7
Trend in the Incidence of Poverty of Pakistan

Years	World Bank*		National Poverty Estimates		SPDC**	
	Head Count *(% of Population)*	Poverty Gap (%)	Head Count *(% of Population)*	Poverty Gap (%)	Head Count *(% of Population)*	Poverty Gap (%)
2000						
2001						
2002	35.9	7.9	34.5	n.a.		
2003						
2004						
2005	22.6	4.4	23.9	n.a	29.8[a]	6.5
2006			22.3	n.a		
2007						
2008	21.0	3.5				
2009						
2010					36.6b	7.9
2011						

Sources:
WDI, World Bank
Haroon Jamal, SPDC Research Report No.83, 2013.

	Head Count		Poverty Depth (%)	
	2008	2011	2005	2011
Urban Poverty	27.7	35.5	6.6	8.1
Rural Poverty	30.9	37.1	6.5	7.8

Sources:
WDI, World Bank
SPDC [2012]

Table 2.8
Multidimensional Poverty Index (2000-2009) in a Sample of Countries

Countries	MPI*	Population Multidimensional Poverty		Population at risk of Multi-dimensional Poverty (%)	Population at least one severe Deprivation in			Population below Income Poverty Line	
		Headcount (%)	Intensity of deprivation (%)		Education (%)	Health (%)	Living Standards (%)	PPP (%)	National Poverty (%)
Pakistan	0.264	49.4	53.4	11.0	51.2	29.2	42.9	22.6	22.3
India	0.283	53.7	52.7	16.4	37.5	56.5	58.5	41.6	27.5
Bangladesh	0.292	57.8	50.4	21.2	31.4	53.1	76.3	49.6	40.0
Sri Lanka	0.021	5.3	38.7	14.4	0.5	9.8	26.4	7.0	15.2
Nepal	0.350	64.7	54.0	15.6	38.0	58.3	77.2	55.1	30.9
Indonesia	0.095	20.8	45.9	12.2	12.6	14.4	31.2	18.7	13.3
Philippines	0.064	13.4	47.4	9.1	13.6	14.2	18.2	22.6	26.5
Vietnam	0.084	17.7	47.2	18.5	12.3	10.8	30.1	13.1	14.5
China	0.056	12.5	44.9	6.3	10.9	11.3	12.4	15.9	2.8
Thailand	0.006	1.6	38.5	9.9	12.6	5.6	1.5	10.8	8.1
Turkey	0.028	6.6	42.0	7.3	15.4	16.0	7.3	2.7	18.1
Egypt	0.024	6.0	40.7	7.2	18.0	16.9	0.9	2.0	22.0

*MPI = Multidimensional Poverty Index
Source: UNDP [2012]

Why has poverty risen after 2008? Clearly, the modest growth rate of per capita income of one percent only is a factor. But a major cause of rising poverty is the phenomenal increase in food prices, cumulatively of almost 100 percent, as compared to the rise in the overall price index of 75 percent. A Food Security Index for Pakistan prepared by the MHHDC shows that the index was at its highest value in 1999-2000 and has since fallen by about 9 percent.

The index of human development of UNDP, which increased by 2 percent annually from 2000 to 2008, has shown little improvement since then and Pakistan is back in the group of countries with low level of human development. Another indicator of the worsening trend is the change in real per consumption expenditure in the bottom two quintiles, according to the HIES (see Table 2.9). Between 2007-08 and 2011-12, this has fallen by 18 percent in the bottom quintile and in the next quintile by 11 percent, primarily due to the disproportionate increase in food prices.

Table 2.9
Trend in Real Per Capita Consumption Expenditure in the Two Lowest Quintiles
(Rs.)

Years	Bottom Quintile				Next Quintile				Price Index (2000-01=100)
	Average Family Size (No)	Monthly Consumption Expenditure	Per Capita Expenditure	Real Per Capita Expenditure	Average Family Size (No)	Monthly Consumption Expenditure	Per Capita Expenditure	Real Per Capita Expenditure	
2001-02	8.78	4004	456	440.4	7.97	5011	629	607.5	1.0354
2004-05	8.66	5171	597	489.4 (3.6)*	7.62	6458	848	695.0 (4.6)	1.2198
2005-06	8.74	5954	681	517.3 (5.7)	7.89	7501	951	722.0 (3.9)	1.3164
2007-08	8.57	7485	873	722.4 (18.1)	7.61	9209	1210	919.0 (12.8)	1.5890
2010-11	8.05	11502	1429	585.0 (-6.8)	7.24	14267	1970	806.5 (-4.3)	2.4426
2011-12	8.16	13122	1608	593.0 (1.4)	7.40	16412	2217	817.6 (1.4)	2.7114

Source: HIES, PBS

2.1.5. Regional Disparities

Disparities among the Provinces of Pakistan have been increasing. IPP [2012] has estimated the time series of the Gross Regional Product of each Province from 1999-2000 to 2010-11. The annual growth rates are presented in Table 2.10.

Table 2.10
Growth Rate of the GRP and Sectors by Province
Annual Growth Rate at Constant Prices (%)
(Rs per day)

	Agriculture	Industry	Services	GRP
1999-2000 to 2010-11				
Punjab	2.4	5.6	5.1	4.5
Sindh	2.6	5.3	4.3	4.7
K-PK	2.9	4.8	5.6	4.4
Balochistan	2.7	2.9	2.8	2.8
Pakistan	**2.5**	**5.5**	**5.0**	**4.6**
2007-08 to 2010-11				
Punjab	1.8	5.0	2.8	3.2
Sindh	2.0	-1.6	2.5	1.0
K-PK	3.5	-4.0	5.8	2.8
Balochistan	0.6	1.6	-0.3	0.4
Pakistan	**1.9**	**2.6**	**2.9**	**2.6**

Source: IPP (2012)

During the period, Sindh has shown the fastest growth, followed by Punjab. The province of Balochistan has experienced a significantly lower growth rate of less than 3 percent. This is clearly a reflection of the disturbed conditions in the Province.

The latter period, 2007-08 to 2010-11, shows the impact on growth of the increasing acts of terrorism and the breakdown in the law and order situation in parts of the country like Karachi. Three provinces have been more affected, with the exception of Punjab. Consequently, this Province has shown a relatively high growth rate of over 3 percent. The growth rate of Sindh has plummeted to only 1 percent, with negative growth in industry. The performance of the (Khyber-Pakhtunkhwa (K-PK) economy has also deteriorated. Balochistan continues to have the lowest rate of growth.

More recent estimates are available upto 2012-13 for employment growth in each province. These are shown in Table 2.11. For the period, 2001-0-2 to 2012-13, Sindh has the highest growth rate of 3.5 percent, with a growth rate approaching 5 percent in the Musharraf period. However, during the last five years, Punjab has had a more buoyant labour market, with annual growth rate of 2.5 percent. Labour market conditions have visibly worsened in Sindh and K-PK.

Table 2.11
Annual Growth Rate of Employment by Province

(%)

	2001-02 to 2007-08	2007-08 to 2012-13	2001-02 to 2012-13
Punjab	2.8	2.5	2.6
Sindh	4.9	1.8	3.5
Khyber-Pakhtunkhwa	4.7	0.6	2.8
Balochistan	4.0	2.4	3.3
Pakistan	**3.5**	**2.1**	**2.9**

Source: LFS, PBS

Overall, there has been divergence in per capita incomes since 1999-2000. Punjab has improved its relative position and has displaced Sindh as the Province with the highest per capita income in Pakistan, 7 percent above the national average. K-PK now has a per-capita income 22 percent below the national average as compared to 14 percent less in 1999-2000. Similarly, Balochistan has slipped further and has an estimated per capita income 15 percent below the national average.

Turning to regional differences in the incidence of poverty, MHHDC indicates that the incidence of poverty is the highest in Balochistan, followed by K-PK, while Punjab and Sindh are close to each other and below the national average. This is due primarily to differences in per capita income, with Balochistan 15 percent below the average. Within provinces, disparities among districts are the highest in Sindh, followed by K-PK and Balochistan, and the lowest in Punjab.

2.1.6. Human Development

Following the 18th Amendment, the prime responsibility for education (except higher education in the transitional period) has shifted to the Provincial Governments. Earlier, the 7th National Finance Commission Award in 2010 had led to a substantial increase in Federal transfers to the Provinces. The question is whether the focus on human development through investing in the people has been enhanced by these major developments?

Table 2.12 shows that in real terms transfers increased faster after the NFC Award, by almost 15 percent per annum and total provincial resources (of the four Provincial governments combined) by 12 percent per annum. However, this was reflected primarily in a big jump in current expenditure while real development expenditure has actually declined. Simultaneously, Provincial governments have generally carried cash surpluses in the period after 2009-10.

Table 2.12
Growth in Key Fiscal Magnitudes of the Four Provincial Governments Combined
(at constant prices)

Annual Growth Rate (%)

	Pre – NFC 2007-08 to 2009-10	Post - NFC 2009-10 to 2012-13
Total Revenues[a]	**7.1**	**11.8**
Transfers	1.8	15.2
Provincial Taxes	-0.6	31.1
Provincial Non-Taxes	-2.2	-1.9
Federal Loans and Grants[b]	I	-12.6
Total Expenditure		
Current Expenditure[c]	2.4	9.0
Development Expenditure[d]	0.6	-0.2

[a] deflator is CPI
[b] I = very large from a very small base
[c] Deflator of Public Administration and Defence
[d] Deflator of Gross Fixed Capital Formation

Source: Fiscal Operations, MOF
PES

Table 2.13 gives the expenditure in social services, education and health, by the Provincial governments. Here again, bulk of the growth is in current expenditure of 15 percent in real terms on expenditure on education and 16 percent on health. It is only in the case of health where development expenditure has expanded rapidly by 22 percent per annum, while it has actually declined on education. Overall, there has been an increase of 0.4 percent of the GDP in expenditure on education by Provincial governments and about 0.2 percent of the GDP in health.

The primary reason for the phenomenal increase in current expenditure is the liberal increase in salary and allowances of government employees since 2010-11. Cumulatively, these have increased by over 125 percent as compared to the 75 percent increase in the consumer price index over the last four years. As a consequence, the remuneration of technical personnel doctors and teachers in the social sectors has gone up correspondingly. While some of the increase represents a process of 'catching up', it has 'crowded out' expenditures in the expansion of coverage of basic services.

Table 2.13
Expenditure on Social Services by Provincial Governments
(Rs in Billion)

	2006-07	2009-10	Growth Rate (%)	2012-13	Growth Rate (%)
EDUCATION	**121.3**	**213.0**	**(20.6)**	**408.1**	**(21.6)**
Current	107.7	187.0	(20.2)	371.9	(25.8)
Development	13.6	26.0	(24.1)	36.2	(11.7)
HEALTH	**42.6**	**71.2**	**(18.7**	**149.8**	**(28.1)**
Current	32.1	59.0	(22.5)	119.9	(26.7)
Development	10.5	12.2	(5.1)	29.9	(34.8)
(% OF GDP)					
Education	1.31	1.43		1.78	
Health	0.46	0.48		0.65	
REAL GROWTH (%)					
Education					
Current			7.2		15.1
Development			12.5		-0.9
Health					
Current			9.5		16.0
Development			-6.5		22.2
Source:					

Table 2.14 gives the rate of expansion in the network of educational institutions, pre-and post-NFC Award. There is a visible decline in the rate of increase of facilities in the latter period, with the exception of high schools and arts and science colleges. Consequently, rates of increase in enrolment have also generally shown a fall after 2009-10.

Overall, there is a sense of 'missed opportunity' for a breakthrough in human development after the 18th Amendment and the 7th NFC Award. In fact, Pakistan has slipped in UNDP rankings of countries in the Human Development Index and has now been brought down from a medium to a low level of human development.

Table 2.14
Rate of Expansion of Services
Annual Growth Rate (%)

	2005-06 to 2009-10	2009-10 to 2012-13
NUMBER		
SCHOOLS		
Primary	0.0	-0.6
Middle	1.2	0.6
High	2.0	5.2
SECONDARY VOCATIONAL INSTITUTIONS	**1.1**	**0.8**
COLLEGES		
Arts and Sciences	2.7	11.3
Professional	6.1	-0.7
UNIVERSITIES	**4.4**	**1.7**
ENROLMENT		
SCHOOLS		
Primary	1.4	0.0
Middle	0.9	5.2
High	4.2	2.2
SECONDARY VOCATIONAL INSTITUTIONS	**3.4**	**2.3**
COLLEGES		
Arts and Sciences	7.0	4.3
Professional	1.9	9.7
UNIVERSITIES	**15.7**	**14.4**

Source: PES

2.2 Present Debates and Policies to Change The Income Distribution

The policy generally followed in Pakistan, especially by Military Governments, has been to promote higher economic growth and rely primarily on the 'trickle down' effect, whereby fast growth stimulates employment and leads to increase in real wages. This policy was followed by the Musharraf Government with some success, as indicated above. But the growth process was inherently unsustainable during the period relying on large net aid inflows, expansionary monetary and fiscal policies and a nominally stable exchange rate. This led to the 'dutch disease', with an unprecedented expansion in the level of imports and resultantly very large trade deficits. Reliance was placed on the utilization of excess capacity in power generation and little investment was made to expand the energy sector. Consequently, soon after the departure of this government, one 'oil price' shock was enough to take the economy into a deep financial crisis in 2008, necessitating a large bail out by the IMF. Also, loadshedding of power started and reached crisis proportions by 2008-09.

Therefore, the current debate focuses on finding a strategy for achieving more sustainable and inclusive growth. The PPP government initially took some major steps in this regard like a hike in POL prices, a large devaluation of the rupee, jump in interest rates and shifting the terms of trade in favour of agriculture, primarily by raising procurement/support prices substantially. Some success was achieved with the current account deficit falling to the manageable level of 1 percent of the GDP from 8.2 percent in 2007-08. Wheat production jumped up to 25 million tons in 2010-11 and Pakistan became a net exporter. But industrial production was constrained by the high and rising levels of power load shedding.

Non-economic factors have been among the principal factors responsible for the slowdown in the growth process. The exponential rise in acts of terror and the breakdown in law and order, especially in Karachi, have led to the plummeting of investment, both foreign and domestic, in the economy. In addition, corruption has risen and the quality of governance has deteriorated.

The return to democracy in 2008 has led to a greater emphasis on the use of fiscal policy for redistribution, primarily on the expenditure side. Consequently, social protection programs were put in place, including especially the introduction of the Benazir Income Support Program (BISP), which involved transfers of Rs 1000 per month to women in poor families. Over 3 million families have benefited from this program with, more or less, satisfactory targeting.

In addition, a major effort was made in the Seventh National Finance Commission Award to achieve fiscal equalization by adoption of multiple criteria for horizontal revenue sharing among the provinces, to the benefit of the relatively backward provinces, Balochistan and K-PK. The unanimously passed 18th Amendment builds in a better balance between different institutions, especially through strengthening the judiciary and promotion of decentralization in the performance of functions.

2.2.1. Taxing the Rich

The ultimate litmus test of future tax reforms in Pakistan will be the taxing more of the rich and powerful. Today, they enjoy wide ranging exemptions and concessions, low effective tax rates and can engage in tax evasion with a degree of impunity, frequently in connivance with a corrupt tax administration. The consequence is a low direct tax-to-GDP ratio which has kept the overall tax-to-GDP ratio at extremely low levels in relation to other countries in the region.

Currently, the direct tax-to-GDP ratio is 3.2 percent. It fell last year by 0.3 percent of the GDP, due to a very low growth rate in income tax revenues of only 0.5 percent. This compares with the direct tax-to-GDP ratio of 11 percent in Malaysia, 8 percent in Thailand and 6 percent in Turkey, India and Indonesia respectively. The share of direct taxes in total tax revenues is 33 percent, as compared to between 45 percent to 60 percent in many Asian countries.

The 'honeymoon' period for the rich was the Musharraf era. First, the wealth tax was abolished. Next, the maximum personal income tax rates were brought down from 30-35 percent to 20-25 percent. The corporate tax rate for commercial banks was simultaneously brought down from 47 percent to 35 percent and on private companies from 43 percent to 35 percent. Exemption was granted from taxation of capital gains on securities at a time when the stock market was booming. This decision alone cost the exchequer over Rs 100 billion annually in foregone revenues.

The distribution of the income tax between corporate entities and individuals in Pakistan stands at about 70:30, as compared to about 60:40 on average in other countries. Also, the direct tax system of Pakistan relies heavily, almost 58 percent, on advance taxes, deduction at source and presumptive taxes rather than on the voluntary filing of returns based on self-assessment, followed by random audit. Many of these levies end up taxing the not-so well off rather than the rich. This includes the advance taxes on mobile phones, electricity bills, imports and so on.

The personal income tax structure of Pakistan has only a limited degree of progressivity. No doubt, the maximum tax rates have been raised to 30-35 percent in the Finance Bill of 2013-14. But this maximum rate is reached at a very high level of income, 55 to 60 times of the per capita income, as compared to ten times in India, 15 times in Indonesia and 24 times in Thailand.

What is also not so well known is the high level of corporate tax evasion. The focus generally has been only on personal income tax evasion. According to the SECP, there are almost 60,000 companies in Pakistan. Only about one third file returns, and among those who do less than half declare taxable profits. The enhancement in the minimum tax on turnover of companies in the latest Budget is an appropriate response.

It is estimated that almost 3 million persons in Pakistan earn more than the exempted income of Rs 400,000 annually. But only about one fourth actually file returns. In effect, one in 260 persons files a return in the country as compared to one in 40 persons in India. One of the most frequently quoted statistics is that a large percentage of the Parliamentarians do not file returns.

The tax base for corporate income tax is eroded by almost half due to exemptions, deductions against labour and charitable contributions, lower (presumptive) taxation of exports, etc. While many of these are in the nature of fiscal incentives, they have implied a revenue loss of almost Rs 160 billion. Further, the performance of FBR in raising demands following company audits is weak. In 2012-13, this was Rs 84 billion, showing a drop of 35 percent in relation to the previous year.

The tax base of personal income tax has contracted due to presumptive / fixed taxation of separate blocks of income, low capital gains tax on securities, deductibility of provident fund and life insurance contributions, exemption of pensions and mark up on housing loans, allowance for investment in approved securities, etc. The consequence is that revenue from the personal income tax is less than 1 percent of the GDP.

The Second Schedule of the Income Tax Ordinance has built into the law favoured tax treatment for various persons and sources of income. VIPs including the President, Prime Minister, Federal Ministers, Supreme and High Court judges and senior armed forces personnel are entitled to various tax exempt allowances and perquisites. A number of Foundations/NGOs have been granted the privilege of receiving tax free donations and exemption on business income. Foreign currency account holders have been exempted from any form of taxation. In fact, FCAs have become a conduit via remittances for money laundering.

The biggest failure is in provincial direct taxes. While the agricultural income tax exists on the statutes, it yields only about Rs 1 billion for the four provinces combined. Effective tax rates are very low and enforcement is extremely weak. Believe it or not, the maximum penalty for not filing a tax return is Rs 1000 only (less than $10).

The taxation of property by the Provinces is also very limited. The urban immoveable property tax remains underdeveloped. Rating areas have not been expanded in line with the growth of metropolitan areas. Assessed rental values capture only a fraction of market rental values, less than one fifth. The capital gains tax on property has only recently been introduced.

The Federal Budget of 2013-14 has made a significant effort at raising the revenue from direct taxes, with a target growth rate of over 31 percent. But the primary focus is on taxation more the existing tax payers by enhancing tax rates and expanding the withholding regime along with higher rates. The real challenge is to tackle evasion, both corporate and personal, by increasing the number of tax payers, through the use of collateral evidence and information technology.

Most importantly, FBR has to be insulated from pressures from vested interests and influential persons. This will require conversion of FBR into an autonomous agency with an independent Board. Simultaneously, the capacity in critical areas like intelligence, audit, information technology, accounts, research and statistics, etc., will have to be augmented.

Recently, the Prime Minister has announced a tax incentive/amnesty scheme which essentially runs counter to the taxation proposals announced in the Budget of 2013-14. The scheme has three components as follows:

- (i) Immunity from audit if 25 percent increase in income declaration over last year.
- (ii) Amnesty to NTN holders for non-filing of returns by payment of Rs 20,000 per year
- (iii) Immunity from taxation of money invested in projects in selected sectors.

It needs to be recognised that the root cause of the failure of the tax system of Pakistan is the very limited taxation of the rich and powerful. This has fundamentally affected the level of tax compliance in the country given perceptions of inequity and unequal treatment in the tax laws and in enforcement of existing laws. Within the next three years, the Government must aim to raise the direct tax-to-GDP ratio to 5 percent of the GDP and motivate its own vote bank to pay more taxes, base on a sense of enlightened self-interest.

In addition, there are over 1900 Statutory Regulatory Orders (SROs) which create many holes in taxes like GST, customs duty and excise duty. These SROs largely benefit strong pressure groups and lobbies.

2.2.2. Social Protection

The new government has up-scaled the BISP from Rs 40 to 75 billion and maintained the subsidy of Rs 140 billion or so on life-line consumption of electricity. Overall, the expenditure on social protection programs is about 1.3 percent of GDP (see Chart 2.2). Further, the Prime Minister has announced six special training and employment schemes for youth. The Government of Punjab is contemplating a program of universal health insurance. The PMs youth program has moved slowly because of the difficulty in providing guarantees by potential borrowers.

Chart 2.2
Social Protection Programmes of Governments in Pakistan

(Rs Billion)

	Scheme	Benefits	Financing	Outlay
1.	**SOCIAL SECURITY**			
	• Government Employees Pension fund	• Provident Fund	• Employees' Contribution	34.5*
		• Old Age Pension	• Federal and Provincial Budget	-
	• Employees Old-Age Benefits Institution (EOBI)	• Old Age Pension	• Employees' Contribution	7.5
		• Invalid Pension		
		• Survivor's Pension		
	• Worker's Welfare Fund (WWF)	• Schools	• Employees' Contribution	4.0
		• Hospitals		
		• Housing Facilities	• Employees' Contribution	-
			TOTAL	**46.0**
2.	**CASH ASSISTANCE**			
	• Benazir Income Support Programme (BISP)	• Cash Support	• Federal budget	40.0
	• Zakat	• Cash Support	• Deduction at source on bank deposits	4.8
	• Baitul Maal	• Cash Support	• Federal Budget	2.0
			TOTAL	**46.8**
3.	**SUBSIDY**			
	• Punjab "Sasti Roti' Scheme	• Subsidised *roti (bread)*	• Punjab Budget	10.6**
	• Utility Stores Corporation	• Subsidised price of sugar and other basic items in special outlets	• Federal Budget	4.2
	• Benazir Tractor Support Program	• Tractor at subsidized price	• Federal Budget	2.0
	• Subsidy for Lime-Line			140.0
	Consumption of Electricity and Gas			
			TOTAL	**--------**
4.	**EMPLOYMENT PROMOTION PROGRAMMES**			
	• People's Works Programme	• Wage payments	• Federal PSDP	22.8
	• Grant to PPAF	• Microcredit	• Federal Budget	3.0
	• Yellow Cab Scheme	• Subsidised Credit for Taxis	• Punjab PSDP	4.0***
			TOTAL	**29.8**
	SUMMARY		**Outlay (Rs in Billion)**	
		Social Security	46.0	
		Cash Assistance	46.8	
		Subsidy	156.8	
		Employment Promotion	29.8	
		TOTAL (Rs in Billion)	**27 9.4**	**(1.2%) of GDP**

Notes: *: 25 percent of the total payment of pension by the federal and provincial governments is assumed to be received by low level (retired) civilian employees and soldiers. **: Largely phased out in 2010-11. ***: Starting in 2011-12.

Source: EOBI, FBR, MoP, Pakistan Poverty Alleviation Fund (PPAF), Punjab Budget and State Bank of Pakistan (SBP) (websites).

2.2.3. Privatisation

Pakistan has also decided to implement an ambitious privatization program. One of the structural benchmarks in the IMF Program to be met by September 30 2013 is as follows:

> *'Develop and approve a PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by CCI'*

The Cabinet Committee of Privatization, chaired by the Finance Minister, has decided to focus on different forms of privatisation in some cases) of the following 31 state-owned entities:

i) ***Transport Sector:*** Pakistan Railway and Pakistan International Airlines (PIA)

ii) ***Companies in the Oil and Gas Sector:*** Oil and Gas Development Company (OGDC), Pakistan Petroleum Ltd. (PPL), Pak-Arab Refinery (PARL), Pakistan State Oil (PSO), Sui Southern Gas Company Ltd. (SSGCL) Sui Northern Gas Pipelines Ltd. (SNGPL)

iii) ***Power Sector:*** Islamabad Electricity Supply Company (IESCO), Gujranwala Electricity Supply Company (GESCO), Lakhra Power Plant

iv) ***Financial Sector:*** National Bank of Pakistan (NBP), First Women Bank (FWB), Small and Medium Enterprises Bank, National Investment Trust (NIT), National Insurance Company Limited, Pakistan Reinsurance Company Ltd, State Life Insurance Corporation (SLIC) and House building Finance Corporation

v) Twelve others.

Many of the entities are mega sized and if this process of privatization goes through it will probably represent the largest transfer of assets in the country's history, estimated in the ball-park of Rs 1500 billion (almost $15 billion).

The primary justification given earlier was of divesting loss making companies to reduce the heavy burden of subsidies, approaching Rs 500 billion, especially in the power sector. But, instead, many profitable companies like NBP, OGDC, PPL, PSO SSGCL, SNGPL, SLIC, etc are being partially divested probably to finance the fiscal deficit.

The government has given the assurance that labour interests will be protected in the process of privatization. A ball park estimate of the employment in the 31 PSEs is about 300,000. Given the over employment in entities like Pakistan Railway and PIA, a significant number of workers may be laid off. But this must be done only after proper severance payments are made. The likelihood of such payments would have been greater in the presence of strong trade unions. Unfortunately, the structure of trade unions in Pakistan is very fragmented with about 2000 in number and average membership per union of only about 200.

2.2.4. Empowerment of the People

The 18th Amendment of the Constitution took a major step forward in the process of empowerment of the people by incorporating Article 140A which states:

> *'Each Province shall, by law, to establish a local government system and devolve political, administrative and financial responsibility and authority to elected representatives of local governments'.*

However, the Provinces have been slow to enact laws consistent with the provisions of the above Article. Ultimately, following pressure from the Supreme Court, these laws have been drafted and passed by the respective Provincial Assemblies. Contents of the new laws are summarised as follows:

NEW LOCAL GOVERNMENT LAWS

PUNJAB

- Back to the 1979 structure of local governments with Metropolitan Corporation (in Lahore), Municipal Corporation and Municipal Committee in Urban areas[1] depending upon population size; District Council in rural areas: lowest tier of Union Councils.

  The composition of local councils is as follows:

	Members	Special Representation
Metropolitan Corporation (Lahore)	All Chairman of UCs	women, 25; workers, 5; technocrats, 3; youth, 2; non-Muslims, 10
Municipal Corporation	All Chairman of UCs	women, max 15; workers, 2; technocrats, 2; youth, 1; non-Muslims, max 5
Municipal Committee	directly elected members form wards	women, max 5; workers, 2; youth, 1; non-Muslims, max 3

- Indirect election of Mayer by councillors
- Establishment of District Education Authority and District Health Authority; Chairman appointed by Provincial Government.
- Elections by the Election Commission of Pakistan (ECP)
- Punjab Finance Commission, with only provincial representation, will determine the formula for transfers to local governments
- Punjab Local Government Commission will conduct audit of local governments
- Punjab Local Government Board will be responsible for matters related to the local government service cadre
- Eleven sources of revenue with urban local governments, including tax on urban immoveable property, various rates, tax on professions, fees on services trades and callings; District Councils can levy local rate on lands assessable to land revenue, various fees and taxes.

[1] But no Town Committees

SINDH LOCAL GOVERNMENT ACT, 2013

- Urban areas will have Metropolitan Corporation, Municipal Corporation, District Municipal Corporation, Municipal Committee, Town Committee and Union Committee; rural areas will have District Council and Union Council.
- Composition of the Councils of the Local Governments is as follows: (4 year term)

	Representation	Special Quota
Karachi Metropolitan Corporation*	All Chairman of UCs	women, 22%; workers, peasants, 5%; non-Muslims, 5%
Municipal Corporation	All Chairman of UCs	women, 22%; workers, peasants, 5%; non-Muslims, 5%
Municipal Committee	each elected member from wards	women, 22%; workers, peasants, 5%; non-Muslims, 5%
Town Committee	each elected member from wards	women, 22%; workers, peasants, 5%; non-Muslims, 5%
District Council	All Chairman of UCs	women, 22%; workers, peasants, 5%; non-Muslims, 5%

- Direct election only to UCs. Elections on Party basis. PEC to conduct elections
- A Chief Executive, appointed by Provincial Government
- Local Cess to be levied by Local Councils in rural areas.
- Limited fiscal powers
- The PFC has mostly provincial representation plus one nominee from each type of local government and two private members
- Provincial Local Government Commission will be responsible for audit, inspection, etc.,
- A Sindh Council Unified Cadres service to be constituted
- Functions of Local Governments have been classified into *Compulsory* and *Optional* Functions, as follows:

	Number of Functions	
	Compulsory	Optional
Metropolitan Corporation	18	67
Municipal Corporation, etc.	16	
District Councils	43	70

- Hospitals, Dispensaries and Education are in the *Optional functions.*

KHYBER-PAKHTUNKHWA LOCAL GOVERNMENT ACT

- The structure of local government is as follows:
  - (a) A City District Government for Peshawar
  - (b) A District Government for other districts
  - (c) A TMA for a Tehsil
  - (d) A TMA for a City District
  - (e) A Village Council
  - (f) A Neighbourhood Council for areas with urban characteristics.
- Village and Neighbourhood Councils shall be composed of 10 to 15 members. 2 for women; 1 for youth, 1 for non-Muslims.
- The Law clearly prescribes the functions of the local council of a local government.
- UIPT stands transferred to the TMAs
- The PFC has some local representation
- Local Government Commission will perform the function of supervision of local governments
- Party-based elections, conducted by PEC.
- Elections will be held at all levels of government directly.

Balochistan has effectively reverted to the 1979 Ordinance.

The above Acts reveal a large variation in the extent of devolution to local governments. At one extreme is Punjab, which has established District Authorities for education and health respectively. These are effectively extensions of the Provincial line departments. In between, are the Governments of Sindh and Balochistan. At the other extreme is the Government of K-PK which has carried the process of decentralization down to the village and neighbourhood level.

Local elections have already been held by Balochistan. The process is somewhat delayed in other Provinces due to limitation of constituencies.

2.3 Likely Future Developments

The big issue at this time is can Pakistan achieve inclusive and sustainable growth in years to come? Pakistan has entered into a new IMF program through the EFF for a period of three years? Who is going to bear the burden of structural adjustment? The rich or the poor? What happens if the program falters and Pakistan runs into a financial crisis?

2.3.1. Key Elements of Inclusive Growth

We first identify the key elements of inclusive growth. This requires, first, a focus on areas and sectors where the poor live and work. Second, the sectoral pattern of growth has to be labour-intensive in character such that there are employment opportunities for the expanding labour force. Third, more resources need to be allocated during the process of growth to goods and services which the poor consume. Fourth, priority has to be placed an enhancing human capability. The overall rate of economic growth may be considered as a necessary but not a sufficient condition for inclusive development.

The implications are that the emphasis should be on rural development, both on-farm and off-farm, on food security, on labour-intensive services, manufacturing, construction and exports and on public expenditure on education and health. The primary focus has to be on alleviation of poverty. This also requires a program of social protection for the vulnerable groups, who are outside the mainstream of the economy.

We first assess whether fiscal policy will be successful in achieving a degree of redistribution. Will the tax burden be shifted towards the richer segments of the population and the program of social protection expanded? The prospects for large-scale withdrawal of income tax exemptions and concessions are not very bright given the 'elite capture' of the state. In some ways, the litmus test is whether the Agricultural Income Tax (AIT) will be developed as a significant source of revenue, with yield currently of 0.004 percent of the GDP!

2.3.2. Development Priorities

The next question is which sectors will receive priority in development allocations over the next few years. Clearly, the greatest emphasis will be on the power sector. Substantial investments, up to 3 percent of the GDP, are required annually not only for rehabilitation of the present system but also for changing the fuel mix and for expansion of capacity of power generation, as per the recently announced Energy Policy. If, in addition, some of the mega projects in the area of transport and highways, promoted by the Prime Minister, are implemented then in the presence of limited development funds, there is a real danger that allocations to other sectors will be 'crowded out', especially to education and health.

The likelihood of a large cutback in the Development Program has increased given the emphasis on fiscal deficit reduction in the IMF program. Nevertheless, if loadshedding is incrementally eliminated by 2017, then in the presence of adequate excess capacity in manufacturing, there could be quick response in terms of higher output and employment, consequently absorbing a major part the currently unemployed and thereby reducing poverty.

2.3.3. Prospects for Rural Development

What is the future for agriculture and rural development? More recently, the agricultural sector has run into supply constraints due to lack of increase in irrigation water, substantially higher prices of fertilizer and shortage of electricity for operating tube wells. Consequently, the production of wheat has fallen in 2012-13 by over 6 percent and *atta* prices has shot up by almost 20 percent. Cotton output has been stagnant. Traditionally, the PML-N has focused more on industry and trade, given its urban vote back. It remains to be seen what will be the official response to further deterioration of food security in the country.

2.3.4. Prospects for Labour-Intensive Exports

Labour-intensive exports, especially of agricultural commodities and textiles, hinge on the future prospects for world trade. The last two years have witnessed stagnation in the volume of exports by Pakistan, especially to the USA and EU. Efforts are being made to diversify the destination of exports. This will depend partly upon the extent to which trade is liberalized in South Asia under SAFTA, following the granting of MFN status to India. Trade with countries like China, Afghanistan, the Middle East and Iran has the potential for growing rapidly, subject to the presence of larger export surpluses.

Overall, the medium-run future is uncertain. Prospects for reduction in inequality and poverty hinge crucially on the degree of success in achieving inclusive growth, along with an upsurge in the rate of GDP growth in the next few years.

Chapter 3: WORLD MARKET STRATEGY AND PROTECTION FROM EXTERNAL SHOCKS

3.1 Past Integration into the World Market

3.1.1. Degree of Openness

The low level of integration of Pakistan in the world markets is perhaps a contributing factor to Pakistan's sluggish economic growth. As highlighted in Chapter 1, Pakistan has been struggling with an anemic economic growth rate of only 3 percent in recent years. Greater global and regional integration can be instrumental in setting in motion a self-sustaining process to stimulate the economy and provide gainful employment opportunities to its rapidly growing labour force.

An important feature of Pakistan's history is that it has continued to fall behind other developing countries in export development by not exploiting opportunities for exports offered by the process of globalization. Exports have remained stagnant at around 13-14 percent of its GDP, with few exceptional years (see Table 3.1).

Table 3.1
Exports and imports as % of GDP

Years	Exports	Imports	Trade Deficit
2000-01	13.4	19.1	-5.7
2001-02	14.3	18.0	-3.7
2002-03	15.2	18.4	-3.2
2003-04	14.3	16.8	-2.5
2004-05	15.1	21.7	-6.6
2005-06	14.8	24.2	-9.4
2006-07	14.1	19.9	-5.8
2007-08	14.1	20.8	-6.7
2008-09	13.8	23.3	-9.5
2009-10	14.0	21.5	-7.5
2010-11	14.6	20.4	-5.8
2011-12	13.2	21.6	-8.4
2012-13	13.2	20.0	-6.8

Source: SBP

There are several reasons why Pakistan has not succeeded in the export field. First, export growth was never a central pillar of development strategy as in Korea, Malaysia, and China, and more recently Turkey and Vietnam. Pakistan's development strategy has been oriented towards import substitution rather than export promotion. Development strategies followed by various administrations in the country did not pay attention to having the export sector become one of the drivers of growth as was very successfully done by the "miracle economies" of East Asia.

Table 3.2
Exports by Commodity

	Unit	2003	2007	2011	2012
Total Exports	***($ Million)***	***11160***	***16976***	***25355***	***24657***
	(% Share)	***100.0***	***100.0***	***100.0***	***100.0***
Animal	*($ Million)*	*176*	*248*	*477*	*531*
	(% Share)	*1.6*	*1.5*	*1.9*	*2.2*
Vegetables	*($ Million)*	*954*	*1603*	*3300*	*2899*
	(% Share)	*8.6*	*9.4*	*13.0*	*11.8*
Animal or vegetable fats and oil products	*($ Million)*	*25*	*89*	*122*	*154*
	(% Share)	*0.2*	*0.5*	*0.5*	*0.6*
Prepared foodstuffs, beverages, spirits and vinegar and tobacco products	*($ Million)*	*133*	*258*	*591*	*774*
	(% Share)	*1.2*	*1.5*	*2.3*	*3.1*
Mineral products	*($ Million)*	*277*	*1083*	*2429*	*1820*
	(% Share)	*2.5*	*6.4*	*9.6*	*7.4*
Products of the chemical or allied industries	*($ Million)*	*160*	*209*	*427*	*448*
	(% Share)	*1.4*	*1.2*	*1.7*	*1.8*
Plastics, rubber and articles thereof	*($ Million)*	*123*	*218*	*546*	*630*
	(% Share)	*1.1*	*1.3*	*2.2*	*2.6*
Raw hide and skins, leather and Fur skins, Travel goods	*($ Million)*	*693*	*979*	*1116*	*1141*
	(% Share)	*6.2*	*5.8*	*4.4*	*4.6*
Textiles and textile articles	*($ Million)*	*7794*	*11014*	*13229*	*13181*
	(% Share)	*69.8*	*64.9*	*52.2*	*53.5*
Footwear, headgear, umbrellas, walking sticks and articles thereof	*($ Million)*	*87*	*118*	*94*	*98*
	(% Share)	*0.8*	*0.7*	*0.4*	*0.4*
Articles of stone, cement, ceramic, glass , asbestos and products thereof	*($ Million)*	*31*	*60*	*124*	*84*
	(% Share)	*0.3*	*0.4*	*0.5*	*0.3*
Natural or cultured pearls, precious metals, stones and articles thereof	*($ Million)*	*25*	*48*	*166*	*218*
	(% Share)	*0.3*	*0.4*	*0.5*	*0.3*
Base metals and articles thereof	*($ Million)*	*81*	*240*	*642*	*743*
	(% Share)	*0.7*	*1.4*	*2.5*	*3.0*
Machinery and mechanical appliances electrical equipments and parts thereof	*($ Million)*	*64*	*205*	*281*	*258*
	(% Share)	*0.6*	*1.2*	*1.1*	*1.0*
Optical, photographic medical or surgical instruments, clock , watches musical instruments etc.	*($ Million)*	*159*	*199*	*312*	*321*
	(% Share)	*1.4*	*1.2*	*1.2*	*1.3*
Miscellaneous manufactured articles thereof	*($ Million)*	*334*	*315*	*490*	*485*
	(% Share)	*3.0*	*1.9*	*1.9*	*2.0*

Source: SBP

3.1.2. Export Performance

Pakistan has laid excessive focus on its principal manufactured exports, textiles and clothing (see Table 3.2). This sector was artificially supported for a long period through the setting of the domestic price of cotton below the international price by an export duty on cotton. The record in fast expanding other manufactured exports like sports goods, surgical equipment, automotive parts jewellery etc, has been poor and their presence in international markets for manufactured goods is negligible. Furthermore, because of the slow growth in productivity, there has been inadequate investment in moving up the value chain in textiles and clothing.

Pakistan's export competitiveness has suffered due to the overvalued exchange rate, especially during the Musharraf years. Pakistan's currency has adjusted somewhat since then but not enough as indicated by the rise in REER (see Table 3.3).

Table 3.3
Movement in NEER and REER

End of Period	NEER Index	% Change	REER Index	% Change
2001	111.46		96.29	
2002	110.94	-0.46	98.89	2.71
2003	107.49	-3.11	95.58	-3.35
2004	104.76	-2.53	98.19	2.74
2005	100.45	-4.12	100.09	1.93
2006	98.04	-2.4	101.83	1.75
2007	93.83	-4.29	101.44	-0.39
2008	78.90	-15.91	98.24	-3.16
2009	69.55	-11.85	94.03	-4.28
2010	67.74	-2.6	100.20	6.56
2011	61.75	-8.84	99.79	-0.41
2012	59.33	-3.92	104.35	4.57
2013-April	56.69	-0.29	102.30	0.77

Source: SBP

Because of political tensions, trade with its large neighbour India, which historically was country's natural trading partner, is quite limited (see Table 3.4). Pakistan's total exports to India, despite recent positive movements from both sides of the border, still stand at only about US$348 million. Pakistan's trade within the SAARC region accounts for less than 5 percent of Pakistan's exports and imports. Likewise, Pakistani exports have also not penetrated the ASEAN countries, with less than 3 percent share. However, the share in imports is higher at over 10 percent (See Table 3.5).

Table 3.4
Pakistan's Trade with Neighbouring Countries

	2000	2005	2006	2011	2012	2013(P)
AFGHANISTAN						
Imports	39	53	65	200	235	45
Exports	124	1065	992	2660	2099	1059
Trade	163	1118	1056	2860	2334	1103
BANGLADESH						
Imports	37	68	56	83	59	59
Exports	142	234	267	947	696	678
Trade	179	302	323	1030	755	737
SRI LANKA						
Imports	36	59	71	61	83	67
Exports	82	154	178	348	301	345
Trade	118	213	249	409	384	412
CHINA						
Imports	550	2349	2915	6471	6688	4762
Exports	245	436	507	1679	2620	2698
Trade	795	2785	3422	8150	9308	7459
IRAN						
Imports	335	363	443	304	120	22
Exports	17	178	179	153	142	94
Trade	351	542	622	457	262	116
INDIA						
Imports	183	577	1115	1607	1573	1677
Exports	65	337	327	273	348	328
Trade	248	914	1442	1880	1921	2005
TOTAL						
Imports	1180	3470	4665	8725	8758	6631
Exports	674	2404	2448	6060	6206	5202
Trade	1854	5874	7113	14786	14965	11833

(P) Projected
Source: SBP, UNCOMTRADE

Table 3.5
Distribution of Destination of Exports

(% share)

Years	Developed Countries			Developing Countries Exports							Total
	Other European Countries	OECD Exports	Total	OIC	SAARC	ASEAN	Other Asian Countries	Others	Total	CMEA*	
1999-00	0.4	60.6	61.0	14.1	3.2	2.8	12.4	6.1	38.6	0.4	100
2000-01	0.4	56.3	56.7	16.5	2.9	3.6	13.0	6.9	42.9	0.4	100
2001-02	0.5	57.6	58.1	19.2	2.5	2.7	11.4	5.6	41.4	0.5	100
2002-03	0.5	55.6	56.1	22.3	2.4	2.9	9.9	5.8	43.3	0.6	100
2003-04	0.7	57.6	58.2	20.7	3.2	2.7	9.4	5.1	41.1	0.7	100
2004-05	0.7	55.2	55.9	21.9	4.6	2.1	8.7	5.9	43.2	0.9	100
2005-06	0.9	53.8	54.7	23.3	4.4	1.7	8.9	6.1	44.4	0.9	100
2006-07	0.9	53.8	54.7	21.6	4.8	1.9	9.2	6.7	44.2	1.1	100
2007-08	1.0	50.0	51.0	26.4	4.4	1.7	8.4	6.9	47.8	1.2	100
2008-09	0.9	45.5	46.4	30.4	5.0	2.1	8.5	6.4	52.4	1.2	100
2009-10	0.9	42.8	43.7	29.1	5.4	2.8	11.2	6.6	55.1	1.2	100
2010-11	1.0	42.3	43.3	28.3	6.5	2.3	11.8	6.5	55.4	1.3	100
2011-12	1.1	39.2	40.3	28.8	5.4	3.0	14.5	6.6	58.3	1.4	100
2012-13(P) *(Jul-Mar)*	1.1	39.0	40.1	27.7	5.6	2.8	15.4	6.8	58.3	1.6	100

(P) = Projected
*Council for Mutual Economic Assistance.
Source: PES

Clearly, Pakistan's record of integration, especially of penetrating regional markets, has been weak. It has also not availed fully the potential of close relationship with China and the FTA to promote exports: indeed it has a large trade deficit with its large neighbour. Currently, Pakistan's imports from China are at over US$ 6 billion while its export are less than are US$3 billion. Penetration by Chinese products has, in fact, adversely affected a number of industries in Pakistan see later section.

The other neighbour Pakistan has not been able to fully develop a trading relationship with, partly because of international sanctions more recently, is Iran, though there is preferential trade agreement between the two countries. Trade with Iran has declined in recent years. Other countries with whom Pakistan has preferential/free trade agreements are Afghanistan, Malaysia, Sri Lanka, and Mauritius. Exports to Afghanistan have expanded rapidly and are now almost $ 2 billion. Also, an important trading relationship has developed with the UAE, especially Dubai.

3.1.3. Growth in Imports

Turning next to the structure of imports, total imports of Pakistan currently stand at US$ 40 billion, increasing at a rate of 14 percent per annum (see Table 3.6). The boost in imports in the middle of the last decade was partly because of the artificial appreciation of the currency as can be seen from Table 3.3. This acceleration in imports, induced by the "*dutch disease*" phenomenon, resulted in the current account crisis faced by the country in 2007-08 soon after, which resulted in a 35 percent devaluation of the rupee in two years.

Major imports of Pakistan as shown by Table 3.6, these include mineral and chemical products and machinery. Petroleum and petroleum products being the major import, over a third to 40 percents of the country's imports have originated in the Organization of Islamic Countries (OIC) while a quarter to a third have come from the developed countries (see Table 3.7).

3.1.4. Home Remittances

As mentioned in Chapter 1, the BOP situation was partially salvaged by home remittances, currently at US$ 13 billion. These have played a key role in providing a cushion to the external accounts, with an average growth rate of 20 percent over the last decade. A significant share of these is remitted from the Middle Eastern countries; USA and UK (see Table 3.8).

Table 3.6
Imports by Commodity

	Unit	2003	2006	2011	2012
Total Exports	***($ Million)*** ***(% Share)***	**12220** **100.0**	**28581** **100.0**	**35872** **100.0**	**40138** **100.0**
Animal or vegetable fats and oil products	*($ Million)* *(% Share)*	668 5.5	819 2.9	2028 5.7	2629 6.5
Prepared foodstuffs, beverages, spirits and vinegar and tobacco products	*($ Million)* *(% Share)*	61 0.5	945 3.3	1002 2.8	470 1.2
Mineral products	*($ Million)* *(% Share)*	3230 26.4	7054 24.7	13086 36.5	14999 37.4
Products of the chemical or allied industries	*($ Million)* *(% Share)*	1801 14.7	3216 11.3	4289 12.0	5272 13.1
Plastics, rubber and articles thereof	*($ Million)* *(% Share)*	600 4.9	1394 4.9	1761 4.9	1922 4.8
Pulp of wood, paper, paper board and articles thereof	*($ Million)* *(% Share)*	221 1.8	434 1.5	515 1.4	558 1.4
Textiles and textile articles	*($ Million)* *(% Share)*	611 5.0	1295 4.5	2515 7.0	2041 5.1
Base metals and articles thereof	*($ Million)* *(% Share)*	720 5.9	2409 8.4	2031 5.7	2340 5.8
Machinery and mechanical appliances electrical equipments and parts thereof	*($ Million)* *(% Share)*	2221 18.2	6009 21.0	3791 10.6	3738 9.3
Vehicles, aircrafts, vessels and associated transport equipments	*($ Million)* *(% Share)*	714 5.8	2319 8.1	1668 4.6	1941 4.8
Optical, photographic medical or surgical instruments, clock , watches musical instruments etc.	*($ Million)* *(% Share)*	158 1.3	354 1.2	301 0.8	326 0.8

Source: SBP

Table 3.7
Distribution by Origin of Imports

(% share)

Years	Developed Countries			Developing Countries Exports							Total
	Other European Countries	OECD Exports	Total	OIC	SAARC	ASEAN	Other Asian Countries	Others	Total	CMEA*	
1999-00	0.6	36.3	36.7	36	1.9	10.2	10.3	3.7	62.1	1.2	100
2000-01	0.5	30.5	31.0	39.3	2.9	10.6	10.6	4.7	68.1	0.9	100
2001-02	0.6	33.7	34.3	35.2	2.4	11.7	10.9	4.4	64.6	1.1	100
2002-03	0.9	33.5	34.4	35.2	1.9	12.2	12.5	3.0	64.8	0.8	100
2003-04	0.8	34.7	35.5	33.7	3.1	11.1	12.3	5.1	63.3	1.2	100
2004-05	3.3	34.7	38.0	29.2	3.2	10.0	13.7	5.9	59.9	2.1	100
2005-06	1.8	32.4	34.2	33.7	3.3	9.1	13.7	6.1	63.6	2.2	100
2006-07	1.8	31.5	33.3	32.0	4.5	9.5	15.9	6.7	64.9	1.8	100
2007-08	3.1	27.1	30.2	33.4	5.0	9.9	15.7	6.9	68.4	1.4	100
2008-09	1.3	27.8	29.1	33.9	3.8	10.4	15.2	6.4	67.8	3.1	100
2009-10	1.0	25.3	26.3	37.4	3.9	11.4	16.3	6.6	72.5	1.2	100
2010-11	0.6	21.6	22.2	38.0	4.7	11.9	17.8	6.5	76.7	1.1	100
2011-12	1.1	19.9	21.0	40.8	3.7	11.8	18.3	6.5	77.9	1.1	100
2012-13(P) *(Jul-Mar)*	1.1	22.3	23.4	38.1	5.0	10.9	18.1	6.8	76.4	0.2	100

(P) = Projected
*Council for Mutual Economic Assistance.
Source: PES

Table 3.8
Level of Home Remittances by Source, 1999-2000 to 2012-13

	Unit	2000	2005	2012	2013(P)
Bahrain	*$ Million*	29	91	211	212
	% Share	*3.0*	*2.2*	*1.60*	*2.05*
Canada	*$ Million*	4	48	178	136
	% Share	*0.4*	*1.2*	*1.35*	*1.32*
Kuwait	*$ Million*	135	215	583	459
	% Share	*13.7*	*5.2*	*4.42*	*4.44*
Qatar	*$ Million*	13	87	319	239
	% Share	*1.4*	*2.1*	*2.42*	*2.31*
Saudi Arabia	*$ Million*	310	627	3687	2979
	% Share	*31.5*	*15.0*	*27.96*	*28.77*
Oman	*$ Million*	46	119	383	286
	% Share	*4.7*	*2.9*	*2.90*	*2.76*
U.A.E.	*$ Million*	148	713	2849	2086
	% Share	*15.0*	*17.1*	*21.60*	*20.15*
Abu Dhabi	*$ Million*	47	153	1368	1131
	% Share	*4.8*	*3.7*	*10.37*	*10.93*
Dubai	*$ Million*	87	533	1411	915
	% Share	*8.8*	*12.8*	*10.70*	*8.83*
Sharjah	*$ Million*	13	26	67	39
	% Share	*1.3*	*0.6*	*0.51*	*0.38*
U.K.	*$ Million*	73	372	1521	1435
	% Share	*7.4*	*8.9*	*11.54*	*13.86*
U.S.A	*$ Million*	80	1294	2334	1637
	% Share	*8.1*	*31.0*	*17.70*	*15.81*
Total	*$ Million*	**984**	**4169**	**13187**	**10354**
	% Share	**100**	**100**	**100**	**100**

Source: PES

3.1.5. Capital Inflows

As far as the financial account is concerned, as mentioned earlier, the FDI pipeline has tapered off after reaching a peak in 2007 and 2008 (see Table 3.9). Bulk of the investment has come from USA and UK, with a rising share of the latter (see Table 3.9). Telecommunications, along with oil and gas exploration and the financial sector, has attracted a high share of FDI (see Table 3.10). Because of the deterioration in the business environment, Pakistan has not attracted much FDI in recent years, despite the liberal capital repatriation policy and absence of capital controls. Today, Pakistan is in a situation, whereby in some major sectors repatriation of profit is more than the net inflow of FDI, implying a flight of capital. This is clearly visible in sectors like beverages, petroleum refining, power and telecommunication sectors (see Table 3.11).

Table 3.9
Level of FDI by Source

Country	Unit	FY00	FY05	2011	2012
China	*$ Million*	10.5	0.4	47.4	126.1
	% Share	*2.2*	*0.0*	*2.9*	*15.4*
Hong Kong	*$ Million*	0.5	32.3	125.6	80.3
	% Share	*0.1*	*2.1*	*7.7*	*9.8*
Italy	*$ Million*	17.7	0.4		200.1
	% Share	*3.8*	*0.0*	*0.0*	*24.4*
Japan	*$ Million*	28.6	45.2	3.2	29.8
	% Share	*6.1*	*3.0*	*0.2*	*3.6*
Netherlands	*$ Million*	10.7	36.7	7.7	22.3
	% Share	*2.3*	*2.4*	*0.5*	*2.7*
Saudi Arabia	*$ Million*	3.4	18.4	-44.3	- 79.9
	% Share	*0.7*	*1.2*	*-2.7*	*-9.7*
Singapore	*$ Million*	-	8.0	69.5	- 61.0
	% Share	*0.0*	*0.5*	*4.3*	*-7.4*
Switzerland	*$ Million*	1.7	137.5	110.5	129.9
	% Share	*0.4*	*9.0*	*6.8*	*15.8*
U.A.E.	*$ Million*	3.2	367.5	238.1	36.8
	% Share	*0.7*	*24.1*	*14.6*	*4.5*
U.K	*$ Million*	40.1	181.5	207.0	205.8
	% Share	*8.5*	*11.9*	*12.7*	*25.1*
U.S.A.	*$ Million*	166.9	326.0	284.2	227.7
	% Share	*35.5*	*21.4*	*17.4*	*27.7*
Total	*$ Million*	**469.9**	**1524.0**	**1634.8**	**820.6**
	% Share	**100**	**100**	**100**	**100**

Table 3.10
Foreign Direct Investment Classified by Economic Groups

($ Million)

ECONOMIC GROUPS	2001-02	2005-06	2012-13(P)
1. Food	8	51	498
2. Food Packaging	0	2	39
3. Beverages	-14	6	38
4. Tobacco & Cigarettes	1	2	45
5. Sugar	0	5	5
6. Textiles	18	47	12
7. Paper & Pulp	1	0	0
8. Leather and Leather Products	1	4	4
9. Rubber and Rubber Products	0	5	1
10. Chemicals	11	63	110
11. Petro Chemicals	2	10	8
12. Petroleum Refining	3	31	143
13. Mining & Quarrying	7	7	2
14. Oil & Gas Explorations	268	313	565
Of which Privatization proceeds	**117**		**0**
15. Pharmaceuticals & OTC Products	7	34	20
16. Cosmetics	0	1	0
17. Fertilizers	0	-108	0
18. Cement	0	39	8
19. Ceramics	0	0	3
20. Basic Metals	0	3	1
21. Metal Products	0	4	3
22. Machinery Other than Electrical	0	1	3
23. Electrical Machinery	10	2	14
24. Electronics	16	18	32
a) Consumer/Household	13	8	23
b) Industrial	3	10	9
25. Transport Equipment *(Automobiles)*	1	33	27
a) Motorcycles	1	3	0
b) Cars	0	27	23
c) Buses, Trucks, Vans & Trail	0	3	4
26. Power	36	321	163
a) Thermal	30	320	115
Of which Privatization proceeds	**0**	**255**	**0**
b) Hydel	7	1	47
c) Coal Based	0	0	1
27. Construction	13	90	50
28. Trade	34	118	59
29. Tourism	0	3	100
30. Transport	21	18	1
31. Storage Facilities	0	0	13
32. Communications	13	1938	188
a) Telecommunications	6	1905	157
Of which Privatization proceeds	**0**	**1186**	**0**
b) Information Technology	6	30	32
i) Software Development	4	5	16
ii) Hardware Development	0	1	1
iii) IT Services	2	24	15
c) Postal and Courier Services	0	2	0
33. Financial Business	4	329	389
Of which Privatization proceeds	**0**	**99**	**0**
34. Social Services	2	3	7
35. Personal Services	8	62	32
36. Others	13	66	67
Total	**485**	**3521**	**2653**
Total without Privatization	**368**	**1981**	**2653**

(P) Projected
Source: SBP

Table 3.11
Repatriation of Profit / Dividend by Sectors

($ Million)

Sr.	Sector	FY12		FY13		% Change
		FDI Net	Repatriation of Profit	FDI Net	Repatriation of Profit	
1	Food	13.6	78.3	493.7	84.3	7.7
2	Food Packaging	2.0	4.7	39.0	9.1	92.8
3	Beverages	27.8	54.0	20.0	68.5	26.8
4	Tobacco & Cigarettes	(3.3)	5.4	0.4	16.0	197.6
5	Sugar	0.6	1.0	4.8	1.0	6.2
6	Textiles	29.8	3.4	10.0	4.0	16.0
7	Paper & Pulp	1.5	4.7	0.3	4.8	1.3
8	Leather & Leather Products	8.7	1.0	4.5	2.8	179.2
9	Rubber & Rubber Products	1.7	3.9	1.4	1.4	(63.8)
10	Chemicals	96.2	45.5	(47.6)	56.3	23.8
11	Petro Chemicals	16.5	13.2	8.1	13.8	4.6
12	Petroleum Refining	14.7	113.2	106.8	118.5	4.6
13	Mining & Quarrying	7.3	-	2.0	-	-
14	Oil & Gas Explorations	629.4	44.4	559.6	45.0	1.4
15	Pharmaceuticals & OTC Products	2.0	23.1	15.8	26.3	13.8
16	Cosmetics	0.2	-	-	0.0	-
17	Fertilizers	0.3	17.5	0.2	14.9	(15.1)
18	Cement	(11.0)	6.3	8.1	17.9	186.6
19	Ceramics	0.3	0.3	3.4	-	(100.0)
20	Basic Metals	3.8	-	1.3	-	-
21	Metal Products	18.8	0.1	3.2	0.1	-
22	Machinery other than Electrical	(5.2)	0.9	2.6	8.2	857.0
23	Electrical Machinery	8.3	0.0	12.0	0.0	(25.0)
24	Electronics	22.8	3.1	20.8	8.1	163.1
	I) Consumer/Household	5.4	-	14.9	2.1	-
	II) Industrial	17.4	3.1	5.9	5.9	93.8
25	Transport Equipment(Automobiles)	31.6	19.1	25.1	31.1	63.0
	I) Motorcycles	-	-	-	-	-
	II) Cars	21.6	13.9	21.7	24.3	75.0
	III) Buses, Trucks, Vans & Trail	10.1	5.3	3.4	6.9	31.0
26	Power	(84.9)	143.2	28.4	85.6	(40.2)
	I) Thermal	(96.2)	143.2	(17.9)	85.6	(40.2)
	II) Hydel	11.3	0.0	45.7	-	(100.0)
	III) Coal	-	-	0.6	-	-
27	Construction	72.1	1.3	46.0	0.7	(43.9)
28	Trade	25.4	7.2	5.7	9.1	27.7
29	Transport	18.7	8.8	44.1	75.0	748.9
30	Tourism	-	106.5	-	-	(100.0)
31	Storage Facilities	0.2	13.7	13.9	7.6	(44.5)
32	Communications	(312.6)	56.0	(385.7)	14.5	(74.2)
	1) Telecommunications	(358.7)	54.8	(408.1)	14.4	(73.7)
	2) Information Technology	46.1	0.0	23.6	0.1	250.0
	I) Software Development	16.8	0.0	7.7	0.1	250.0
	II) Hardware Development	1.0	-	1.1	-	-
	III) I.T.Service	28.3	-	14.8	-	-
	3) Postal & Courier Services	-	1.2	(1.2)	-	(100.0)
33	Financial Business	64.4	247.6	314.2	314.2	26.9
34	Social Services	3.6	0.1	7.3	0.1	(10.0)
35	Personal Services	21.2	9.2	17.7	9.7	5.6
36	Others	94.3	24.7	60.3	30.0	21.4
	Total	**820.7**	**1,061.3**	**1,447.3**	**1,078.6**	**1.6**

Source: SBP

3.2 Present Debate about Integration In The World Markets

There appears to be a realization by the policy makers that Pakistan needs to push up its growth rate while stabilizing the macro economy. While efforts are underway to negotiate an Extended Financing Facility (EFF) with the IMF to overcome the dangerous threat of default, attention has to be given simultaneously to find sustainable mechanisms of improving the BOP position. The country can and must try to regain some of the export ground it has lost over the years by not just setting ambitious goals but even more important, by developing policies and programmes, monitoring mechanisms and reversing the inward orientation and anti-export bias that has characterized its trade policy regime in the past.

3.2.1. Trade with India

The gravity model of trade suggests that Pakistan should trade more with the large countries in its immediate neighbourhood—China and India. The thawing in the relations between these two South Asian nations in 2012 should add significantly to their trade and growth, especially if India opens its agriculture and textiles to Pakistan under SAFTA after the granting of MFN status by Pakistan. The possibilities of expanding trade with India need to be followed up urgently and diligently. While there may be losers and winners resulting from this trade expansion, the overall impact on Pakistan is likely to be positive. The proponents of Indo-Pak trade highlight the savings in the import bill, resulting in reduction in landed prices and consumer welfare gains and larger exports as a major advantage of opening up of trade with the Eastern neighbour (see Table 3.12). It is however, extremely important that India reciprocates by relaxing the tariff and non-tariff barriers for commodities in which Pakistan has a comparative advantage (agriculture and textiles).

3.2.2. Trade with China

At the same time to deal with the large negative balance with China, public policy should aim to develop supply chains that will link up with China's large industrial sector. These chains should take advantage of the entrepreneurship that exists in the sector of small and medium scale entrepreneurs. (See Box 3.1 for the FTA with China).

Table 3.12
Product-wise Savings in Import Bill, Reduction in Landed Price and Consumer Welfare Gains due to Normalization of trade with India

HS Code	Description	Savings in Import Bill* ($ Million)	% Reduction in Landed Price	Magnitude of Consumer Welfare Gains ($ Million)
EXISTING				
3004	Medicaments*	7	3	8
1701	Sugar*	14	2	18
0902	Tea	29	8	34
5201	Cotton*	60	6	62
0808	Insecticides	4	2	4
3204	Synthetic Col Mat*	52	29	68
2902	Cyclic Hydrocarbons	17	3	18
0703	Onions	13	15	13
Total of Above		**201**	**6**	**220**
NEW				
2710/11	Light Petroleum Oils*	12	1	11
2710/19	Other Petroleum oils*	53	1	60
5402	Syn. Filament Yarn	0	0	1
8708	Auto Parts*	31	23	46
8704	Vehicles for Goods*	27	16	44
8703	Vehicles for Passengers*	25	4	36
8517	Elec App for Telephony	44	8	48
2701	Coal	82	52	52
2601	Iron Ore	28	16	9
7208	Flat Rolled Iron & Steel	-1	1	2
Total of Above		**302**	**4**	**307**
Total of Above Selected Items		**503**	**4½%**	**527**
Others		**250**	**n.a.**	**200**
TOTAL		**753**	**n.a.**	**727**

[a] higher oil price but lower landed price(which includes customs duty and GST)
Source: IPP (2013)

However, some will argue that the boom in world exports is over and, in any case, Pakistan has now a very steep hill to climb in terms of competitiveness. But the pessimism about further globalization is not justified. International comparative advantage will continue to shift. Like Japan earlier, the share of many East Asian countries in labour-intensive manufactured goods has been declining. Recently the rate of exports from China has also slowed reflecting cost pressures emanating from higher wages. Pakistan's exports of cotton yarn and fabrics to China have trebled in the last three years. So even with the slowing in international trade Pakistan can hope to gain market share provided it follows policies that strengthen competitiveness, improve the base of technology, diversify the product mix, and move up the value chain.

Box 3.1
The FTA with China

The architecture of the bilateral Free Trade Agreement includes Trade in Goods and Investments in the first Phase and the leaders of both the countries have decided to negotiate on Trade in Services during 2007 to enlarge the coverage of the Free Trade Agreement.

The Early Harvest Programme between the two countries which was put into operation on 1st January 2006, has been merged into the bilateral FTA. In the overall package Pakistan will get market access at zero duty on industrial alcohol, cotton fabrics, bed-linen and other home textiles, marble and other tiles, leather articles, sports goods, mangoes, citrus fruit and other fruits and vegetables; iron and steel products and engineering goods. China will also reduce its tariff by 50 percent on fish, dairy sectors; frozen orange juice; plastic products, rubber products; leather products; knitwear; woven garments etc.

Pakistan has given market access to China mainly on machinery, organic; and inorganic chemicals, fruits and vegetables, medicaments and other raw materials for various industries including engineering sector, intermediary goods for engineering sectors, etc.

The FTA is being implemented in two phases, as follows:

Category No	Track	No of Tariff Lines	% of Tariff Lines at 8 digit
I	Elimination of Tariff (Three Years)	2681	35.5%
II	0-5% (five years)	2604	34.5%
III	Reduction on Margin of Preference of 50% (five years	604	8.0%
IV	Reduction on Margin of Preference from 20% (five years)	1132	7.0%
V	No Concessions	1132	15.0%

Phase-I – Tariff Reduction Modality of **Pakistan** within five years after entry into force of this agreement:

Category No	Track	No of Tariff Lines	% of Tariff Lines at 8 digit
I	Elimination of Tariff (Three Years)	2423	35.6%
II	0-5% (five years)	1338	19.9%
III	Reduction on Margin of Preference of 50% (five years	157	2.0%
IV	Reduction on Margin of Preference from 20% (five years)	1768	26.1%
V	No Concessions	1025	15.0%
VI	Exclusion	92	1.4%
Note: elimination of tariff on the products covered in the Early Harvest Program (EHP) shall continue in accordance with the earlier agreed modality of tariff elimination for EHP.			

Phase-II – Both Parties shall endeavour to eliminate the tariffs of no less than 90 percent of products, both in terms of tariff lines and trade volume within a reasonable period of time on the basis of friendly consultation and accommodation of the concern of both Parties.

Note: *The base year for tariff reduction/elimination for China is 2006 and for Pakistan fiscal year of 2006-2007.*

Source: IPP (2013)

3.2.3. Trade with European Union and GSP Plus

The 27 countries of the European Union include large countries of Europe like Germany, France, U.K., Italy, etc. Pakistan's exports to EU countries aggregated to $5.6 billion in 2012-13, equivalent to over one fourth of total exports. Major importers within EU of Pakistani products are UK ($1.4 billion), Germany ($1 billion), Italy ($0.6 billion), Spain ($0.4 billion), France ($0.4 billion), Netherlands ($0.4 billion) and Belgium ($4 billion).

Given the state of recession in European countries, Pakistan's exports to EU have been declining in recent years. During the last two years, exports have declined by over 7 percent. In particular, big declines have been observed in exports to Germany, France and Italy of 16 percent, 11 percent and 25 percent respectively. Some growth is observed in the case of exports to U.K. of 7 percent.

Recently, Pakistan has been granted GSP+ by the EU for ten years. This has increased the probability that Pakistan's exports will start rising once again. What is the GSP+?

The Generalized System of Preferences, also known as GSP+, is a trade program of the EU which allows duty free (or at preferential duty) access to certain designated developing countries. Pakistan has also become a beneficiary with effect from January 1, 2014. Other countries with GSP+ benefits include Bangladesh, Sri Lanka, Turkey, Morocco, Tunisia and Mexico.

With GSP+ Pakistan can now export some 6,000 tariff lines free of duty, including textiles and clothing. This provides an edge with respect to export from China and India. The major exports of Pakistan currently to EU are garments ($1730 million), textiles made-ups ($1230 million), textiles ($885 million), leather and leather goods ($509 million), footwear ($72 million) and carpets ($49 million). Some products like rice, sports goods and surgical instruments already enjoy duty free access to the EU.

One of the conditions under GSP+ is that exports of a product from a beneficiary country cannot exceed 6 percent of the EU's total exports. The big question is the extent to which exports of Pakistan to the EU will increase following GSP plus. The Government is quite optimistic about the quantum of increase of over $1 billion, almost 20 percent jump on the present level of exports to the EU. Textiles exports, in particular, are projected to rise by 25 percent. Some estimates are even higher at $2 billion.

The EU has placed 27 restrictions which relate to child labour, wages, environment and governance. Pakistan has to ratify a number of international conventions including these on the Rights of the Child, on Civil and Political Rights, on Economic, Social and Cultural Rights, on Elimination of All Forms of Discrimination against Women, on Forced or Compulsory Labour, on Equal Remuneration for Men and Women Workers, Kyoto Protocol to the UN Framework Convention on Climate Change, UN Convention against Corruption and so on.

There is need to understand that most of the EU countries are in a state of deep recession. Total imports have been falling. In particular, imports of textiles and clothing have declined sharply by 12 percent in 2012. Countries are competing for a shrinking market. Turkey, a major exporter to the EU, has devalued its currency last year by as much as 26 percent to maintain its exports.

Despite duty free access now, Pakistan will face stiff competition in increasing its exports. Also, there are supply-side constraints like shortage of energy. As such, it appears more likely that exports to EU will rise by about $400 to $500 million. Of course, if the economy of EU recovers, the increase could eventually be larger. The International Trade Centre (ITC) also expects this quantum of increase.

3.2.4. Import Compression

The debate on the import side focuses on the opposing objectives of relieving demands on foreign exchange reserves to reduce the trade imbalance, versus the need to stimulate growth which will require enhancement in investment and thereby increase pressure on foreign exchange reserves. We have argued earlier that regulatory duties on non essential imports and/or enhancement in the import margin requirement may become essential to curtail imports and ease the pressure on reserves, the government has not yet implemented any such measure in the budget. However, the government has recently announced ban on gold trade, as its smuggling to India affected the exchange rate and clearly indicates government's concerns regarding the movement in the exchange rate. Other measures to discourage flight of capital, like reporting of national Identity card number at time of purchase foreign currency were imposed temporarily but withdrawn.

3.3 Likely Future Developments

The specific policy actions that are likely to be taken to promote exports are described below:

3.3.1. Diversification of Exports

Pakistan has a narrow export base both in terms of the geographical spread of markets and the range of products. Table 3.13 quantifies the extent of concentration of Pakistan's exports and compares this with India and Bangladesh. There appears to have been only a modest degree of diversification of exports of these countries over the last two decades. Pakistan's exports are more diversified than Bangladesh, but less than India.

Table 3.13
Extent of Concentration of Pakistan's Exports

	1995	2005	2012
PAKISTAN			
Market Concentration Index*	0.235	0.226	0.183
Diversification Index**	0.782	0.769	0.722
SAARC COUNTRIES			
Market Concentration Index	0.127	0.116	0.145
Diversification Index	0.639	0.569	0.522
INDIA			
Market Concentration Index	0.138	0.133	0.173
Diversification Index	0.581	0.542	0.502
BANGLADESH			
Market Concentration Index	0.332	0.385	0.359
Diversification Index	0.796	0.828	0.800

*An index closer to 1 indicates a very concentrated market
**An index closer to 1 indicates a bigger difference from the world average
Source: UNCTAD

Fast growing markets for Pakistan in recent years include China (64 percent),[2] Indonesia (67 percent), Egypt (31 percent), Malaysia (37 percent), Thailand (29 percent), Saudi Arabia (20 percent) and India (15 percent). These growth rates are in sharp contrast to the overall decline in exports of 2 percent.

Emerging exports which have shown fast growth are fish and fish preparations (14 percent), meat and meat preparations (18 percent), leather manufactures (13 percent), pharmaceuticals (10 percent), jewellery (57 percent), guar and guar products (202 percent) and cement (7 percent). The export marketing strategy of Trade and Development Authority of Pakistan (TDAP) needs to focus on these products and on the above-mentioned countries.

3.3.2. Export Promotion Policies

In addition, the following measures need to be adopted.

- An exchange rate which fully reflects the differential between the movements in Pakistan prices and the international price level.
- A review of all SROs and their gradual elimination in three years because they essentially provide more domestic protection and thus increase the anti-export bias.
- Strong incentives for new investments and skill upgrading in textiles that increase scale and update technology, while encouraging the exit of the enterprises with low productivity and profitability.
- A determined push aimed at small and medium industries for expansion and export diversification in areas outside textiles. Other developing countries have also resorted to various export incentives to boost their exports like lower tax rates, refinancing at concessional rates etc.(see Table 3.14)

Table 3.14
Export Incentives in South Asian Countries

	India	Pakistan	Bangladesh
Cash Incentives			✓
Lower Income Tax Rate on Export		✓	✓
Higher Duty Drawback(with implicit subsidy)	✓		✓
Exemptions/ Concessions on Import of machinery		✓	✓
Tax holiday			✓
Export Refinance at Concessional Rate		✓	✓
Compulsory Export Credit Allocation	✓		
Tax free EZPs/EOUs	✓	✓	✓
Zero Rating of Domestic Sales from GST/VAT		✓	
Export Credit Guarantee Scheme	✓		✓
Freight Subsidy		✓	
R & D Subsidy		✓	

Sources: Trade Policy Review, WTO, with MOC in each country

[2] Cumulative growth in exports from 2010-11 to 2012-13

The impact of export incentives in the three countries – Pakistan, Bangladesh and India – is given in Table 3.15. Clearly, more incentives are being offered, especially by Bangladesh, to textiles exporters. This has affected Pakistan's relative competitive position. At the minimum, there is need to provide a higher duty-drawback to exporters to compensate for the substantially higher cost of electricity in Pakistan.

Table 3.15
Value of Export Incentives* in
Bangladesh, India and Pakistan

(%)

	Spinning, Weaving and Fishing	Made-up Textiles	Other Textiles
Bangladesh	27.0	37.5	45.9
India	20.0	24.7	44.9
Pakistan	12.7	21.5	23.7

*The value of export incentive is derived as the exchange rate which would have yielded the same profit in the absence of the export incentives. The Table gives the percentage difference between this exchange rate and the actual official exchange rate.

Sources: IPP (2013)

- Joint public and private sector efforts to promote foreign investment in textiles, clothing and other promising export sectors from countries like China which are losing ground in labour-intensive industries due to high and rising wage costs. This may become more attractive following the granting of GSP plus to Pakistan by EU. The focus of these efforts should be to encourage foreign investment that will help to upgrade skills and technology and make use of established export channels.

- A special focus on expanding exports to regional partners especially China and India, the two fastest growing economies in the region. The large negative trade balance with these countries can provide some leverage. With China, negotiations should focus on increase in exports of cotton yarn, fabrics and made-up textiles. For example, currently meets only 21 percent of its requirements from Pakistan of cotton yarn and 8 percent in the case of fabrics.

- A special and speedy implementation review of the FTA and establishment of an EPZ with China and assessment of their likely impact on exports in the near term.

- There are also some concerns that the FTA with China has adversely impacted on a number of industries in Pakistan, especially in the presence of under invoicing of imports, approaching 40 to 50 percent in the case of some imports. Industries which have suffered big losses in output in the presence of competition from relatively cheap imports from China include iron and steel, tyres, electric generators, pharmaceuticals, chemicals, electrical goods and motor cycles.

  The problem of under-invoicing needs to be tackled by requesting China to provide real-time information on export prices to Pakistan. If this is not possible, then a regime of minimum import prices may be introduced selectively on some tariff lines. This is permissible under WTO rules.

- A similar review of key constraints and principal opportunities for expanding trade with India.
- Focus on the development of export supply chains using the work being done in the context of the National Trade Corridor Improvement Project, the NTCIP.
- Strengthening monitoring mechanisms including quarterly meeting of the high level Export Board.
- Implementing recommendations in the Strategic Trade Policy Framework (STPF) 2012-15 to reduce anti export bias by the withdrawal of protection from inefficient industries, minimization of taxation at investment stage, and elimination or zero rating of customs duty on important inputs to textiles and clothing exports.
- Closer coordination of commerce ministry policies and activities not only with textile ministry but all other production related ministries appears to be sorely needed.

Chapter 4: GREEN NEW DEAL AND BENEFITS OF AN ECOLOGICAL FOCUS

4.1 Overview about Ecological Problems

Pakistan is a confronted with a number of serious environmental problems including an emerging water scarcity, rapid deforestation, rising air pollution and increasing vulnerability to natural disasters. In addition, there are concerns about the impact of climate change.

Table 4.1
Environmental Performance Indicators for a Sample of Countries
(Percentile)*

Indicators	Pakistan	India	Sri Lanka	Bangladesh	Malaysia	Indonesia
Environmental Burden of disease	33	29	31	30	64	34
Access to sanitation	31	9	55	17	66	28
Access to Water	44	42	31	26	71	27
Water quality index	57	70	91	85	50	55
Water stress index	10	10	30	44	67	69
Water scarcity index	5	60	24	94	49	59
Indoor air pollution	14	18	12	4	74	20
Outdoor air pollution	3	33	13	-	71	12
Sulphur dioxide emissions per populated land area	36	25	36	49	43	43
Nitrogen oxides emissions per populated land area	70	-	35	47	36	44
Non-methane volatile organic compound emissions per populated land area	58	32	26	26	18	16
Ecosystem zone	25	11	70	21	47	20
Greenhouse gas emissions per capita (including land use emissions)	86	91	83	99	20	35
Industrial greenhouse gas emissions intensity	23	13	79	48	49	55
CO_2 emissions per electricity generation	56	-	61	27	32	23
Biome protection	61	26	63	9	84	88
Marine protection	63	50	35	25	69	68
Trawling and dredging intensity	37	42	63	-	2	17
MTI slope	65	81	31	6	73	80
Annual change in forest cover	2	100	9	32	24	4
Growing stock rate	1	76	2	23	65	100
Agricultural water intensity	3	10	12	95	55	61
Pesticide regulation	15	17	47	6	62	64
Agriculture subsides	54	14	45	94	30	22

Note: *: The higher the percentile, the better the performance.
Source: Yale University 2011.

An Environmental Performance Index (EPI) has been developed by Yale University, USA. The standing of Pakistan in different indicators in 2011 is compared with countries like India, Sri Lanka, Bangladesh, Malaysia and Indonesia (see Table 4.1; a lower percentile indicating a worse ranking among 132 countries). Pakistan does poorly in the water scarcity index (5^{th} percentile), indoor air pollution (14^{th}

percentile), outdoor pollution (3rd percentile), annual change in forest cover (2nd percentile), growing stock rate (1st percentile) and pesticide regulation (15th percentile).

4.1.1. Water Shortage

The country's fresh water supply is primarily fed by river flows (140 MAF) which supply 70 percent of the water, with the rest by rainfall in monsoons. The river flows are largely fed by glacial and snow-melt from the Hindukush – Karokaram – Himalayan (HKH) mountains, which are sensitive to climate changes.

Since 1999-2000, there has been little change in overall water availability at the farm gate, ranging from 133 to 138 MAF. Surface water provided by the irrigation system is subject to significant losses due to poor maintenance of canals. Ground water is mostly extracted by private tube wells, the number of which has increased by 58 percent since 1999-2000 to almost one million currently. 81 percent of these tube wells are operated with diesel and the rest, 19 percent, by electricity. 84 percent of the tube wells are in Punjab, while a number of deep tube wells have been installed in Balochistan. The 'over tubewellisation' is a classic example of the 'tragedy of the commons', with the water extracted per tubewell falling by 78 percent in the last decade. A market has also developed for tubewell water, especially in Punjab.

4.1.2. Deforestation

Deforestation is taking place rapidly in Pakistan. Almost 22 percent of the forest area has been depleted since 2000, which now stands at just above 2 percent of the land area. Almost two thirds of the forest area is in the Northern part of the country. According to the World Bank the annual cost of deforestation is in excess of 2 percent of the GDP.

Deforestation in the North leads to more rapid silting of dams, reservoirs and canals. It increases vulnerability to floods. One of the primary causes of deforestation is the poverty of people who live close to the forests, who overexploit the resources for meeting their fuel and fodder requirements. Also, depletion of forests is the consequence of poor regulations and governance, with large-scale smuggling of timber for furniture and construction activities.

4.1.3. Air Pollution

Urban air pollution is emerging as a serious hazard, leading to higher incidence of respiratory diseases. Emission from vehicles, burning of solid waste, brick kilns and natural dust are responsible for the increase in SPM. The highest incidence is in Lahore (117 ug/m^3), followed by Peshawar (71 ug/m3) and Karachi (42 ug/m^3). Indoor air pollution (due to burning of fuel wood) and water pollution (due to inadequate sanitation and presence of chemicals) are emerging problems.

CO2 emissions are relatively low in Pakistan as compared to other countries, and have grown by 3 percent on a per capita basis. The share of emissions due to gaseous fuel is about 42 percent, followed by liquid fuel with 37 percent and solid fuel with 11 percent. The contribution of gaseous fuel has been enhanced in Pakistan by the greater dependence on natural gas as a source of energy.

4.1.4. Natural Disasters

The Incidence of natural disasters has also increased. Since 2000, Pakistan has seen a severe drought in 2001, the earthquake in 2005 and the mega floods of 2010, which covered almost 20 percent of the land area. Almost 10 percent of the crop output was lost due to the drought. The earthquake in the North destroyed, completely or partially, almost 600,000 housing units. ERRA has since invested over Rs 110 billion in earthquake rehabilitation and reconstruction work. Recently, parts of Balochistan have been hit by a severe earthquake. The floods of 2010 affected over 20 million people, almost 5 million acres of cropped area, over 2000 deaths and loss of over 320,000 livestock. The damages have been estimated at almost $9 billion.

Table 4.2
CO2 Emissions in a Sample of Countries

Country	Year	In Metric tons per capita	Kg per 2005 PPP $ per capita
China	2009	5.77	0.93
India	2009	1.66	0.58
Indonesia	2009	1.90	0.51
Malaysia	2009	7.14	0.55
Pakistan	2009	0.95	0.40
Sri Lanka	2009	0.62	0.14
Thailand	2009	4.10	0.55

Source: WDI

4.1.5. Effects of Climate Change

There are growing concerns about the impact of climate change on Pakistan. The potential threats include increased variability of monsoons (as we are currently seeing) resulting in greater risk of floods and droughts; recession of the HKH glaciers threatening water flows into the Indus River System; threat to coastal areas (including Karachi) due to sea level rise and greater cyclonic activity due to higher sea surface temperatures.

4.2 Present Debate to Solve Ecological Problems

Pakistan was one of the first developing countries to pass a landmark Environmental Protection Act in 1997. In addition, there exist a National Drinking Water Policy, a National Forest Policy, a National Water Policy and the National Environment Policy of 2005. However, the fundamental problem is the, more or less, complete lack of implementation of these policies.

The absence of commitment to a 'green' economy is due to the perceptions, first, that this is an attempt on the part of advanced countries to impose emission standards on developing countries when they pollute much more and, second, that this is likely to lead to some loss of growth.

4.2.1. Green Economy and Growth

UNEP defines a green economy as one that results in "improved human well-being and social equity, while significantly reducing environmental risks and scarcities". In its simplest expression, a green economy is low-carbon, resource efficient and socially inclusive.

In a green economy, growth in income and employment is driven by public and private investments that reduce carbon emissions and pollution, enhance energy and resource efficiency and prevent the loss of biodiversity and ecosystem services. In fact, the greening of economies can be a new 'engine of growth'.

These investments need to be catalysed and supported by targeted public expenditure, policy reforms and regulation changes. The development path should maintain, enhance and, where necessary, rebuild natural capital as a critical economic asset and as a source of public benefits, which are important for the livelihood and security of poor people who depend more on nature.

'Green' economy can make a fundamental contribution to more inclusive growth by reducing poverty across a range of important sectors – agriculture, forestry, freshwater, fisheries and energy. Sustainable forestry and ecologically friendly farming methods help preserve soil fertility and water resources. This is especially important for subsistence farming. In this sense, the 'green' economy is particularly important in the Pakistani context with the on-going deforestation and emerging water scarcity.

4.2.2. 'Green' Initiatives in Khyber-Pakhtunkhwa

The Pakistan Tehrik-e-Insaf (PTI) provincial government in Khyber-Pakhtunkhwa has recognised the special ecological problems in the Northern part of the country and launched the 'Green Growth Initiative'. It heralds the beginning of the most advanced environment-friendly initiatives for preserving the environment, addressing national energy shortages and promoting tourism. The key initiatives proposed under 'Green Growth' are as follows:

PLANT

Forest:

- Increase forest area up to 22% by 2018
- Convert 30,000 hectares of additional land into forest annually
- Launch of "Tree Tsunami" campaign
- Increase tree covered area upto 30% by 2018
- Commencement of "Youth Nurseries" Program
- Establish rules for REDD+ to assign carbon value to forests
- Preserve Khyber-Pakhtunkhwa's forests as valued natural asset
- Complete ban on cutting down trees in reserved forests

PRESERVE

National Parks:

- Establishment of an autonomous National Parks authority
- Training of special Youth Park Management force
- Increase protected area upto 15% by 2018
- Build recreational Natural Wildlife Parks in every district

PROMOTE

Clean Energy:

- Zero carbon growth by 2018
- 80% power generation from hydro and solar sources by 2018
- 356 community driven small hydro power projects by 2014

Source: Advertisement in newspaper, Dawn.

4.2.3. Environmental Management

There is debate also on where the environment protection function should be placed. Following the abolition of the Concurrent List in the Constitution' by the 18th Amendment, this function has essentially passed on to the provincial governments. However, these governments have limited capacity to perform this function. A new Ministry for Climate Change has been created at the federal level, with a still unclear mandate.

The management of water resources is a very contentious issue. Almost 40 MAF is lost from the water system due to lack of adequate reservoirs. For many years, construction of the Kalabagh Dam in the North West of Punjab has been under discussion. This Dam could provide an additional 6.5 MAF of water. While Punjab has been pushing for this dam, Sindh has been vehemently opposed on the grounds that it will reduce the availability of water downstream, while K-PK is worried that some districts, like Nowshera, will be submerged. The debate on construction of large dams has now acquired greater importance because of the realization that more cheap hydel power is needed to solve the power crisis.

There is consensus, however, on the Diamer-Basha Dam, with the ability to store 8.5 MAF and provide 4500 MW of electricity. It will also lessen the likelihood of floods. But the cost is very high at over $11 billion and the major sponsors, except USAID, appear to be reluctant to finance the project. More recently, the focus has shifted to construction of the Dasu Dam.

In the absence of increased water supplies for agriculture, there is growing appreciation of the need to conserve and use more efficiently the water available. More public resources are being allocated for lining of canals, especially in Punjab. The big emerging issue is water pricing to promote efficient use. The irrigation charges (Abiana) are currently very low and cover only about 20 percent of the O&M costs of the canal system. But this is being resisted by large landowners who have disproportionate political representation. Eventually, with rising water scarcity, Pakistan will have to adopt new irrigation practices, like drip irrigation, and change the cropping pattern away from water-intensive crops, like sugarcane and rice.

The use of tube wells has substantially exceeded the optimal level and led to overexploitation of ground water resources. But instead of discouraging further installation, the PPP government, in one of its last acts, reduced the power tariff for tube wells by 20 percent. This has since been withdrawn.

The water issue also has a regional dimension. The common perception is that India is building dams upstream, like the Kishanganga Dam, to reduce the water flow to rivers in Pakistan. This is potentially a serious issue and could damage the already strained relations between the two countries.

Turning to the problem of managing forests, the provincial government of K-PK has to play the primary role. One possibility is the provision of alternate fuels at subsidized prices to people living in proximity to the forest areas. Alternatively, punitive taxation may be introduced on wood and wood products industries.

In an effort to reduce urban pollution and lower transport costs, the use of CNG in motor vehicles was introduced. Consequently, the use of CNG has increased rapidly by 36 percent annually. Now, the debate is that given the depletion of gas reserves in the country, the available gas should be diverted to higher value sectors, like power generation. Consequently, efforts are being made to ration the use of CNG and raise substantially the price, but this is meeting with stiff resistance.

However, some steps have been taken to reduce air pollution including a restriction on leaded gasoline and reduction in the sulphur content of diesel oil. But there is need to introduce further regulation to ensure tougher emission standards on vehicles, encourage the use of pollution control technology by industry and relocate brick kilns far from urban centers. Also, given the highest level of air pollution in Lahore, the use of three-wheel rickshaws could initially be banned in this city, as has been done in New Delhi. But this has been argued against on the grounds that it will deprive a significant number of people of their livelihoods.

The newly elected government of PML-N has announced that bulk of the new investment in power generation (about 7000 MW) will be with coal as the fuel source, instead of furnace oil. The implications of this on future levels of emission need to be worked out.

Finally, a National Disaster Management Authority (NDMA) was set up in 2006 following passage of the appropriate legislation. This is in addition to the multiplicity of agencies that already exist (see Chart 4.1). There is need to clarify the distribution of functions among these agencies and between different levels of government.

Chart 4.1
Multiplicity of Disaster Management Institutions in Pakistan*

Phase	Institutions
Prevention/mitigation	Federal Flood Commission Provincial Irrigation Departments Water and Power Development Authority (WAPDA)/Dams Safety Council
Preparedness and response	Armed forces Civil Defence Emergency Relief Cell Fire Services National Crisis Management Cell Pakistan Metrological Department Police Provincial Communication and Works Provincial Food Departments Provincial Health Departments Provincial Relief Commissioners Provincial Agriculture and Livestock Departments Rescue 1122 Space and Upper Atmospheric Research Commission (SUPARCO)
Recovery and reconstruction	Earthquake Reconstruction and Rehabilitation Authority (ERRA) Provincial Irrigation Departments Provincial Communications and works Departments Other line departments

Note: *: Besides the NDMA, Provincial Disaster Management Authority (PDMAs) and District Disaster Management Authority (DDMAs)
Source: GoP 2007b.

4.3 Strategy and Coherence of Industrial Policies

4.3.1. The Power Sector

Pakistan has run into a severe power deficit since 2007. As described earlier, power outages have reached unprecedented levels, on average about 10-12 hours a day. The estimated cost of these power outages is in excess of Rs 1400 billion, equivalent to 7 percent of the GDP in 2012, according to IPP. This is indicated by the fact that electricity consumption since 2007 has increased by less than one per cent per annum as compared to almost 6 percent between 2000 and 2007. Electricity generation has fallen by almost 2 percent, even though there has been some increase in installed capacity by about 3000 MW (see Table 4.3).

Table 4.3
Long-Term Trend in Capacity and Generation in Pakistan of Electricity 1970-71 to 2010-11

Years	Installed Capacity (MW)	Annual Growth Rate (%)	Electricity Generation (GWH)	Annual Growth Rate (%)	Index of Capacity Utilization (%)
1970-71	1862		7202		81
1980-81	4105	8.2	16062	8.4	82
1990-91	8356	7.4	41042	9.8	102
2000-01	17498	7.7	68117	5.2	81
2010-11	23327	2.5	100582	3.3	88
2011-12	23538	0.9	98664	-1.9	86

Source: Handbook of Statistics, SBP; Pakistan Economic Survey, MoF, GoP

The roots of the outages problem can be traced, first, to the slow expansion in capacity during the Musharraf era and the obsolescence of many relatively old plants in the public sector. Second, the decline in availability of natural gas and its diversion to other uses has created a shortage for thermal power and necessitated greater resort to relatively expensive imported furnace oil. (see Table 4.4). Third, poor maintenance and lack of modernization of the transmission and distribution system has increased losses, alongwith with a failure of the distribution companies to reduce theft or fully recover bills.

Table 4.4
Level and Sources of Electricity Generation and System Losses in Selected countries

Countries	Per Capita Electricity Production (kwh)	Sources of Electricity					System Losses (%)
		Goal (1)	Hydro (2)	Gas (3)	Nuclear (4)	Oil (5)	
Bangladesh	257.6	1.7	4.1	89.4	0.0	4.8	2.3
China	2776.0	78.8	16.7	1.4	1.9	0.4	5.2
India	744.7	68.6	11.9	12.4	2.1	2.9	23.3
Indonesia	654.9	41.8	7.3	22.1	0.0	22.8	9.9
Malaysia	3759.7	30.9	6.3	60.7	0.0	2.0	3.9
Nepal	106.1	0.0	99.6	0.0	0.0	0.4	14.2
Pakistan	**559.2**	**0.1**	**29.4**	**29.4**	**3.0**	**38.0**	**19.7**
Philippines	675.3	26.6	15.8	32.	0.0	8.7	12.1
Sri Lanka	483.3	0.0	39.5	0.0	0.0	60.3	14.6
Thailand	2159.9	19.9	4.8	70.7	0.0	0.5	5.3
Vietnam	967.3	18.0	36.0	43.4	0.0	2.5	5.1

Source: World Bank, WDI, 2009.

The liquidity problem of the sector is frequently referred to as 'circular debt'. It is primarily due to difference between the cost of generation (currently about Rs 14 per kwh) and the revenue from tariffs (Rs 9 per kwh). The federal government has been compelled to give a tariff differential subsidy (TDS), which has increased from Rs 111 billion (0.8 percent of the GDP) in 2008-09 to Rs 654 billion (2.9 percent of the GDP) in 2012-13 (see Table 4.5). It is indeed unfortunate that Pakistan now spends 40 percent more on subsidizing the power sector compared to the level of public expenditure on education.

Table 4.5
Trends in Tariff Differential Subsidy to the Power Sector
(Rs in Billion)

Years	TDS	% of GDP
2008-09	111	0.84
2009-10	179	1.20
2010-11	343	1.88
2011-12	464	2.30
2012-13	654*	2.85
2013-14(B)	365*	1.40
Cumulative	**2116**	

(B) = Budgeted
Source: Budget-in-Brief, MoF, GoP.

Turning to the manufacturing sector, this sector showed exceptional dynamism in the peak of the Musharraf period, with the growth rate rising to 15.5 percent in 2004-05. This was due to rapid increase in aggregate demand, presence of ample excess capacity built up in the 90s, low interest rates which stimulated demand for consumer durables, some export growth and, more or less, stable prices of domestic and imported inputs.

4.3.2. Manufacturing Sector

Since 2007-08 the growth rate of the manufacturing sector has plummeted to 1 percent only. Private investment in the sector has fallen from almost 3 percent to 1 percent of the GDP. Industries which have shown sharp declines including fertilizer, cigarettes, paints, TV sets, electrical appliances, steel products, and automobiles. One of the principal reasons for the slowdown is the high and growing incidence of power outages. In addition, exports have shown only modest growth. The gas shortage has affected industries like fertilizer. Interest rates have been high and the private sector has been 'crowded out' from bank credit due to excessive borrowings by government.

Pakistan has traditionally followed a policy of import substitution. A high import tariff wall has been used to give protection to domestic industry, which has also created an anti-export bias. Currently, the maximum tariff is 30 percent, although this has been augmented by large number of SROs. Industries which enjoy high levels of effective protection include vegetable oils and fats, dairy products, other food products, textiles, wearing apparel and motor vehicles and parts (see Table 4.6). As opposed this, industries which are more exposed to international competition are chemicals and pharmaceuticals, electrical equipment, machinery, iron and steel.

The burden of taxes is the highest on industry. While the sector accounts for about 21 percent of the GDP, it contributes 71 percent to federal tax revenues. Industries with relatively high tax burden are cigarettes, motor vehicles, edible oil and cement. On the other hand, industries which receive subsidy are fertilizer, steel (PASMIC) and oil refineries.

Export incentives have also been put in place, especially for textiles. These include concessionary export finance, low presumptive tax (at 1 percent) on exports, zero-rating of domestic sales of export-oriented industries from GST, tax holidays (especially in EPZ) and exemption from import duties on machinery.

While the nominal exchange rate is close to Rs 104 per $, the effective exchange rate to textile exporters is as high as Rs 115 per $ due to the incentives.

Table 4.6
Effective Rates Protection Sector wise

(%)

Agriculture		Manufacturing Agro-based	
Rice	10.5	Processed Rice	17.6
Wheat	10.7	Vegetable Oils and Fats	151.8
Cereal n.e.c.	0.5	Daily Products	75.0
Vegetables, Fruits	14.5	Sugar	17.0
Oil Seeds	2.3	Food Products n.e.c.	121.5
Sugarcane	2.9	Beverages and Tobacco	390.0
Crops n.e.c.	3.6	**Textiles and Clothing**	
Live Animals	-3.3	Textiles	57.1
Raw Milk	-5.0	Wearing Apparel	66.7
Wool	-0.8	**Mining**	
Animal Products n.e.c.	8.7	Coal	1.5
Forestry	5.5	Oil	8.7
Fishing	9.3	Gas	-1.6
Others			
Leather Products	68	Motor Vehicles and Parts	115.0
Wood Products	19.3	Transport Equipment	17.0
Paper Product, Publishing	21.4	Electrical Equipment	10.1
Petroleum Products	24.6	Machinery	11.3
Chemicals, Rubber and Plastic Products n.e.c.	11.5	Transport Equipment	17.0
Mineral Products	26.6		
Iron and Steel	11.6		
Metal Product n.e.c.	4.2		

(B) = Budgeted
Source: IPP [2012]

4.4 Likely Future Developments

4.4.1. The New Energy Policy

The new government of PML-N has made the elimination of power loadshedding its number one priority. It has moved with speed and commitment to resolve the problem. The liquidity constraint in the power sector has been removed, at least temporarily, by retirement of circular debt of Rs 480 billion (almost 2 percent of the GDP). On August 1 2013, a large increase, averaging 35 percent, was announced for industrial, commercial and bulk consumers, which could reduce the TDS by over one third.

The new Energy Policy for 2013 to 2018 envisages the following:

- Power Sector loadshedding will be phased out by 2017 and the subsidy will be eliminated by 2016
- Generation of Surplus Electricity by 2018
- Privatization of government-owned power plants (GECOs) and a few power distributing companies (DISCOs)
- Bringing the double-digit cost of power generation to single-digit
- Restructuring of the Water and Power Ministry
- Restructuring of NEPRA and OGRA
- Adjustment of outstanding dues of public and private organization through Federal Adjusters
- Formation of Regional transmission and power trading systems
- Create a culture of energy conservation
- Minimise pilferage and adulteration in fuel supply
- Promote world class efficiency in power generation
- Create a cutting edge transmission network
- Minimise financial losses across the system
- Align the Ministries involved in the Energy Sector
- Competition will be built on three pillars – upfront tariff, competitive bidding and key client management
- Strengthening of the National Grid Transmission Network
- Build a Regional Transmission and Power Trading System
- The tariff and competitive bidding process will be controlled by a World Class Regulatory Authority
- Low cost of energy will be ascertained by altering fuel mix towards less expensive fuels such as hydro, biomass and coal. The power sector will be afforded a privileged access to gas allocation
- Investment required for the low cost fuel mix will necessitate rationalization of the power tariff
- The TDS will be targeted to the 'abject' poor and clearing it out through a cross-subsidisation mechanism
- The local industry will be granted three-year exemption period to bring its required production to higher power efficiency
- The strategy *may* impose timing restrictions for evening commercial activities and introduce time of use metering to discourage utilization during peak hours by charging different rates for on and off-peak timings. Solar and alternative power solutions will be encouraged for end users
- Local and foreign investment will be sought for small – and medium – sized projects of hydel run-of-the –river. LNG terminals will be developed in collaboration with friendly countries such as China

- The Strategy focuses on redirecting the supply of fuel from inefficient GENCOs to the most efficient IPPs. This reallocation alone has the potential of saving Rs 3 billion per month and generating an additional 500 MW
- At the same time, the Water and Power Ministry will sign performance contracts with GENCOs, PSO and Fuel Transporters and hold them accountable for the quality and theft in oil
- Establishing plant efficiency through external heat rate testing, and allocating fuel to the most meritorious plants. The strategy calls for privatization or O&M based leasing of GENCOs
- Transmission plants will be built closer to load centres, high voltage transmission lines will be expanded and 220 kv rings around cities will be strengthened
- Performance contracts will be signed with the heads of distribution companies focused on reducing distribution losses because of technical reasons, theft and lack of recovery / collection
- Smart meters will be installed at the feeder level, profit and loss accounts will be managed at the feeder level and the accountability will be appropriated to the XEN
- The Strategy focuses on collecting outstanding receivables from the provinces and government departments. Federal adjuster will be appointed to settle disputes. GST refunds will be collected from the FBR and a mechanism will be developed to avoid future build-ups
- The strategy is geared towards punishing private defaulters and proposes severing the electricity connection after 60 days of non-payment, and only reconnecting them to the grid with pre-paid meters
- The Strategy calls for the notification of an official coordination council comprising the Ministry of Power, Petroleum, Finance and the Planning Commission.

There has been a spate of announcements on new power projects including the Dasu dam, 6600 MW from coal-based projects in Gaddani, Jamshoro coal-based project and so on. The Provincial government of Punjab is proposing some initiatives in renewable energy, including utilization of biogases, biomass and solar energy.

As highlighted earlier, the new Energy Policy, passed by the CCI, envisages investment in 7000 MW of coal-fired plants. The gas tariff is being rationalized on CNG and for fertilizer, industry and commercial sectors. It is proposed to privatise same government owned power plants and DISCOs. On October 1, 2013, the power tariff was raised for domestic consumers (except those consuming less than 200 kwh per month) and agricultural tube wells.

The success of the Energy Policy will depend on the ability to raise resources of $7 billion or more for the expansion of installed capacity in the next five years. The private sector, both foreign and local, has become increasingly shy to invest in the power sector due to its poor track record. In 2007 the private sector invested almost $2.7 billion in the energy sector, which has since fallen to about $600 million, mostly in oil and gas exploration. Apparently, the Prime Minister has received some commitments during his recent visit of greater involvement by China in the development of the power sector.

Construction of large dams, like Diamer-Basha or Dasu dams, is also contingent on the availability of substantial funds from the PSDP. Currently, there is, in fact, the prospect of a large cut in the national

PSDP for 2013-14 due to the emphasis on fiscal deficit reduction in the proposed program with the IMF.

Pakistan has significantly potential for development renewable energy sources. The prime such source is, of course, hydroelectricity with potential upto 5000 MW. One of the major projects in the pipeline is the 720 MW Karot Hydropower Project on the Jhelum river, with sponsorship by the Chinese, CTGI. It is being implemented on a BOOT basis, with an indicative tariff of 5.40 cents per kwh.

Other hydropower projects which are proposed include the 84 MW New Bong Escape Hydropower Project of 84 MW, with a tariff of 8.55 cent per kwh, and the 150 MW Pat rind Project in Azad Jammu and Kashmir. The major on-going project is the Neelum-Jhelum project.

Other promising sources include waste-to-energy, bio fuels, geothermal, wind, biogases and solar. These technologies are generally more capital intensive, although with substantially lower operating costs and much less dependence on imported fuel.

Estimates of costs per kwh of renewable technologies by NEPRA are wind (9 cents), solar (18 cents) and biogases (9 cents). NEPRA will need to notify the tariffs that can be offered for different renewable technologies. In addition, attractive fiscal incentives may be offered. A feasible target for the next five years is that 5 percent of the electricity should be generated by renewable technologies, other than hydro-power by 2018.

Therefore, partial success will be achieved in the short-to-medium run largely by better utilization of existing gas supplies, increase in power generation, improvement in the transmissions and distribution system and reduction in losses. In a long run setting more emphasis will have to be placed on development of renewable energy sources.

In the short run, it is also difficult to see a major improvement in water management and conservation practices. The potential flash point is water supply in large cities like Karachi, Lahore and Faisalabad. Also, the problem of air pollution will only began to be seriously addressed when there is growing public agitation.

4.4.2. Industrial Growth

Industrial growth will hinge crucially on removal of the energy constraint. But the recent large hike in industrial power tariffs (inclusive of other levies) to about 25 cents per kwh will seriously reduce export competitiveness in textiles and other industries. The corresponding tariff in India is 13 cents per kwh and in Bangladesh, 7 cents. However, industries catering primarily for the domestic market have significant excess capacity (see Table 4.7) which can be put to use quickly if the supply of electricity improves.

As indicated earlier, private investment is at an all-time low. This could revive somewhat in the presence of a business-friendly government. But a big upsurge will hinge on improvement in the business environment, with regard to reduction in acts of terrorism and improvement in the general law and order situation, especially in Karachi.

Table 4.7
Rate of Capacity Utilization in Selected Industries

S. No	Items	Units of Measure	Annual Installed Capacity (000)	2010-11 (July- June) % Capacity Utilization	2011-12 (July – Jan) % Capacity Utilization
1	Sugar	Th. Tones	7	61	75
2	Cigarettes	Mln Nos	96	68	62
3	Cotton Yarn	Th. Kgs	3,240	91	92
4	Cotton Cloth	Th. M2	12,644	71	72
5	Jute Hessian	Tones	24	76	78
6	Jute Sacking	Tones	120	52	49
7	Jute Others	Tones	36	34	34
8-11	Paper & Paper Board	Tones	900	48	55
12	Chip Board	Tones	95	29	30
13	Sodah Ash	Tones	500	76	73
14	Caustic Soda	Tones	230	75	74
15-21	Fertilizer	Tones	7,264	83	83
22	Glass Sheet	Tones	71	19	20
23	Cement	Th.M2	41	69	68
24	Bicycles	Th. Tons	700	49	33
25	Coke	Nos	970	31	19
26	Pig Iron/ H.Metal	Tones	1,230	35	22
27	Cast / Rolled Billet	Tones	660	1	0
28	Hr. Coils/ Plates	Tones	792	45	25
29	Cr. Coils	Tones	210	42	14
30	Glav Products	Tones	100	3	0
31-33	Cars/LCVs/Jeeps	Tones	280	55	58
34-35	Trucks/Buses	Nos	25	13	12
36	Tractors	Nos	75	94	34
37	Motor Cycles	Nos	2,935	56	56

Source: PES

Chapter 5: GENERAL EVALUATION

Today, as described above, Pakistan is the slowest growing country in South Asia, Inflation is rapidly getting back to a double-digit rate, investment is at an all time low, there is a burgeoning fiscal deficit and the external balance of payments is in a precarious position with foreign exchange reserves enough not even for just one month of imports.

5.1. A Failing State?

Growth has been seriously retarded by the rampant acts of terror, record levels of power outages, emerging water shortage and breakdown of law and order, with rising levels of crime. Unfortunately, the time has come when some observers of Pakistan believe that the country is a 'failing state'.

Reference needs to be made to the Failed States Index (FSI) of the Fund for Peace, USA. This index is dismissed by most Pakistanis as being very biased. But it is worth seeing, as a somber reminder, according to at least one institution, where Pakistan stands internationally. In the 2012 ranking of 177 countries, Pakistan is ranked 13th (the higher the ranking the greater the vulnerability to failure) as compared to Bangladesh at 29th, India at 79th, Nepal at 30th, Bhutan at 62nd and Sri Lanka at 28th position (see Table 5.1). Fortunately, Pakistan has slightly improved its ranking after 2008. The only country of Asia which is in a worse position than Pakistan is Afghanistan.

Table 5.1
The Failed States Index for south Asian Countries

Total No. of Countries	Years	Pakistan	Afghanistan	Bangladesh	India	Nepal	Bhutan	Sri Lanka
76	2005	34	$\boxed{11}$	17	76	35	26	-
146	2006	$\boxed{9}$	$\boxed{10}$	19	93	20	39	25
177	2007	$\boxed{12}$	$\boxed{8}$	16	110	21	47	25
177	2008	$\boxed{9}$	$\boxed{7}$	12	98	23	50	20
177	2009	$\boxed{10}$	$\boxed{7}$	19	87	25	48	22
177	2010	$\boxed{10}$	$\boxed{6}$	24	79	26	50	25
177	2011	$\boxed{12}$	$\boxed{7}$	25	76	27	50	29
177	2012	$\boxed{13}$	$\boxed{6}$	29	78	27	59	29
177	2013	$\boxed{13}$	$\boxed{7}$	29	79	30	62	28

$\boxed{}$ = Country in the Red Alert Category

Source: The Fund for Peace, Failed States Index, USA.

According to the FSI, Pakistan's failure is most acute in managing mounting demographic pressures, movement of IDPs, inter-group conflict, failure of the security apparatus, reduced writ of the state and intervention of external actors.

5.2. Medium Term Economic Forecasts

A similar prospect, although not so pessimistic, is indicated by the economic forecasts of international agencies. In, the EFF, the IMF sees a fall in the GDP growth rate to 3.1 percent only in 2013-14 and a rise in the rate of inflation to double-digit.

The ADB Scenario for 2014 is similar to that of the IMF (see Table 5.2). The World Bank in the Country Economic Memorandum has undertaken a useful exercise to derive the change in critical variables from 2011-12 to 2017-18 to achieve a high growth rate of 7 percent in the terminal year, as follows:

i) The level of power outages must fall to about one third of the magnitude in 2011-12
ii) The tax-to-GDP ratio has to rise from 10 to 14 percent of the GDP
iii) Investment, both public and private, in infrastructure to increase from 3 to 5 percent of the GDP
iv) The fiscal deficit has to fall from 8.5 to 4 percent of the GDP
v) Exports of goods to increase from below 11 to 15 percent of the GDP
vi) Net foreign exchange reserves to rise to 3 months import cover (equivalent to over $15 billion) by 2017-18.

Table 5.2
The ADB Scenario for Pakistan

	2008	2009	2010	2011	2012	2013	2014
GDP Growth Rate	3.7	1.7	3.1	3.0	3.7	3.6	3.5
Growth Rate of Per Capita GDP	1.5	-0.4	0.9	0.9	1.6	2.2	1.7
Growth Rate of Agriculture	1.0	4.0	0.6	2.4	3.1	-	-
Rate of Inflation	12.0	20.8	10.1	13.7	11.0	9.0	9.5
Change in money Supply	15.3	9.6	12.5	15.9	14.1	-	-
Growth of Merchandise Exports	18.2	-6.4	2.9	28.9	-2.8	1.0	3.5
Growth of Merchandise Imports	31.2	-10.3	-1.7	14.9	11.9	0.0	2.2
Trade Balance *($ Billion)*	-15.0	-12.6	-11.5	-10.5	-15.5	-15.2	-15.3
Current Account Balance *(% of GDP)*	-8.5	-5.7	-2.2	0.1	-2.0	-0.8	-0.9
FE Reserves *($ Billion)*	8.6	9.1	13.0	14.8	11.8	-	-
External Debt *($ Billion)*	46.2	52.3	57.4	61.8	65.8	-	-
Debt Service Ratio	13.0	17.2	16.7	11.3	14.6	-	-

Source: The Fund for Peace, Failed States Index, USA.

Many of the targets above are ambitious and highlight some of the challenges that Pakistan confronts if it is to eventually get back to a high growth trajectory.

Table 5.3
The Government's New Macroeconomic Framework

Variables	Unit	2012-13	2013-14	2014-15	2015-16
Real GDP growth	%	3.6	4.4	5.5	7.0
Inflation	%	7.5	8.0	8.0	8.0
Fiscal	% of GDP				
Total Revenue	**% of GDP**	**13.2**	**14.0**	**14.0**	**14.2**
Tax Revenue	% of GDP	9.9	10.6	11.4	12.0
(FBR Tax Revenue)	% of GDP	(8.8)	(9.5)	(10.4)	(11.0)
Non Tax Revenue	% of GDP	3.3	3.6	3.6	2.2
Total Expenditure	**% of GDP**	**22.0**	**20.3**	**18.9**	**18.2**
Current Expenditure	% of GDP	16.5	15.2	13.6	12.9
Development Expenditure	% of GDP	4.2	5.1	5.2	5.3
Fiscal balance	% of GDP	-8.2	-6.3	-5.0	-4.0
Total Public Debt	% of GDP	63.5	61.3	59.1	55.2
Memo Item:					
GDP at market prices	Billion Rs	22909	26001	29479	34622

Source: Ministry of Finance, Budget-in-Brief, 2013-14.

At the other extreme, a very optimistic macroeconomic framework (see Table 5.3) has been developed by the Ministry of Finance, GoP, at the time of presentation of the Budget of 2013-14, which sets the following targets:

i) Real GDP growth rate of 7 percent, by 2015-16
ii) Constant inflation rate at 8 percent
iii) Tax revenue to increase from about 10 percent of the GDP in 2012-13 to 12 percent in 2015-16
iv) Total public expenditure to fall from 22 percent of the GDP to just above 18 percent in 2015-16
v) The fiscal deficit to fall from 8.2 percent to 4 percent of the GDP.

5.3. Critical Elements of the Economy Of Tomorrow

In view of the above, there is considerable uncertainty about the 'economy of tomorrow' of Pakistan. The scenarios range widely from a 'falling down the precipice' scenario and becoming more of a 'failing state' to a 'robust recovery' scenario.

Based on the analysis in the previous chapters we identify (see Chart 5.1) what we see as critical elements that will determine the nature of the 'economy of tomorrow' of Pakistan.

- If the probabilities generally remain 'low' then the scenario for Pakistan is 'muddling through' or 'falling down the precipice.
- If the probabilities generally are in the 'medium' range, then the scenario for Pakistan is one of 'moderate growth' of 4 to 4.5 percent.
- If the probabilities generally become 'high' then scenario is one of Pakistan getting back to the trajectory of 'high growth' of 6 to 7 percent, with inclusive and sustainable growth.

It appears that Pakistan currently stands on the 'knife edge'. It could go either way. The future of the economy itself is uncertain. Looking too far into the future will be a very speculative exercise. However, we have identified the non-economic and economic factors that need to change in the right direction if Pakistan is to successfully emerge from the near 'perfect storm' that it currently faces and get on to the path of faster and more inclusive and sustainable growth.

Chart 5.1
Critical Elements of the 'Economy of Tomorrow'

	PROBABILITY
Non-Economic Factors	***(Low/Medium/High)***
• End or substantial reduction in acts of terrorism	
• Major improvement in the law and order situation, especially in Karachi	
• Resolution of the insurgency problem in Balochistan	
• End to sectarian violence and ethnic polarization	
Macroeconomic Stabilization	
• Fulfilment of IMF program Performance Criteria and Structural Benchmarks	
• Attainment of the revenue target of Rs 2345 billion (9.5 percent of the GDP) by FBR in 2013-14 and increase to 12 percent of the GDP by 2015-16	
• Reduction in current expenditure by 2 percent of GDP by 2015-16, especially reduction in TDS by two-thirds and elimination of losses of public enterprises	
• Provincial governments behave in a fiscally responsible manner	
• The national PSDP rises to 5 percent of GDP, to accommodate the lumpy investments in the power and water sectors	
• Return of FDI, of upto \$3 to \$4 billion annually, especially in the energy sector	
• Net inflows of foreign aid become positive again, of about \$1.5 billion to \$2.0 billion annually	
• Reserves exceed \$9 billion by end 2014-15	
• Home remittances continue to show significant growth	
• Oil prices remain stable or fall	
Growth	
• Exports show significant growth due to reduction in loadshedding, better performance of the world economy and access to GSP	
• Regional trade expands, and Pakistan's exports to India and China rise rapidly	
• The investment level rises sharply from the current low of 14 percent of GDP, especially due to the 'big push' in the power sector	
• Private consumption rises especially of the lower quintiles	
• The industrial sector revives quickly following reduction in loadshedding and in the presence of excess capacity	
• The agriculture sector shows higher growth in the presence of attractive crop prices, stable fertilizer price and some improvement in water availability from tube wells	
• Monetary policy retains a mildly expansionary stance	
Poverty Reduction	
• Relative stability in food prices	
• Adoption of employment – intensive growth strategy	
• Expansion of Social Protection Programs	
• Focus on Women and Youth	

Chart 5.1
Critical Elements of the 'Economy of Tomorrow'

	PROBABILITY
Ecology	
• Focus on 'Green Economy' and Implied Interventions	
• Strengthening of capacity for environmental management	
Government and Institutions	
• The democratic process remains stable	
• Mechanisms for greater transparency and accountability and reducing corruption are put in place	
• Domestic security policy is put in place and the security apparatus is strengthened	
• Quality of Tax Administration is improved	
• Better management of PSEs or privatization leading to less burden on the exchequer	
• Establishment of autonomous elected local governments	

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