STATE OF THE ECONOMY

Annual Review
2004

A Shift towards Growth

SPDC SOCIAL POLICY AND DEVELOPMENT CENTRE

Foreword

The Social Policy & Development Centre is pleased to present its annual review of the state of the economy in the light of the Economic Survey 2003-04 and the Federal Budget 2004-05. SPDC and other independent economists have over the last 3 years highlighted the pitfalls - with respect to economic revival and impact on the poor - of according excessive weight to stabilization vis-à-vis growth; leading to a debate in the media and among public representatives. The first sign that this viewpoint had begun to find a voice within the economic decision making corridors was when the State Bank of Pakistan's Annual Report 2003 echoed the position regarding increasing poverty, the challenge of job creation, the need to shift policy focus towards human resource development and infrastructure, the imperative of utilizing the fiscal space for financing pro-poor budgetary expenditures, and the role of public investment to crowd-in private investment. That the Budget 2004-05 also signals a tentative move in these directions is testimony to the role that civil society organizations can play in ensuring that governments at least begin to address the concerns of the populace and, in particular, the poor.

The Review is an effort to objectively present the situation with respect to the state of the economy. It acknowledges the gains made over the year, but also identifies the areas where weaknesses are pronounced and where policy shifts are called for. And in line with SPDC's perspective, the Review highlights the equity, employment-generation and poverty reduction aspects of macroeconomic and fiscal policies.

Dr. Kaiser Bengali
Managing Director

SPDC Team

Research

Kaiser Bengali
Qazi Masood Ahmed
Haroon Jamal
Kalim Hyder
Muhammed Sabir
Iffat Ara
Tabinda Areeb
Farhan Sami Khan
Haider Hussain

Editing

Themrise Khan

Computer Graphics & Designing

Rizwanullah Khan
Zakir Husain

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MACROECONOMIC ANALYSIS

The national economy appears to be emerging out of the recessionary straits that it has been mired in for about three quarters of the decade. This is indicated by the higher than targeted growth in GDP and, in particular, the manufacturing sector. The improvement is partly an outcome of measures to stabilize the economy and partly of a move away from an almost exclusive concern with stabilization goals and an acknowledgement of the importance and urgency of growth objectives. That due attention appears to have been paid to growth is evident from the fact that the development allocation for FY2004 has been utilized to the extent of over 96 percent. The welcome shift in priorities is also evident from the fact the the Federal Budget 2004-05 provides for an over 30 percent increase in development expenditure over revised expenditure of FY2004. More notably, it is for the first time since FY1993 that the allocation for development has exceeded that for defence; albeit marginally.

The Economic Survey 2003-04 reports a 6.4 percent growth in GDP. This is the first time since FY1996 that the growth rate has crossed the 6 percent mark. Significantly, the growth is led by manufacturing and energy sectors; perhaps, setting the stage for modernization of the economy. On the downside, the 5.9 percent growth in Public Administration and Defence -- an unproductive sector -- does not augur well for growth and development.

Re-basing of National Accounts:

The re-basing of National Accounts has now resulted in a more comprehensive coverage of the economy and was indeed overdue. However, the ends of transparency would have been better served if (1) the methodological details of the re-basing exercise had been made public in advance and (2) the GDP and sectoral and sub-sectoral growth rates for FY2004 had also been made available under the 1980-81 base. This would have enabled a comparison of growth rates under the old and the new 'regimes'. For example, the Economic Survey reports large-scale manufacturing growth at 17.1 percent; apparently, using revised weights. However, the State Bank of Pakistan's estimate[1], apparently using the old weights, reports a large scale manufacturing growth rate of 13.5 percent. It would also have enabled the decomposition of the extent of change due to adjustment of base year, redefinition of variables, addition of industries, etc.

Several of the databases used for the estimation of the National Accounts have also not yet been released. For example, the Census of Manufacturing Industries (CMI), 2000-01, referred to in the Economic Survey and used for the estimation of manufacturing value added, has not been made public and enquiries have indicated that it is not likely to be released at least for the next six months. The absence of the CMI 2000-01 has rendered it impossible for the performance of the manufacturing sector in FY2004 to be analyzed in depth.

Initial analysis, however, shows that about one-fifth of the increase in GDP and investment is on account of inclusion of new economic activities and changes in computation methodology and the rest due to change of base. In the case of private investment, about one-third of the increase is due to new activities and change in methodology and the rest on account of change in base [see table 1).

[1] State Bank of Pakistan, Third Quarterly Report, 2003-04 *[www.sbp.org.pk/ecodata/gdp-table.pdf]*

TABLE 1
UNDERSTANDING CHANGE IN GDP

	FY 2000	FY 2001	FY 2002	FY 2003
GROSS DOMESTIC PRODUCT				
Nominal GDP (Old Methodology)	3,147,167	3,423,080	3,628,731	4,018,112
Nominal GDP (New Methodology)	3,793,436	4,162,654	4,401,699	4,821,303
Difference in Nominal GDP	646,269	739,574	772,968	803,191
Real GDP (Old Methodology)	697,745	715,548	735,924	778,718
Real GDP (New Methodology)	3,793,436	3,863,994	3,988,377	4,193,757
Difference in Real GDP	3,095,691	3,148,446	3,252,453	3,415,039
Difference due to:				
Inclusion of new activities and change in methodology	646,269	686,511	700,386	698,647
Share (%)	*21*	*22*	*22*	*20*
Change in Base	2,449,422	2,461,935	2,552,067	2,716,392
Share (%)	*79*	*78*	*78*	*80*
TOTAL INVESTMENT				
Nominal Total Investment (Old Methodology)	452,280	475,567	476,113	526,270
Nominal Total Investment (New Methodology)	607,410	659,325	680,373	713,859
Difference in Nominal GDFCF	155,130	183,758	204,260	187,589
Real Total Investment (Old Methodology)	97,268	100,406	96,891	106,630
Real Total Investment (New Methodology)	607,410	634,423	632,134	638,580
Difference in Real Total Investment	510,142	534,017	535,243	531,950
Difference due to:				
Inclusion of new activities and change in methodology	155,130	176,818	189,778	167,807
Share (%)	30	33	35	32
Change in Base	355,012	357,199	345,465	364,143
Share (%)	70	67	65	68
PRIVATE INVESTMENT				
Nominal Private Investment (Old Methodology)	264,681	285,889	303,574	347,200
Nominal Private Investment (New Methodology)	394,749	423,097	496,464	542,096
Difference in Nominal Private Investment	130,068	137,208	192,890	194,896
Real Private Investment (Old Methodology)	55,022	57,268	57,492	66,704
Real Private Investment (New Methodology)	394,749	406,003	459,634	483,381
Difference in Real Private Investment	339,727	348,735	402,142	416,677
Difference due to:				
Inclusion of new activities and change in methodology	130,068	131,665	178,581	173,787
Share (%)	38	38	44	42
Change in Base	209,659	217,070	223,561	242,890
Share (%)	62	62	56	58

Figure in Paranthesis are shares of change

Source: Economic Surey (various issues)

It is not the intention of the present publication to question the integrity of official data. However, instances of reduced transparency proliferate. For example, earlier issues of the Economic Survey provided a detailed break-up of Current Account components, including that of Private Unrequited Transfers. The Economic Survey FY2004 merely provides the aggregate figure for Net Private Unrequited Transfers and the figure for the Workers Remittances component of it. Other components of Private Unrequited Transfers, amounting to one-third of receipts under this head, are not specified.

One particular instance raises critical questions. The customs duty data for 13 commodity groups reported in the Budget documents for the years FY2003, FY2004 and FY2005 show the same growth rate for 10 out of 13 items for each of the years. For example, the growth in customs duty receipts is a uniform 3.1 percent, 9.7 percent, and 27.0 percent for 10 out of 13 items for the years FY2003, FY2004 and FY2005, respectively. This is clearly not plausible and it appears that the data has been created by applying a uniform growth rate for each year [see table 2].

While a detailed examination of the newly released National Accounts data is not possible at this stage, it can be said that official data has to date been generally reliable; although not problem free. And, subject to the reservations about the data, a reasonable analysis of the Economic Survey 2003-04 and the Federal Budget 2004-05 can be attempted.

Agriculture:

A disquieting development is the poor performance in agriculture, with growth in minor crops and fishing being lower than national population growth.

TABLE 2
GROWTH IN CUSTOMS DUTIES BY COMMODITY GROUP

(Rs in Million)

		FY 2002 Revised	FY 2003 Revised	FY 2004 Revised	FY 2005 Budgeted	GROWTH (%) FY 2003	FY 2004	FY 2005
1	Chemical and chemical products	7,476.0	7,711.0	8,459.0	10,739.0	3.1	9.7	27.0
2	Dyes, colours, paints and varnishes	2,105.0	2,171.0	2,382.0	3,024.0	3.1	9.7	27.0
3	Iron, steel and manufactures	5,330.0	5,496.0	6,030.0	7,655.0	3.1	9.7	26.9
4	Machinery	7,309.0	7,540.0	9,081.0	10,500.0	3.2	20.4	15.6
5	Metals (other than gold)	1,014.0	1,046.0	1,147.0	1,465.0	3.2	9.7	27.7
6	Minerals, fuel oils (POL)	883.0	4,259.0	4,671.0	5,930.0	382.3	9.7	27.0
7	Rubber and rubber products	1,563.0	1,612.0	1,769.0	2,246.0	3.1	9.7	27.0
8	Plastic resins etc.	5,632.0	5,808.0	6,372.0	8,089.0	3.1	9.7	26.9
9	Vehicles	5,556.0	6,730.0	7,787.0	7,981.0	21.1	15.7	2.5
10	Wood pulp and papers	2,273.0	2,344.0	2,572.0	3,265.0	3.1	9.7	26.9
11	Yarn and fabrics	2,870.0	2,960.0	3,247.0	4,122.0	3.1	9.7	26.9
12	Medical & photographic equipment	943.0	973.0	1,068.0	1,356.0	3.2	9.8	27.0
13	Other items	36,458.5	39,950.0	50,015.0	56,837.0	9.6	25.2	13.6
Gross Collection		**79,412.5**	**88,600.0**	**104,600.0**	**123,200.0**	**11.6**	**18.1**	**17.8**
Refund and Rebates		28,912.5	19,000.0	18,000.0	20,000.0	-34.3	-5.3	11.1
Net Collection		**50,500.0**	**69,600.0**	**86,600.0**	**103,200.0**	**37.8**	**24.4**	**19.2**

Source: Explanatory Memorandum on Federal Receipts 2002-03 (page # 7), 2003-04 (page # 8) & 2004-05(page # 9).

That *all* the sub-sectors in agriculture have suffered from low growth is even more worrisome. Crop production has been volatile in the last few years and is to some extent subject to the vagaries of nature; however, the fact that growth in livestock[2], fishing and forestry have lagged behind as well points to serious underlying problems - technical, economic and institutional - in the rural economy in general and the agriculture sector in particular.

Water availability is a serious constraint, but water use efficiency is even more problematic. There is excessive penchant for water storage, whereas it is water conservation that perhaps deserves more attention. The decline in minor crops can be attributed to the continuing effects of drought in Balochistan and parts of Sindh, where thousands of hectares of orchards have been desiccated and thousands of families have lost their livelihoods. In Loralai district of Balochistan, for example, fruit production has been reduced by about 65 percent between FY1998 and FY2004.

The decline in fishing can be attributed partly to the oil spill, which devastated the coastline along Karachi. However, Pakistan has a 1000 km plus coastline and the oil spill did not affect deep-sea fishing off the Karachi coast. Local fishing sources attribute the decline in the fishing industry to shrinking of mangroves, obsolescence of the fishing fleet, and the operation of foreign trawlers in or near Pakistani waters.

The problems in agriculture need to be addressed with due seriousness, given that the sector constitutes the foundation of the economy as a whole. Unfortunately, the budget does not appear to have taken due cognizance of these fundamental problems.

Large-scale Manufacturing:

The most striking aspect of the performance of the economy during FY2004 is the 17.1 percent growth rate in large-scale manufacturing; particularly, since it comes in the wake of the 7.2 percent growth in the previous year (FY2003). Furthermore, this growth is fairly broad-based, with growth in textiles increasing from 3.6 percent in FY2003 to 7 percent in FY2004 and 7 industrial sectors - Food, Beverages & Tobacco, Leather Products, Pharmaceuticals, Chemicals, Cement, Electronics, and Automobiles - reporting double-digit growth. Of these, Automobiles has recorded 53 percent growth, followed by 46 percent growth in Electronics. The 7 percent growth in Basic Metals and in Light Engineering is also indicative of the emergence of non-traditional sectors in manufacturing [see chart 1].

There are some concerns, though, and they need to be identified in order to help policymakers with measures to overcome weaknesses in the sector and to consolidate the growth momentum. The two fastest growing sectors - Automobiles and Electronics - owe their growth largely to lease financing offered by commercial banks. Their products classify as 'consumer durables' and have a service life of a few to several years, at the least. As such, they are not purchased every year. Given that it is the upper and upper middle income section of the population that can afford to access bank financing and they constitute a numerically small section of the population, the growth of these sectors cannot be expected to be sustained in the domestic market.

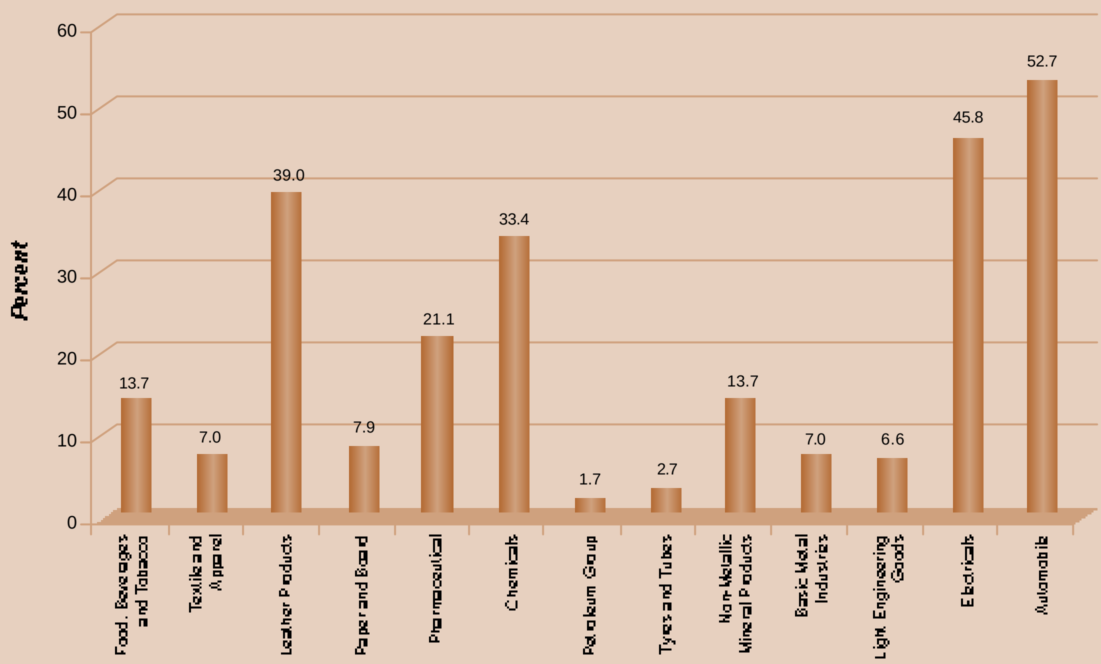
Sustainability will require building or enhancing the capacity of these industries to enter the export market. Herein arises the issue of the cost efficiency of the

[2]Growth in livestock is low even after taking into account the shifting of slaughtering from livestock to manufacturing.

CHART 1
GROWTH PERFORMANCE OF MAJOR INDUSTRIES
(*July-March FY 2004*)

(%)

Overall Growth 17.1%



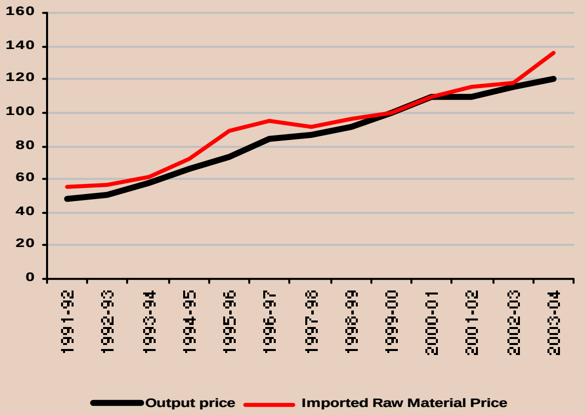
Source: Economic Survey (2003-04)

manufacturing sector. Cost efficiency is partly a function of the cost of inputs into the production process. An analysis of manufacturing input price trends shows that, over the period FY1992-2004, manufacturing output price has grown at a higher rate than the wage rate and at the same rate as imported raw material price. However, the rate of price increases in local raw materials and energy has been higher by about 2 and 3 percentage points (or 22 to 35 percent), respectively. Given that wages comprise only 7 percent of the production cost and local raw materials and energy constitute 69 percent, the input cost regime faced by the manufacturing sector is clearly adverse. There has been a further worsening of the situation since FY2000. Except for wages, which has remained static since FY1998, the growth rate of other input prices has been 3 to 4 percentage points (or 70 to 110 percent) higher than that of manufacturing output prices [see table 3, chart 2]. Clearly, the manufacturing sector has been rendered somewhat uncompetitive relative to manufactures in the international market. Remedial measures are called for.

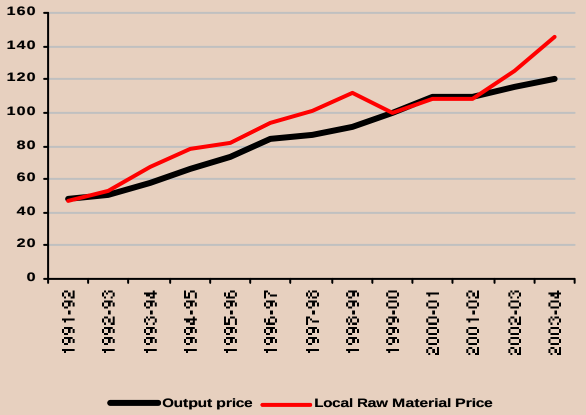
Given the underlying concerns about the data, questions about the reliability of growth estimates cannot but keep surfacing. Table 4 shows that while manufacturing value added has increased by 13.4 percent, industrial consumption of electricity, gas and oil has decreased by

CHART 2
COMPARISON OF INPUT AND OUTPUT PRICES

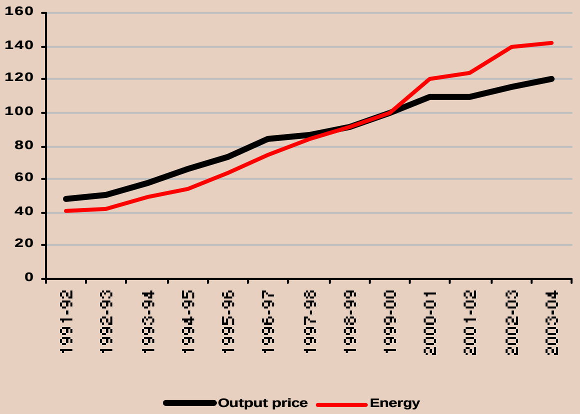
IMPORTED RAW MATERIAL PRICES



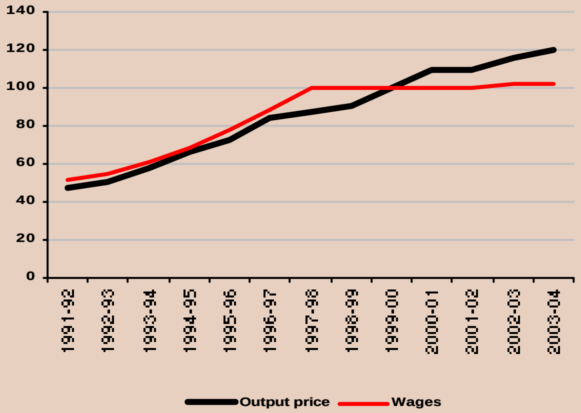
LOCAL RAW MATERIAL PRICE



ENERGY



WAGES



Note: GDP deflator of large scale manufacturing is used as a proxy for output price.

Sources:

Economic Survey (various issues)

Labour Force Survey (various issues)

TABLE 3
INPUT AND OUTPUT PRICE INDICES
(1999-00 = 100)

	Output*	Imported Raw Material	Local Raw Material	Energy	Nominal Wages
1991-92	47.70	55.15	47.39	40.99	51.72
1992-93	50.01	56.88	52.68	41.88	54.79
1993-94	58.01	61.89	67.70	49.07	60.60
1994-95	66.69	72.31	78.10	53.99	68.65
1995-96	72.93	89.28	82.21	63.67	78.10
1996-97	84.17	94.55	94.18	74.76	88.87
1997-98	87.08	90.85	101.54	83.75	100.31
1998-99	90.84	96.31	111.71	91.16	100.15
1999-00	100.00	100.00	100.00	100.00	100.00
2000-01	109.37	109.74	108.24	120.25	99.68
2001-02	109.06	114.89	108.57	124.03	99.36
2002-03	115.44	117.62	125.02	139.43	101.60
2003-04	119.97	135.80	145.26	141.79	102.50
Growth (%)					
1992-04	7.35	7.18	9.00	10.02	5.40
2000-04	3.71	6.31	7.75	7.23	0.50
Weights in Variable Cost		24%	60%	9%	7%

*GDP deflator of large scale manufacturing is used as a proxy for output price.

Sources:

Economic Survey (various issues)
Labour Force Survey (various issues)
Census of Manufacturing Industries (various issues)

TABLE 4
ENERGY UTILIZATION IN MANUFACTURING SECTOR

	Manufacturing Value Added (Million Rs.)	Energy Consumption			Energy Consumption per unit of Manufacturing Value Added		
		Oil (Tonnes)	Gas (mm cft)	Electricity (GWH)	Oil	Gas	Electricity
Base Year: 1980-81							
1992-93	86,346	1,479,935	102,991	13,043	17.140	1.193	0.151
1993-94	90,272	1,653,516	100,631	12,637	18.317	1.115	0.140
1994-95	92,561	1,889,443	104,098	12,528	20.143	1.125	0.135
1995-96	96,016	2,416,278	111,202	12,183	25.165	1.158	0.127
1996-97	95,945	2,141,065	110,365	11,982	22.316	1.150	0.125
1997-98	102,593	2,081,172	115,250	12,297	20.286	1.123	0.120
1998-99	106,767	2,139,889	121,431	12,061	20.043	1.137	0.113
Base Year: 1999-00							
1999-00	522,801	2,115,860	134,916	13,202	4.047	0.258	0.025
2000-01	57,1357	1,924,048	138,503	14,348	3.367	0.242	0.025
2001-02	596,841	1,611,995	151,416	15,141	2.701	0.254	0.025
2002-03	637,964	1,604,068	164,968	16,181	2.514	0.258	0.025
2003-04	723,335	1,295,513	142,246	12,833	1.791	0.196	0.018

Note: All values are for July - March
Source: Economic Survey (various issues)

TABLE 5
TRENDS IN SAVING AND INVESTMENT
(as % of GDP)

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004*
TOTAL INVESTMENT	**17.4**	**17.2**	**16.8**	**16.7**	**18.1**
Changes in Stock	1.4	1.4	1.3	1.9	1.7
FIXED INVESTMENT	**16.0**	**15.8**	**15.5**	**14.8**	**16.4**
Public Investment	5.6	5.7	4.2	3.6	4.7
Private Investment	10.4	10.2	11.3	11.2	11.7
NATIONAL SAVINGS	**15.8**	**16.5**	**18.6**	**20.6**	**19.8**
Domestic Savings	17.1	17.8	18.1	17.4	17.6

*July - March.
Source: Economic Survey (2003-04)

19.2, 13.8 and 20.7 percent respectively. This implies an increase of energy use efficiency of between 24 to 29 per cent between FY 2003 and FY 2004[3]. The sharp enhancement in energy use efficiency in the manufacturing sector over the period of just one year raises questions of plausibility.

Investment:

The re-basing of the National Accounts has propelled investment/GDP rates from the 15-percentage range to the 18-percentage range. Investment growth in FY2004 is shown to be 16 percent, after dismal performances of 4.4 percent in FY2001, -0.4 percent in FY2002 and 1.0 percent in FY2003. Private investment in FY2004 is more or less constant, reporting a 0.5 percentage points increase. Public investment has grown by 1.1 percentage points [see table 5].

The analysis of Gross Fixed Capital Formation (GFCF) shows that the bulk of the growth has occurred in the public sector, where it is about 40 percent [see table 6]. Growth in the private sector stands at about 8 percent. The sectors where growth is significant are large-scale manufacturing (28.4 percent), transport and communication (32.7 percent), construction (15.0 percent), and ownership of dwellings (25.0 percent). These are core areas in terms of the modernization of the economy and the high rate of capital formation therein augurs well for future growth.

Some sectors have registered negative growth, which is certainly worrisome. Agriculture is the mainstay of the economy and capital formation therein has declined by 6.1 percent. The decline in electricity and gas -- a vital sector that drives the commodity producing sectors -- is a significant 14.5 percent.

The growth in investment and capital formation is corroborated by the sharp growth of 129 percent in credit disbursement to the private sector [see table 7]. A more meaningful interpretation of credit disbursement trends can be made on the basis of the share of project and non-project credit off-take. The decomposition of credit disbursement between project and non-project loans in the previous year showed that the share of the former was only about 20 percent. This information is not available for the current year.

An important feature of higher credit disbursement is that it has tended to enhance demand and exerted an upward pressure on prices. This is particularly visible in the real estate market. Subject to continuation of the trend, investment can be expected to ensue with a lag.

[3]The ratios of energy consumption to manufacturing value added has remained generally constant or stable from FY1993 to FY2003.

TABLE 6
GROSS FIXED CAPITAL FORMATION (GFCF) BY ECONOMIC ACTIVITY

(%)

Sector	GROWTH RATES At Constant Market Prices of FY 2000			
	FY 2001	FY 2002	FY 2003	FY 2004
GFCF (A+B+C)	4.4	-0.4	1.0	14.7
A. Private Sector	2.9	13.2	5.2	7.9
B. Public Sector	11.1	-35.4	-29.4	40.8
C. General Govt.	-0.8	2.9	20.3	31.1
Private & Public (A+B)	5.1	-0.7	-1.3	12.3
SECTOR-WISE:				
1. Agriculture	-13.9	0.0	3.8	-6.1
2. Mining and Quarrying	79.0	38.5	26.7	-10.2
3. Manfacturing	1.6	7.6	-2.7	25.1
Large Scale	0.3	7.3	-4.9	28.4
Small Scale	9.4	9.4	9.4	9.4
Slaughtering	-96.3	0.0	0.0	0.0
4. Construction	-18.7	8.7	-50.5	15.0
5. Electricity & Gas	-2.6	-19.5	-29.6	-14.5
6. Transport and Communication	26.2	-20.2	-14.5	32.7
7. Wholesale and Retail Trade	17.7	18.6	17.8	7.4
8. Finance & Insurance	-50.4	92.7	143.9	5.5
9. Ownerships of Dwellings	8.9	-2.7	0.6	25.0
10. Services	3.8	2.1	0.2	-0.3

Source: Economic Survey (2003-04)

TABLE 7
SCHEDULED BANK'S NET CREDIT DISBURSEMENT TO THE PRIVATE SECTOR

(Million Rs.)

				% Share		
	FY 2003*	FY 2004*	Change	FY 2003	FY 2004	Change
Agriculture	3,902	11,470	7,568	3.7	4.7	5.5
Mining & Quarrying	-201	6,162	6,363	-0.2	2.5	4.6
Manufacturing	61,741	126,351	64,610	57.9	51.7	46.8
Textiles	43,210	64,371	21,161	40.5	26.3	15.3
Leather	2,280	6,350	4,070	2.1	2.6	3.0
Non-metallic Mineral	420	6,056	5,636	0.4	2.5	4.1
- Cement	-1,694	5,049	6,743	-	-	4.9
Miscellaneous	15,831	49,574	33,743	14.8	20.3	24.5
Commerce	18,233	8,257	09,976	17.1	3.4	-7.2
Wholesale and Retail Trade	15,641	2,051	-13,590	14.7	0.8	-9.9
Exporters	2,080	4,111	2,031	2.0	1.7	1.5
Importers	-33	5,591	5,624	0.0	2.3	4.1
Transport, Storatge and Communication	-1,581	5,142	6,723	-1.5	2.1	4.9
Services	-39	28,130	28,169	0.0	11.5	20.4
Other Private Business	5,829	3,863	-1,966	5.5	1.6	-1.4
Credit to Trust and NPOs	-295	5,104	5,399	-0.3	2.1	3.9
Personal Loans	19,040	50,080	31,044	17.9	20.5	22.5
Overall Advances	**106,629**	**244,563**	**137,934**	**100.0**	**100.0**	**100.0**

*July - March

Source: Economic Survey (2003-04)

A positive aspect is that almost half (46.8 percent) of the credit has been directed towards the manufacturing sector. About 20 percent of the credit is directed towards the services sector, which has raised the sector's share in credit from zero to 11.5 percent. About 23 percent of the credit has been disbursed in the form of personal loans, increasing its share from 17.9 to 20.5 percent, and which explains the growth of automobile and electronics manufacturing industries.

Analysis of Balance of Payments:
Imports and Exports:
Import and export data tend to corroborate the growth in the manufacturing sector. Significant increases have been recorded in chemical and metal imports. The rise in international prices has raised the oil import bill by 26 percent, while the impact on other imports ranges from 5 to 13 percent [see table 8]. While the higher growth in Petroleum Crude is accounted for by higher international prices, the increase in road vehicles and electrical apparatus is due to the consumer demand created on account of lease financing provided by commercial banks for consumer durable purchases [see table 9].

Performance on the export front has also been commendable, with the value of exports exceeding US$ 10 billion during the first nine months of the year [see table 10]. This increase has been achieved on account of higher international unit prices. However, textiles continued to increase its share to 65 percent of total exports - up from 63.6 percent in FY2002. That the export base is consistently moving towards concentration rather than diversification, constitutes a point of caution. Within textiles, export growth is led by cotton yarn, cotton cloth and knitwear. The former two are low value added items. However, readymade garments - a labour intensive and high value-adding sector that provides employment opportunities to women - registered a 7.5 percent decline. Growth in bed wear and towels is also lower than in the previous year. One bright spot on the export front is the entry of engineering goods, registering a 33 percent growth over the previous year. The sector will, however, have to be actively supported to

TABLE 8
ADDITIONAL IMPORT PAYMENTS DUE TO PRICE INCREASE
($ Million)

Commodities	Imports FY 2004*	Imports at FY 2003 Prices	Additional Cost: Value	Additional Cost: Percent
Palm Oil	506.8	482.3	24.5	5.1
Petroleum Products	1,073.6	853.9	219.7	25.7
Petroleum Crude	1,406.5	1,317.5	89.0	6.8
Fertilizer	201.5	182.0	19.5	10.7
Plastic Material	434.9	397.7	37.2	9.4
Medicinal Products	218.8	193.8	25.0	12.9
Iron Steel	399.0	367.2	31.8	8.7

* July - April
Source: Economic Survey (2003-04).

TABLE 9
MAJOR IMPORTS

(Million $)

Commodities	FY 2002		FY 2003		Growth	FY 2003*		FY 2004*		Growth
	Value	Share (%)	Value	Share (%)	(%)	Value	Share (%)	Value	Share (%)	(%)
Food Groups	**823**	**8.0**	**978**	**8.0**	**18.8**	**823**	**8.1**	**859.3**	**7.2**	**4.5**
Wheat Unmilled	50		28.7		-42.6	28.7		22.2		-22.6
Tea	156.6		172.7		10.3	150.5		168.1		11.7
Soyabean Oil	12.7		47.5		274.0	41.9		42.4		1.2
Palm Oil	380.3		539.3		41.8	445.9		506.8		13.7
Pulses	135.9		115.6		-14.9	100.6		56.4		-43.9
Others	88		74		-15.4	55		63		14.6
Machinery Group	**2,175.8**	**21.0**	**2,839.1**	**23.2**	**30.5**	**2,302.4**	**22.8**	**2,820.7**	**23.5**	**22.5**
Power Generating	203.8		268.5		31.7	224.5		217.9		-2.9
Textile	406.9		531.9		30.7	425.1		455		7.0
Construction & Mining	118.6		101.3		-14.6	78.3		78		-0.4
Electrical & Apparatus	128		216.6		69.2	176.2		197.2		11.9
Road Motor Vehicles	329.9		500.6		51.7	402.3		524.4		30.4
Others	989		1220		23.4	996		1348		35.4
Petroleum Group	**2807**	**27.1**	**3,066.4**	**25.1**	**9.2**	**2,688.1**	**26.6**	**2,480.1**	**20.6**	**-7.7**
Petroleum Products	1,576.2		1,699.9		7.8	1478		1073.6		-27.4
Petroleum Crude	1,230.8		1,366.5		11.0	1210.1		1406.5		16.2
Textile Group	**187.5**	**1.8**	**221.6**	**1.8**	**18.2**	**184.7**	**1.8**	**207.4**	**1.7**	**12.3**
Agri/Other Chemical Group	**1,862.9**	**18.0**	**2,160.5**	**17.7**	**16.0**	**1,774.9**	**17.6**	**2,196.4**	**18.3**	**23.7**
Fertilizer	176.2		239.8		36.1	212.1		201.5		-5.0
Insecticides	85.9		58.5		-31.9	49.2		84.5		71.7
Plastic Material	352.7		421.1		19.4	345.3		434.8		25.9
Medicinal Products	228.1		221.8		-2.8	176.9		218.8		23.7
Others	1020		1,219.3		19.5	991.4		1,256.8		26.8
Metal Group	**433.9**	**4.2**	**507.4**	**4.2**	**16.9%**	**401.3**	**4.0**	**535.1**	**4.5%**	**33.3**
Iron & Steel	336.1		402.3		19.7%	322		399		23.9
Others	97.8		105.1		7.5%	79.3		136.1		71.6
Miscellaneous and Others	**2,049.2**	**19.8**	**2,447.1**	**20.0**	**19.4%**	**1923.8**	**19.1**	**2,913.4**	**24.3**	**51.4**
Total	**10,339.5**	**100.0**	**12,220.3**	**100.0**	**18.2%**	**10,097.8**	**100.0**	**12,012.4**	**100.0**	**19.0**

*July - April.
Sources:
Economic Survey (2003-04)
SBP Annual Report (2002-03)

TABLE 10
MAJOR EXPORTS

(Million $)

Commodities	FY 2002		FY 2003		Growth	FY 2003*		FY 2004*		Growth
	Value	Share (%)	Value	Share (%)	(%)	Value	Share (%)	Value	Share (%)	(%)
Primary Commodities	**833.2**	**9.1**	**1,029.1**	**9.2**	**23.5**	**830.9**	**9.4**	**818.3**	**8.2**	**-1.5**
Rice	448.2		555.5		23.9	454.7		508.2		11.8
Raw cotton	24.7		49		98.4	46.3		40.9		-11.7
Fish & Fish Preparations	125.6		134.5		7.1	109.2		126.4		15.8
Fruits	83.1		83.2		0.1	68.8		82.2		19.5
Tobacco	-		-			4.5		10.5		133.3
Wheat	71.4		129.6		81.5	110.5		6		-94.6
Others	80.2		77.3		-3.6	36.9		44.1		19.5
Textile Manufactures	**5,810.6**	**63.6**	**7,263.6**	**65.1**	**25.0**	**5,717.3**	**64.6**	**6,535.4**	**65.3**	**14.3**
Cotton Yarn	929.7		928.4		-0.1	776.1		964.8		24.3
Cotton Cloth	1,130.8		1,345.7		19.0	1,066.5		1,370.8		28.5
Knitwear	845.9		1,146.7		35.6	881.7		1132		28.4
Bedwear	918.6		1,329.1		44.7	1,033.6		1,136.4		9.9
Towels	267.7		374.8		40.0	283.9		312.5		10.1
Readymade Garments	875		1,092.6		24.9	891.2		824.1		-7.5
Synthetic Textile	410		574.3		40.1	439.3		396.1		-9.8
Others	432.9		472		9.0	345		398.7		15.6
Other Manufactures	**1,770.2**	**19.4**	**1,923.6**	**17.2**	**8.7**	**1,681.3**	**19.0**	**1,730.4**	**17.3**	**2.9**
Carpets, Rugs & Mats	249.6		220.9		-11.5	174.5		184		5.4
Petroleum Crude	190.7		248.6		30.4	34.8		27.7		-20.4
Petroleum Products						156.7		181.9		16.1
Sports Goods	304.5		335.2		10.1	262.4		257.7		-1.8
Leather Tanned	239.9		234.8		-2.1	188.5		192.9		2.3
Leather Manufactures	383.2		386.5		0.9	313.9		340.2		8.4
Leather Garments	-		-			176.4		268.1		52.0
Chemicals & Pharmaceuticals	152.8		260.9		70.7	210.1		204.6		-2.6
Engineering Goods						55.1		73.5		33.4
Others						108.9		0		-100.2
Others	**720.6**	**7.9**	**943.3**	**8.5**	**30.9**	**616.8**	**7.0**	**916.9**	**9.2**	**48.7**
Total	**9,134.6**	**100.0**	**11,160.2**	**100.0**	**22.2**	**8,846.3**	**100.0**	**10,001.0**	**100.0**	**13.1**

*July - April.

Sources:

Economic Survey (2003-04)

SBP Annual Report (2002-03)

TABLE 11
BALANCE OF PAYMENTS

($ Million)

	FY 2002	FY 2003	Absolute Change FY02 - FY03	Percentage Change FY02 - FY03	FY 2003*	FY 2004*	Absolute Change FY03 - FY04	Percentage Change FY03 - FY04
Current Account	1,338	3,165	1,827	137.5	2,706	1,369	-1,337	-49.4
Capital Account	2,241	1,944	-297	-13.2	1,710	-425	-2,135	-124.8
Balance	3,579	5,109	1,530	42.7	4,416	944	-3,472	-78.6

*July - March
Source: Economic Survey (2003-04)

enable it to continue to expand and to establish a place in the international market.

Current account balance:
The Current Account surplus, after having registered an increase of 137 percent in the previous year, has now declined by 50 percent from US$ 2,706 million in FY2003 to US$ 1,369 million in FY2004 [see table 11]. The Capital Account balance too has declined from a surplus of US$ 1,710 million in FY2003 to a deficit of US$ 425 million in FY2004. Consequently, the Balance of Payments surplus has declined from US$ 4,416 million to US$ 944 million over the year. This decline has come about on account of the pre-payment of foreign debt to the tune of US$ 1.17 billion. Given that this component of foreign debt was relatively expensive, this is a positive and commendable move and correspondingly reduces the economic as well as the political burden on the national economy.

Despite the pre-payment, however, total public and publicly guaranteed external debt has actually increased by US$ 0.95 billion over FY2004; implying that new debt to the tune of at least US$ 2.12 billion has been incurred. To the extent that this debt is contracted at a relatively lower cost renders it justifiable and the US$ 906 million reduction in interest on foreign debt appears to underline the justification.

The analysis of the Current Account balance, however, raises some concerns [see table 12]. The trade and services balances remain in deficit, which have actually increased. The combined deficit for FY2004 amounts to US$ 3,017 million. Private Unrequited Transfers are in surplus of US$ 4,386 million (of which, remittances constitutes US$ 2,875 million or 66 percent), to provide the Current Account surplus of US$ 1,369 million. As has been the case in previous years, the Current Account surplus is not attributable to the performance of the domestic economy, but exclusively to factors that lie outside the country's economy.

Remittances:
Remittances, the principal source of the Current Account surplus has shown a decline of about 10 percent [see table 13]. Post-2001, the North American share in remittances increased from about 8 to 30 percent at the expense of the Middle Eastern share, which went down from 70 to 45 percent. For FY2004, the North American share has increased to 32 percent, despite a 3 percent decline in remittances. This is on account of the 16 percent decrease in remittances from the Middle East; thereby, reducing its share further to 42 percent. Receipts from

TABLE 12
CURRENT ACCOUNT BALANCE

($ Million)

	FY 2002	FY 2003	Absolute Change FY02 - FY03	Percentage Change FY02 - FY03	FY 2003*	FY 2004*	Absolute Change FY03 - FY04	Percentage Change FY03 - FY04
Trade Balance	**-294**	**-444**	**-150**	**51**	**-587**	**-757**	**-170**	**29**
Exports (f.o.b)	9,140	10,889	1,749	19	7,779	9,175	1,369	18
Imports (f.o.b)	-9,434	-11,333	-1,899	20	-8,366	-9,932	-1,566	19
Services (Net)	**-2,617**	**-2,128**	**489**	**-19**	**-1,031**	**-2,260**	**-1,229**	**119**
Receipts	2,027	2,967	940	46	2,439	2,376	-63	-3
Payments	-4,644	-5,095	-451	10	-3,470	-4,636	-1,166	34
- Shipment	-809	-951	-142	18	-694	-911	-217	31
- Investment Income	-2,430	-2,381	49	-2	-1,656	-1,687	-31	2
- Others	-1,405	-1,763	-358	25	-1,120	-2,038	-918	82
PRIVATE UNREQUITED								
Transfers (Net)	**4,249**	**5,737**	**1,488**	**35**	**4,324**	**4,386**	**62**	**1**
(Workers Remittances)	2,389	4,237	1,848	77	3,231	2,875	-356	-11
Current Account Balance	**1,338**	**3,165**	**1,827**	**137**	**2,706**	**1,369**	**-1,337**	**-49**

*July - March

Source: Economic Survey (2003-04)

TABLE 13
WORKERS' REMITTANCES

(Million $)

	FY 2002	FY 2003	FY 2003*	FY 2004*	Share (%) FY 2003*	Share (%) FY 2004*
Middle East	**1070.12**	**1892.65**	**1601.18**	**1342.80**	**45.27**	**41.82**
Bahrain	39.58	71.46	59.99	67.71		
Kuwait	89.66	221.23	197.96	144.86		
Qatar	31.87	87.68	74.56	74.06		
Saudi Arabia	376.34	580.76	472.98	468.83		
Oman	63.18	93.65	77.82	87.03		
UAE	469.49	837.87	717.87	500.31		
North America	**799.50**	**1252.71**	**1038.99**	**1017.56**	**29.38**	**31.69**
Canada	20.52	15.19	12.33	18.84		
USA	778.98	1237.52	1026.66	998.72		
Europe	**171.92**	**309.59**	**246.66**	**320.22**	**6.97**	**9.97**
Norway	6.55	8.89	7.15	8.52		
Germany	13.44	26.87	20.87	38.55		
UK	151.93	273.83	218.64	273.15		
Other Countries	**299.25**	**735.78**	**616.30**	**489.85**	**17.42**	**15.26**
Other Receipts	**48.26**	**46.12**	**33.80**	**40.14**	**0.96**	**1.25**
Total	**2389.05**	**4236.85**	**3536.93**	**3210.57**	**100.00**	**100.00**

*July - April

Source: Economic Survey (2003-04)

Europe, particularly Norway, Germany and UK, has shown a 30 percent increase. The decline in remittances from North America, albeit as yet marginal, was expected; given that they are more in the nature of capital transfers rather than income flows. The decline from the Middle East cannot be attributed to a shift of transfers through the *hundi* system and may be ascribed to a decline in income flows; which is worrisome. The decline in remittances from the Middle East, given that they largely serve middle to low income households, also has adverse distributional implications.

since FY1999. This is indicated by the fact that the share in national income of the richest 20 percent of the population has increased from 44 percent in FY1988 to 47 percent in FY1999 and to 48 percent in FY2002. Correspondingly, the share of the poorest 20 percent has decreased from 9 percent to 8 percent to 7 percent over the same period [see table 14]. Consequently, it is not surprising that the richest 10 percent of households have boosted their purchasing power by 33 percent between FY1988 and FY2002, while the poorest 10 percent of households have suffered a 9 percent erosion in their purchasing power

TABLE 14
INEQUALITY MEASURES

	1988	1999	2002
Gini Coefficients			
Pakistan	0.35	0.40	0.41
Urban	0.40	0.42	0.44
Rural	0.30	0.36	0.35
Income Share of Lowest 20% Population (%)			
Pakistan	8.8	7.8	7.0
Urban	7.8	6.6	6.6
Rural	9.6	8.7	8.0
Income of Highest 20% Population (%)			
Pakistan	43.5	46.5	47.6
Urban	47.8	50.1	50.3
Rural	40.0	41.8	43.2
Ratio Highest to Lowest			
Pakistan	4.9	6.0	6.8
Urban	6.1	7.6	7.6
Rural	4.2	4.8	5.5

Source: Household Integrated Economic Survey (HIES) (1987-88, 1998-99 and 2001-02)

Income distribution, unemployment, inflation and poverty:

That the Economic Survey 2003-04 does not address the issue of income distribution, except cursorily, is disturbing. Income distribution has been worsening since FY1988 and has continued to do so over the same period. The impoverishment of households at the lower rungs of income can also be seen in terms of real wage trends. Manufacturing real wages have declined continuously since FY1999 and the fall is estimated at -3.1 percent in FY2004 [see table 15].

TABLE 15
WAGES IN MANUFACTURING SECTOR

	Nominal Wages (Rs.)	CPI (FY 2001 = 100)	Real Wages (Rs.)	Growth (%)
1991-92	21,764.0	47.4	45,905.9	
1992-93	23,057.6	52.1	44,281.9	-3.5
1993-94	25,500.8	57.9	44,012.4	-0.6
1994-95	28,887.2	65.5	44,116.0	0.2
1995-96	32,867.4	72.6	45,303.1	2.7
1996-97	37,396.1	81.1	46,105.4	1.8
1997-98	42,211.6	87.5	48,269.4	4.7
1998-99	42,146.4	92.5	45,583.4	-5.6
1999-00	42,081.3	95.8	43,935.3	-3.6
2000-01	41,945.8	100.0	41,945.8	-4.5
2001-02	41,810.8	103.5	40,381.3	-3.7
2002-03	42,754.4	106.8	40,051.0	-0.8
2003-04	43,027.4	110.9	38,801.9	-3.1

Sources:
Economic Survey (various issues)
Labour Force Survey (various issues)

No reference has also been made to the issue of regional disparity. It is now clear that a north-south divide has emerged in the country. Compared to Punjab and NWFP, where the incidence of poverty is less than 30 percent, it is over 30 percent in Sindh and nearly 40 percent in rural Sindh. Balochistan presents the worse case scenario, with about 50 percent of the population subsisting below the poverty line [see table 16].

TABLE 16
POVERTY INCIDENCE
(*Percentage of Population Below the Poverty Line*)

Province	Overall	Rural Areas
Punjab	26	24
Sindh	31	38
NWFP	29	27
Balochistan	48	51
Pakistan	33	35

Source: Estimated from Pakistan Integrated Household Survey, 2001-02.

Unemployment:
Unemployment has also been rising and has been admitted to have grown from 6 percent in FY1999 to over 8 percent in FY2004. Admittedly, the high rate of growth in the labour force - on account of the high rate of population growth in the last two decades - combined with the low rate of economic growth is primarily responsible for growing unemployment. Government policy cannot, however, be absolved for the unfortunate state of affairs. The contractionary macroeconomic policies, designed to serve stabilization objectives at the cost of growth, has to be assigned some responsibility for growing unemployment.

That unemployment has also increased over FY2004, despite the high economic and manufacturing growth rate is not surprising, if the composition of growth is analyzed. Of the 7 industries in the large-scale manufacturing sector that are reported to have posted double-digit growth, 6 are capital-intensive in terms of production technology. The exception is the Food, Beverage and Tobacco group. Two of the industries - Automobiles and

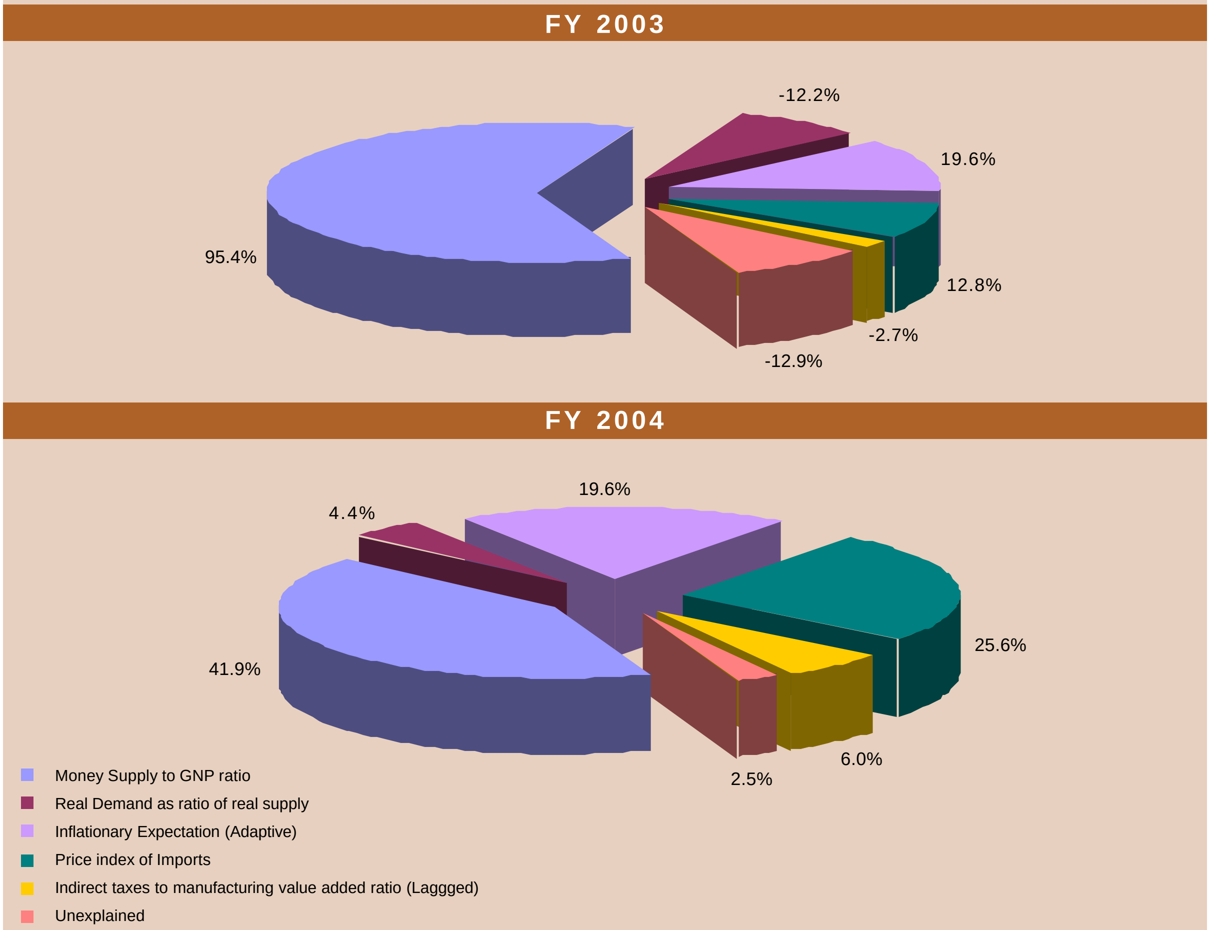
Electronics - are largely assembly type operations and one - Pharmaceuticals - is largely a packaging operation. Their multiplier effect is as such low and there is a low likelihood of the generation of secondary employment opportunities. The large-scale manufacturing sector is, thus, displaying a phenomenon of jobless growth.

Inflation:

The inflation rate continues to be low by Pakistan's historical standards, although there has been an increase in FY2004. However, while overall consumer prices have increased by 3.9 percent, food prices have risen by 4.9 percent and wheat prices have surged by about 16 percent. Given that wheat commands a weight of nearly 30 percent in the household food budget of the lowest 20 percent of households, the wheat price inflation has been particularly damaging to the economy of poor households.

The analysis of inflation factors shows that supply factors tend to dominate inflationary trends [see chart 3]. The major (41.9 percent) contribution to inflation is provided by money supply, followed by import prices (25.6 percent). The demand

CHART 3
SOURCES OF INFLATION



Source: SPDC estimates (ISPM Unit)

factor continues to be weak; implying weak purchasing power. The contribution of demand to inflation was estimated at zero in FY2001 and -12.2 percent in FY2003. There has been a slight improvement in FY2004, with demand contributing 4.4 percent to inflation.

The Economic Survey 2003-04 tends to stress on what it defines as 'core inflation', i.e., the inflation rate excluding food and energy price changes. Core inflation is important; however, from the perspective of the poor, it is food and energy prices that are more important. Ironically, core inflation is low on account of low purchasing power. It appears, therefore, that a financial statistic stands improved at the cost of the poor.

Poverty:

Agriculture, where over 40 percent of the country's labour force resides has reported low growth, unemployment has increased, and inter-personal as well as inter-regional inequality has worsened. As such, the reported 4.2 percent decline in poverty is counter-intuitive and surprising. An examination of the methodology by which the estimate has been made shows that it is conceptually and statistically flawed on a number of points.

The poverty reduction claim is based on the fact of the 35 percent increase over FY2002-2004 in average monthly consumption expenditure, against a 4 percent increase over FY1999-2002[4]. However, this is the average growth rate. The 'average' conceals the possibility that consumption growth in upper income households can be significantly larger and consumption growth in poorer households lower or even negative. The Economic Survey does not report consumption growth by income groups.

However, there are even more serious problems in terms of statistical methodology. Reference needs to be made to the government's unwillingness to accept the results of the Pakistan Integrated Household Survey (PIHS) 2001, conducted by the Federal Bureau of Statistics, which showed a rise in poverty between FY1999 and FY2001. As a consequence, the government conducted an alternative Household Consumption Expenditure Survey (HCES) in 2004. This survey, carried out over the period April 19 to May 6: 2004, sampled 5,046 rural and urban households in the four provinces of the country. By comparison, the PIHS 2001 had sampled 14,536 households.

It is implied that the data from the HCES 2004 has been tabled against the segment of the data from PIHS 2001 collected over the same period, i.e., April 19 to May 6. An examination of the raw data of PIHS 2001 shows that 1,096 (614 rural and 482 urban) households were sampled during this period. This is clearly not a representative sub-sample for comparison and the statistical bias is apparent. According to the full PIHS 2001 sample, the incidence of national, urban and rural poverty is estimated at 32.1, 22.67 and 38.99 percent, respectively. According to the sub-sample, the same is estimated at 27.3, 23.1 and 30.6, respectively. National poverty turns out to be 4.8 percentage points (15 percent) lower, rural poverty 8.39 percentage points (22 percent) lower, and urban poverty 0.43 percentage points (2 percent) higher [see table 17]. The comparison would have been valid if the same households had been enumerated in both the surveys. But that does not appear to be the case.

The Economic Survey 2003-04 has taken the difference in the poverty incidence reported by the PIHS 2001 sub-

[4]The latter comparison is based on the full samples of the PIHS 1999 and 2002; the former comparison is based on small HCES 2004 sample and the PIHS 2002 sub-sample.

TABLE 17
OFFICIALLY ESTIMATED POVERTY TRENDS

	HIES 2000-01	April 19 to May 6 HIES 2000-01 (Sub-Sample)	April 19 to May 6 HCES 2004
Sample Size	**14,536**	**1,096**	**5,046**
National	32.10	27.30	23.10
Urban	22.67	23.10	13.60
Rural	38.99	30.60	28.35

Source: Pakistan Economic Survey (2002-03 and 2003-04)

sample and HCES 2004 and concluded that poverty has declined over FY2001-2004 by 4.2 percentage points. Given the questionable methodology employed, the comparison of poverty data over FY2001-2004 is spurious and the result clearly doubtful. By the same token, the results on living conditions and selected social indicators, based on HCES 2004, are open to question.

According to SPDC estimates based on consistent methodology applied for all years, poverty in FY2002 has increased by 3.3 percent from 30 percent in FY1999 to 33 percent in FY2002 with urban poverty increasing by 6.7 percent from 25 percent in FY1999 to 30 percent in FY2002 [see table 18].

TABLE 18
SPDC POVERTY ESTIMATES

(%)

	FY 1988	FY 1997	FY 1999	FY 2002
Pakistan	23	28	30	33
Growth (%)		*2.4*	*3.6*	*3.3*
Urban	19	25	25	30
Growth (%)		*3.5*	*0*	*6.7*
Rural	26	30	32	35
Growth (%)		*1.7*	*3.3*	*3.1*

Source: HIES/PIHS 1987-88, 1996-97, 1998-99 and 2001-02.

FISCAL ANALYSIS

The Budget 2004-05 has been prepared under conditions of relaxed constraints and there are several positive aspects that deserve to be commended. Several welcome shifts, albeit slight, can be discerned in the direction of policy. There appears to be a tentative shift in emphasis from stabilization to growth, from monetary policy to fiscal policy, and from contractionary to expansionary fiscal policy. This is indicated somewhat by the increase in development expenditure, the rationalization of sales tax rates, the acknowledgement of the need to reduce the cost of production in order to render manufacturing exports competitive, and so on.

These measures are certainly likely to boost economic activity and provide jobs and raise incomes. However, given that there has been a distinct increase in unemployment and poverty, the Budget does not appear to make meaningful allowances for direct efforts to generate employment or alleviate poverty. There appears to be a continuing reliance on the operation of the 'trickle-down effect'. However, the 'trickle-down effect' cannot be expected to operate for the simple reason that asset and income distribution in Pakistan are highly skewed and there is evidence that the increments in national income have been appropriated largely by upper income groups. As such, it not enough to be content with a higher rate of growth. The composition of growth and the distribution of the benefits of growth also need to be taken into account.

A detailed analysis of budgetary trends is constrained by the change in reporting formats, which renders exact correspondence between historical data and new estimates difficult. For instance, the previous budgets presented general administration, debt servicing, and grants

TABLE 19
BUDGET PERFORMANCE IN FY 2004 AND FY 2005

(Billion Rs.)

	Heads	FY 2004 Budgeted (1)	FY 2004 Revised (2)	Difference (2-1)	FY 2005 Budgeted (3)	Difference (3-2)
	Current Expenditures	645.2	714.0	68.8	700.8	-13.2
Minus	Repayment of Foreign Loans	46.0	111.3	65.3	51.1	-60.2
	Current Expenditures (Excluding Repayments of Foreign Debt)	599.3	602.8	3.5	649.7	46.9
Plus	Development Expenditures	160.0	154.4	-5.6	202.0	47.6
Minus	Net Revenue Receipts	513.5	549.6	36.0	557.1	7.6
Minus	Self-Financing of PSDP by Provinces	30.0	34.8	4.9	33.1	-1.7
Minus	Recovery of Loans from Provinces	11.8	17.3	5.5	13.2	-4.1
Minus	Provincial Surplus	28.0	14.3	-13.6	31.6	17.2
Minus	Net Lending to others	-11.1	-32.8	-21.7	3.6	36.4
	FISCAL DEFICIT	179.1	173.9	-5.2	213.0	39.2

Source: Estimates based on Federal Budget in Brief 2004-05

to provinces as separate heads of expenditure, but have now been clubbed under 'General Public Services'. Other minor reshuffling of minor heads has also been made. Subject to these constraints, an analysis of the Budget is attempted, nevertheless.

Budget Deficit:

The revised budget deficit is lower than the budget estimate for FY2004 by Rs. 5.2 billion (or 2.9 percent), but is projected to increase to Rs. 213 billion in FY2005. The projected increase amounts to an increase of about 22 percent over the revised deficit for the outgoing year. This appears to be indicative of the tentative movement towards an expansionary policy framework [see table 19].

The analysis of the financing of the fiscal deficit shows that the deficit for FY2004 was financed to the extent of over 90 percent from domestic sources - bank and non-bank borrowing and privatization proceeds - and only 9 percent from external resources. This is on account of the pre-payment of foreign debt. For FY2005, external financing of fiscal deficit is projected to increase to 37 percent. It is possible that there is an attempt to take advantage of the low cost of borrowing in international money markets. However, the rise in external indebtedness needs to be carefully monitored [see table 20].

Analysis of Revenues:

Net Revenue Receipts is the difference between Gross Revenue Receipts and transfers to provinces. The former is the sum of tax revenues, surcharges and non-tax revenues. The latter is the sum of divisible pool and straight transfers to provinces under the NFC Awards.

A comparison of budgeted and revised gross revenue receipts indicates a higher collection of Rs. 32.6 billion, or 4.5 percent [see table 21]. The increase in gross revenue receipts is provided entirely by non-tax sources, which have grown by 20 percent, and by surcharges, which have grown by 5 percent. The growth in non-tax receipts is the outcome of higher collection of Rs. 12.3 billion from defence, Rs. 9.6 billion from dividends in

TABLE 20
ANALYSIS OF FISCAL DEFICIT FINANCING

Heads	FY 2004 Budgeted (1)	FY 2004 Revised (2)	Difference (2-1)	FY 2005 Budgeted (3)	Difference (3-2)
FINANCING OF THE DEFICIT	**179.1**	**173.9**	**-5.2**	**213.0**	**39.2**
Non-Bank Borrowings	51.8	73.0	21.2	74.7	1.6
Share (%)	*28.9*	*42.0*		*35.0*	
Net External Resources	89.4	15.8	-73.6	78.2	62.4
Share (%)	*44.9*	*8.8*		*36.7*	
Bank Borrowings	27.9	74.1	46.1	45.2	-28.9
Share (%)	*15.6*	*42.6*		*21.2*	
Privitization Proceeds	10.0	11.0	1.0	15.0	4.0
Share (%)	*5.6*	*6.6*		*7.1*	

Source: Federal Budget in Brief 2004-05

TABLE 21
COMPARISON OF TARGET AND ACTUAL FEDERAL RECEIPTS

(Billion Rs.)

	FY 2000	FY 2001	FY 2002	FY 2003*	FY 2004*
Gross Revenue Receipts					
Target	560.9	594.6	643.8	674.9	728.4
Actual	531.3	535.1	622.7	703.3	761.0
Actual as % of Target	94.7	90.0	96.7	104.2	104.5
Tax Revenues (CBR)					
Target	356.0	435.7	457.7	460.6	510.0
Actual	347.1	392.3	404.1	460.6	510.0
Actual as % of Target	97.5	90.0	88.3	100.0	100.0
Direct Taxes					
Target	127.0	137.5	149.8	148.4	161.1
Actual	113.0	124.6	142.5	151.7	161.5
Actual as % of Target	88.9	90.6	95.1	102.2	100.2
Indirect Taxes					
Target	229.0	298.2	307.9	312.2	348.9
Actual	234.2	267.7	261.6	308.9	348.5
Actual as % of Target	102.3	89.8	85.0	98.9	99.9
Import Duties					
Target	65.5	73.0	69.6	56.5	78.1
Actual	61.7	65.0	47.8	69.1	86.6
Actual as % of Target	94.1	89.1	68.7	122.3	110.9
Federal Excise					
Target	67.0	52.6	53.1	50.0	47.7
Actual	55.8	49.1	47.2	45.0	43.5
Actual as % of Target	83.3	93.3	88.9	90.1	91.2
Sales Tax					
Target	96.5	172.6	185.2	205.7	223.1
Actual	116.7	153.6	166.6	194.8	218.4
Actual as % of Target	120.9	89.0	89.9	94.7	97.9
Surcharges					
Target	63.3	38.0	47.0	60.5	61.1
Actual**	38.9	30.5	53.9	66.9	64.4
Actual as % of Target	61.5	80.3	114.7	110.5	105.3
Non-Tax Revenues					
Target	141.7	120.9	139.1	153.8	157.2
Actual	145.3	112.3	164.7	175.8	186.6
Actual as % of Target	102.5	92.9	118.4	114.3	118.7

Sources:
Targets and Revised Estimates are from Federal Budget in Brief various Issues
Actuals are from SBP Annual Report Various Issue, SBP Website
* Revised Estimates for FY 2003 (only surcharges and non tax revenues) and FY 2004
** Included arrears of 5.768 Billion in 2002-03 and 3.774 Billion in 2003-04

government investments, and Rs. 11 billion from other sources. The additional receipts from surcharges are on account of collection of arrears. This is indicated by the fact that while the additional receipts equal Rs 3.3 billion, collection of arrears equals Rs. 3.8 billion.

This is the second year in which actual revenue receipts have exceeded the target, by a little over 4 percent in each of the two years. This is indeed commendable. However, this is also the second year in which the targeted and actual tax collections are *exactly* the same. The targeted and actual receipts for direct and indirect taxes are also *exactly* the same for the year FY2004. This is bewildering.

Subject to questions regarding the data, there are two disconcerting aspects with respect to trends in tax receipts. The Budget FY2004 set the GDP growth target of 5.1 percent and the tax revenue growth target was fixed accordingly. However, despite the impressive higher than target 6.5 percent growth in GDP in FY2004, tax collection[5] failed to exceed the pre-fixed target of Rs. 510 billion. Rather, growth in tax revenues, as well as in all components is lower in FY2004 compared to FY2005 [see Table 22]. Resultantly, the tax-GDP ratio declined from 9.6 percent in FY2003 to 9.3 percent in FY2004. Moreover, the revenue-GDP ratio also declined from 15.0 to 14.3 percent during this period. This is indicative of either low buoyancy of the tax regime or slippage in tax collection.

Further, there is a continuing decline for the second year in the share of direct taxes in total tax receipts. The share has fallen from 35.3 percent in FY2002 to 32.9 percent in FY2003 to 31.6 percent in FY2004 and is projected to decrease further - albeit, marginally - to 31.4 percent in FY2005. The direct tax-GDP ratio has

TABLE 22
ANALYSIS OF GROWTH IN CBR TAX COLLECTIONS

(Billion Rs.)

	ACTUAL				Revised	Budgeted
	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
TAX REVENUES	**347.1**	**392.3**	**404.1**	**460.6**	**510.0**	**580.0**
Growth	12.5%	13.0%	3.0%	14.0%	10.7%	13.7%
Direct Taxes	**113.0**	**124.6**	**142.5**	**151.7**	**161.1**	**181.9**
Growth	2.5%	10.3%	14.4%	6.5%	6.2%	12.9%
% Share in Taxes	*32.5*	*31.8*	*35.3*	*32.9*	*31.6*	*31.4*
Indirect Taxes	**234.2**	**267.7**	**261.6**	**308.9**	**348.5**	**398.1**
Growth	18.1%	14.3%	-2.3%	18.1%	12.8%	14.2%
% Share in Taxes	*67.5*	*68.2*	*64.7*	*67.1*	*68.3*	*68.6*
Customs	**61.7**	**65.0**	**47.8**	**69.1**	**86.6**	**103.2**
Growth	-5.6%	5.5%	-26.5%	44.5%	25.3%	19.2%
Federal Excise	**55.8**	**49.1**	**47.2**	**45.0**	**43.5**	**45.7**
Growth	-8.4%	-12.0%	-3.9%	-4.6%	-3.4%	5.1%
Sales Tax	**116.7**	**153.6**	**166.6**	**194.8**	**218.4**	**249.2**
Growth	61.9%	31.6%	8.5%	16.9%	12.1%	14.1%

Source: SBP Annual Report Various issues and Federal Budget in Brief 2004-05.

[5]Tax collection by Central Board of Revenue (CBR)

also declined from 3.08 percent in FY2003 to 2.95 percent in FY2004. The distributional implication of this decline is not inconsequential.

Analysis of Current Expenditures:

A comparison of budgeted and revised current expenditures indicates over-spending of Rs. 68.8 billion or 11 percent [see table 23]. However, the bulk of this increase is on account of the hefty retirement of expensive foreign debt, with the result that the revised debt servicing payments have been posted at about 24 percent above the target. The reduction of debt liabilities is certainly likely to strengthen the economy. Net of debt repayment, current expenditures have been more or less on target.

Defence expenditure has again overrun by 13 percent, while expenditure on subsidies is below target, with only 63

TABLE 23
COMPARISON OF BUDGETED AND ACTUAL FEDERAL EXPENDITURES
(Billion Rs.)

	FY 2000	FY 2001	FY 2002	FY 2003*	FY 2004*
Current Expenditures					
Budget Estimates	525.9	577.6	621.7	608.0	645.2
Actual	592.5	593.6	650.4	673.3	714.0
Actual as % of B.E.	112.7	102.8	104.6	110.7	110.7
Defence					
Budget Estimates	142.0	13.5	131.6	146.0	160.3
Actual	152.8	131.1	149.3	160.1	180.5
Actual as % of B.E.	107.6	98.2	113.4	109.7	112.7
Debt Servicing					
Budget Estimates	287.4	305.6	329.2	289.7	256.0
Actual	330.6	312.7	318.7	257.4	317.7
Actual as % of B.E.	115.0	102.3	96.8	88.9	124.1
Subsidies					
Budget Estimates	2.4	11.8	20.7	20.8	63.9
Actual	20.4	20.4	25.5	49.8	40.4
Actual as % of B.E.	841.7	172.4	123.2	239.4	63.3
Other Current Expenditures					
Budget Estimates	94.1	126.6	140.2	151.4	165.2
Actual	88.7	129.4	156.9	206.0	175.3
Actual as % of B.E.	94.3	102.2	111.9	136.0	106.1
Public Sector Development Program (PSDP)					
Budget Estimates	116.3	120.4	130.0	134.0	160.0
Actual	95.6	89.8	125.0	131.6	154.4
Actual as % of B.E.	82.2	74.6	96.2	98.2	96.5
Federal Current Expenditure + PSDP					
Budget Estimates	642.2	698.0	751.7	742.0	805.2
Actual	688.1	683.4	775.4	804.9	868.3
Actual as % of B.E.	107.1	97.9	103.1	108.5	107.8

Sources:
Budgeted and Revised Estimates are from Federal Budget in Brief various Issues
Actuals are from SBP Annual Report Various Issue, SBP Website
*Revised Estimates.

percent of budgeted allocations being spent. The decline is due to the non-utlilization of Rs. 21.5 billion allocated under the sub-head 'Shortfall in Offsetting Liabilities of Public Sector Enterprises'. This, perhaps, indicates improved performance on the part of public sector enterprises. The analysis of subsidies shows that WAPDA is the single largest recipient of subsidies at Rs. 15.8 billion, followed by KESC at Rs. 11.7 billion. The combined share of the two power utilities in total subsidies amounts to 68 percent, against the budgeted share of 44.3 percent [see table 24].

For FY2005, the allocation for subsidies stands reduced by 16.3 percent from the revised expenditure of Rs. 40.4 billion in FY2004 to Rs. 33.8 billion in FY2005. However, the share of the two power utilities can be seen to have increased to 73.7 percent. It appears that WAPDA and KESC, which have received significant write-offs of accumulated deficits over the last 2-3 years, are continuing to hemorrhage the public treasury.

For FY2005, the most outstanding feature of the Budget is the projected Rs 13.2 billion or 2 percent decrease in current expenditure over the revised expenditures of FY2004. While the amount reduced is small, the move towards reduction of current expenditure in nominal terms is eminently welcome [see table 25].

The composition of the changes in budgeted current expenditures, however, renders the exceptional feat somewhat off-colour. The decrease occurs on account of a 5.4 percent reduction in

TABLE 24
ANALYSIS OF SUBSIDIES

(Billion Rs.)

	FY 2004				FY 2005	
	Budgeted	Share (%)	Revised	Share (%)	Budgeted	Share (%)
Subsidies for WAPDA	**15.1**	**23.6**	**15.8**	**39.1**	**16.1**	**47.6**
WAPDA for Adustment of GST	12.1		13.3		13.3	
WAPDA for Tariff Differantial AJ&K	1.0		1.0		1.1	
WAPDA for Agricultural Tubewells in Balochistan	1.5		1.5		1.7	
WAPDA for Tubewells (PM Directives)	0.5		0.0		0.0	
Subsidies for KESC	**13.2**	**20.7**	**11.7**	**29.0**	**8.8**	**26.0**
KESC for Adustment of GST	1.5		2.1		2.3	
KESC to Pickup Cash Shortage	11.7		9.6		6.5	
Others	**35.6**	**55.7**	**12.9**	**31.9**	**8.9**	**26.4**
Fauji Fertilizer Bin Qasim LTD.	1.1		1.1		1.0	
Oil Refineries	7.0		6.0		6.0	
TCP on Export of Cotton	0.3		0.3		0.0	
Shortfall in Off-setting Liabilities of PSEs	21.5		0.0		0.1	
PASSCO for Wheat Export	3.5		4.5		1.3	
Afghan Refugees	0.0		0.0		0.0	
Punjab Govt on Account of Wheat Export	1.6		0.5		0.0	
TCP on Export of Sugar	0.6		0.5		0.6	
AMSL on Account of Operational Losses	0.1		0.1		0.0	
Total	**63.9**	**100.0**	**40.4**	**100.0**	**33.8**	**100.0**

Source: Details of Demand for grants and appropriations 2004-05, Current Expenditure Volume 1.

TABLE 25
ANALYSIS OF GROWTH IN CURRENT EXPENDITURES

(Billion Rs.)

	FY 2004			FY 2005	
	Budgeted (1)	Revised (2)	Difference (2-1)	Budgeted (3)	Difference (3-2)
General Public Service	**377,926**	**448,430**	**70,504**	**423,835**	**-24,595**
Executive & Legislative Organs, Financial	308,440	377,217	68,777	349,514	-27,703
Interest on Domestic Debt	170,500	161,520	-8,980	170,209	8,689
Interest on Foreign Debt	39,490	44,945	5,455	44,039	-906
Repayment of Foreign Debt	45,978	111,258	65,280	51,080	-60,178
Pensions	37,625	40,995	3,370	42,533	1,538
Others	14,847	18,499	3,652	41,653	23,154
Foreign Economic Aid	61	61	0	60	-1
Transfer Payments	62,058	65,026	2,968	65,412	386
General Services	1,639	1,644	5	1,727	83
Basic Research	404	577	173	566	-11
R&D General Public Services	2,114	2,187	73	2,453	266
Admn. Of General Public Service	189	189	0	422	233
General Public Services not defined elsewhere	3,021	1,529	-1,492	3,681	2,152
Defence Affairs & Services	160,250	180,537	20,287	193,926	13,389
Public Order and Safety Affairs	12,957	14,048	1,091	15,068	1,020
Economic Affairs	78,164	54,758	-23,406	48,767	-5,991
Environment Protection	132	132	0	136	4
Housing and Community Amenities	821	926	105	832	-94
Health Afairs and Services	2,805	2,809	4	3,254	445
Recreational, Cultural and Religion	2,002	2,003	1	2,197	194
Education Affairs and Services	9,644	9,641	-3	12,215	2,574
Social Protection	535	737	202	539	-198
Total	**645,236**	**714,021**	**68,785**	**700,769**	**-13,252**

Source: Federal Budget in Brief 2004-05

expenditure on 'General Public Services', i.e, debt, pensions, research, transfer payments, and general public services, and in human development heads, i.e., economic affairs, environment, housing, community amenities, health, recreation, religion, education, and social protection. This decrease is partly offset by the 7.4 percent increase in security related heads, i.e., defence and public order and safety It needs to be highlighted, however, that within the human development heads, allocation to education has been increased by a significant 27 percent [see table 25].

For FY2005, foreign debt repayment is estimated at Rs 51.1 billion and other current expenditures are budgeted at Rs. 649.7 billion. The latter constitutes a Rs. 47 billion or 7.8 percent increase over revised expenditures in FY2004 [see table 3]. This increase, at about twice the inflation rate, indicates a significant growth in real terms in non-debt related current expenditures and implies that the benefit of lower debt servicing burden is proposed to be channeled in a rather profligate manner.

TABLE 26
ANALYSIS OF GROWTH IN DEVELOPMENT EXPENDITURES

(Billion Rs.)

	FY 2004		FY 2005		Growth
	Amount	Share	Amount	Share	(%)
Federal Program	**113,003**	**70.6%**	**148,002**	**73.3%**	**31.0%**
Federal Ministries/Divisions	61,335	38.3%	96,583	47.8%	57.5%
Cabinet Division	44	0.0%	448	0.2%	918.2%
Interior Division	2,729	1.7%	4,930	2.4%	80.7%
Pakistan Atomic Energy Commission	575	0.4%	4,820	2.4%	738.3%
Defence Division	593	0.4%	963	0.5%	62.4%
Law & Justice Division	2,125	1.3%	2,400	1.2%	12.9%
Finance Division	3,911	2.4%	7,629	3.8%	95.1%
Population Welfare Division	3,115	1.9%	2,586	1.3%	-17.0%
Women Dev. & Social Welfare Division	1,028	0.6%	1,259	0.6%	22.5%
Communications Divisions	3,089	1.9%	6,245	3.1%	102.2%
Information Tech. & Telecom Division	2,000	1.2%	2,733	1.4%	36.7%
Education Division & HEC	7,585	4.7%	12,463	6.2%	64.3%
Health Division	4,373	2.7%	6,045	3.0%	38.2%
Food, Agriculture & Livestock Division	1,500	0.9%	7,290	3.6%	386.0%
Water & Power Division	14,689	9.2%	20,767	10.3%	41.4%
Housing & Works Division	701	0.4%	926	0.5%	32.1%
Others	13,278	8.3%	15,079	7.5%	13.6%
Corporations	35,699	22.3%	31,334	15.5%	-12.2%
WAPDA (Power)	12,630	7.9%	13,714	6.8%	8.6%
WAPDA - Village Electrification	1,000	0.6%	500	0.2%	-50.0%
KESC	3,672	2.3%	0	0.0%	-100.0%
National Highway Authority	18,397	11.5%	17,120	8.5%	-6.9%
Special Program	6,600	4.1%	8,840	4.4%	33.9%
Special Area	9,369	5.9%	11,245	5.6%	20.0%
Provincial Program	**47,000**	**29.4%**	**54,000**	**26.7%**	**14.9%**
TOTAL PSDP	**160,003**	**100.0%**	**202,002**	**100.0%**	**26.2%**

Source: Federal Budget in Brief 2003-04 and 2004-05

Analysis of Development expenditure:

Development expenditure for FY2004 is on target to the extent of almost 97 percent. This is indeed commendable. The over 30 percent increase in the development budget for FY2005 is also laudable. Unfortunately, however, the allocation falls far short of what is required to raise and sustain the rate of growth of the economy or for a meaningful reduction of poverty. Huge gaps exist in the availability and need for employment opportunities, particularly in rural areas, and for housing, health, and education, and substantial enhancements in allocations are urgently called for to meet the challenges. At the very minimum, at least 5 percent of GDP needs to be allocated for development expenditures; implying a minimum allocation of Rs. 255 billion in FY2004 prices.

The highlight of the development programme for FY2005 is that, between FY2004 and FY2005, the share of Federal Ministries and Divisions has increased from 38 to 48 percent and this increase is proposed to be at the cost of the Corporations, which stands reduced from 22.3 to 15.5 percent, and of the Provincial Programme, which stands reduced from 29.4 to 26.7 percent. About 84 percent of the decrease in the allocation for Corporations is on account of KESC, which has been provided zero allocation for FY2005 [see table 26].

Within the federal programme, 85 percent of the allocation is for on-going schemes and 15 percent for new schemes. Within on-going schemes, the top three sectors in terms of allocations are water (Rs. 20.4 billion), power (Rs. 13.7 billion), and highways (Rs. 14.4 billion). The priority that is being accorded to the water sector is appropriate, given that agricultural growth is increasingly a function of water use efficiency. Within the new schemes, the three top sectors are education (Rs. 4.2 billion), highways (Rs. 2.7 billion) and interior (Rs. 2.0 billion). The allocation for education is largely for higher education, given that lower levels of education is the domain of provincial governments. Nevertheless, the attention accorded to education was long over-due and is certainly welcome. The large additional allocation for the Interior Division is understandable, given the worsening internal security situation [see table 27].

Three areas where on-going allocations are already relatively low and there has been less than 10 percent increase in terms of new allocations are housing, health, and food, agriculture & livestock. This is clearly inadequate. Moreover, given that the share of the provincial programme has declined, provincial allocations for these sectors are also unlikely to increase meaningfully. Significant augmentation of resources for these sectors, at the federal as well as provincial levels, is necessary for a sizeable and rapid dent in poverty.

Regional development:

As stated earlier, a north-south divide has emerged in the country [see table 15], with poverty in Punjab and NWFP being below 30 percent and in Balochistan and rural Sindh in the 40 to 50 percent range. The federal contribution to the provincial development programmes in FY2004 is likely to exacerbate this divide [see table 28]. On the one hand, the extent of federal contribution is 56 percent to NWFP and 28 percent to Punjab and, on the other hand, it is just 19 percent to Sindh and 8 percent to Balochistan. The distribution of Foreign Project Assistance is similarly skewed, with the respective shares of Punjab, NWFP, Sindh and Balochistan being 53, 29, 12 and 6 percent.

For FY2005, the share of federal financing of the provincial development programme has been enhanced significantly for Balochistan from 8 to 58 percent. The shares for Punjab and Sindh also stands increased to 34 and 23 percent, respectively. These budgeted increases have occurred at the expense of NWFP, with its share projected to reduce from 56 to 50 percent. The share of foreign project assistance for FY2005 has also increased for Balochistan from 6 to 21 percent. Correspondingly, it has decreased for Punjab from 53 to 42 percent, for NWFP from 29 to 27 percent, and for Sindh from 12 to 10 percent.

Admittedly, development projects are characterized by 'lumpiness' and the location of any one large federally financed project in any one year can alter inter-provincial shares dramatically. Nevertheless, particular attention is in order to correct the growing north-south divide.

TABLE 27
COMPOSITION OF DEVELOPMENT EXPENDITURES

(Million Rs.)

		Allocation for FY 2005				
		Total	Ongoing	Share	New	Share
I.	**INFRASTRUCTURE DEVELOPMENT**	**80,610**	**72,735**	**90.2**	**7,875**	**9.8**
	Water & Power Division (Water Sector)	20,767	20,383	98.2	384	1.8
	WAPDA (Power)	13,714	13,714	100.0	0	0.0
	WAPDA - Village Electrification	500	0	0.0	500	100.0
	National Highway Authority	17,120	14,420	84.2	2,700	15.8
	Pakistan Atomic Energy Commission	4,820	4,549	94.4	271	5.6
	Petroleum & Natural Resources Division	534	81	15.2	453	84.8
	Communications Divisions (Ports)	6,245	6,245	100.0	0	0.0
	Railways Division	9,281	9,026	97.3	255	2.7
	Finance Division	7,629	4,317	56.6	3,312	43.4
II.	**SOCIAL DEVELOPMENT**	**22,444**	**16,989**	**75.7**	**5,455**	**24.3**
	Education Division & HEC	12,463	8,188	65.7	4,275	34.3
	Health Division	6,045	5,502	91.0	543	9.0
	Population Welfare Division	2,586	2,586	100.0	0	0.0
	Women Dev. & Social Welfare Division	1,259	674	53.5	585	46.5
	Labor, Manpower & OP Division	91	40	43.8	51	56.2
III.	**OTHERS**	**24,863**	**19,379**	**77.9**	**5,484**	**22.1**
	Cabinet Division	448	138	30.8	310	69.2
	Commerce Division	40	40	100.0	0	0.0
	Cluture, Sports, Tourism & YA Division	631	502	79.6	129	20.4
	Defence Division	963	628	65.2	335	34.8
	Environment Division	355	318	89.5	37	10.5
	Establishment Division	5	4	80.0	1	20.0
	Food, Agriculture & Livestock Division	7,290	6,967	95.6	323	4.4
	Industires & Investment Division	392	87	22.2	305	77.8
	Information & Broadcasting Division	500	456	91.3	44	8.7
	Information Tech. & Telecom Division	2,733	2,005	73.4	728	26.6
	Interior Division	4,930	2,979	60.4	1,951	39.6
	Law & Justice Division	2,400	2,400	100.0	0	0.0
	Local Govt. & Rural Development Division	272	272	100.0	0	0.0
	Narcotics Control Division	167	163	97.6	4	2.4
	Planning & Development Division	688	357	51.9	331	48.1
	Science & Technilogical Research Division	1,910	1,188	62.2	722	37.8
	Statistics Division	63	8	13.0	55	87.0
	Housing & Works Division	926	867	93.6	59	6.4
	Foreign Affairs Division	150	0	0.0	150	100.0
Federal Ministries/Divisions/ Corporations (I+II+III)		**127,917**	**109,103**	**85.3**	**18,814**	**14.7**

Source: Public Sector Development Programme 2004-05

TABLE 28
FINANCING OF PROVINCIAL DEVELOPMENT PROGRAMME FY 2004

(%)

	Punjab	Sindh	NWFP	Balochistan	Total
Province-wise Composition of ADP Financing					
ADP	100.0	100.0	100.0	100.0	100.0
Provincial Contribution	71.9	80.8	44.1	91.9	73.3
Federal Assistance	28.1	19.2	55.9	8.1	26.7
Foreign Project Assisstance	27.9	18.9	55.7	8.0	26.5
Loans	19.4	18.8	39.6	6.9	19.7
Grants	8.5	0.1	16.1	1.1	6.8
Financing as percentage of Total Provincial ADP (Four-Province Combined)					
ADP	50.1	16.5	14.0	19.4	100.0
Provincial Contribution	49.1	18.2	8.4	24.3	100.0
Federal Assistance	52.9	11.9	29.4	5.9	100.0
Foreign Project Assisstance	52.9	11.8	29.5	5.9	100.0
Loans	49.4	15.7	28.1	6.8	100.0
Grants	63.1	0.3	33.4	3.2	100.0
FINANCING OF PROVINCIAL DEVELOPMENT PROGRAMME FY 2005					
Province-wise Composition of ADP Financing					
ADP	100.0	100.0	100.0	100.0	100.0
Provincial Contribution	66.1	76.6	50.5	42.4	61.3
Federal Assistance	33.9	23.4	49.5	57.6	38.7
Foreign Project Assisstance	33.7	23.2	49.4	57.4	38.5
Loans	33.7	23.0	38.5	53.2	35.6
Grants	0.0	0.2	10.8	4.2	2.9
Financing as percentage of Total Provincial ADP (Four-Province Combined)					
ADP	47.9	17.1	21.2	13.9	100.0
Provincial Contribution	51.6	21.3	17.4	9.6	100.0
Federal Assistance	42.0	10.4	27.0	20.6	100.0
Foreign Project Assisstance	41.9	10.3	27.1	20.7	100.0
Loans	45.4	11.0	22.9	20.7	100.0
Grants	0.0	1.0	78.9	20.1	100.0

Source: Explanatory Memorandum on Federal Receipts 2004-05

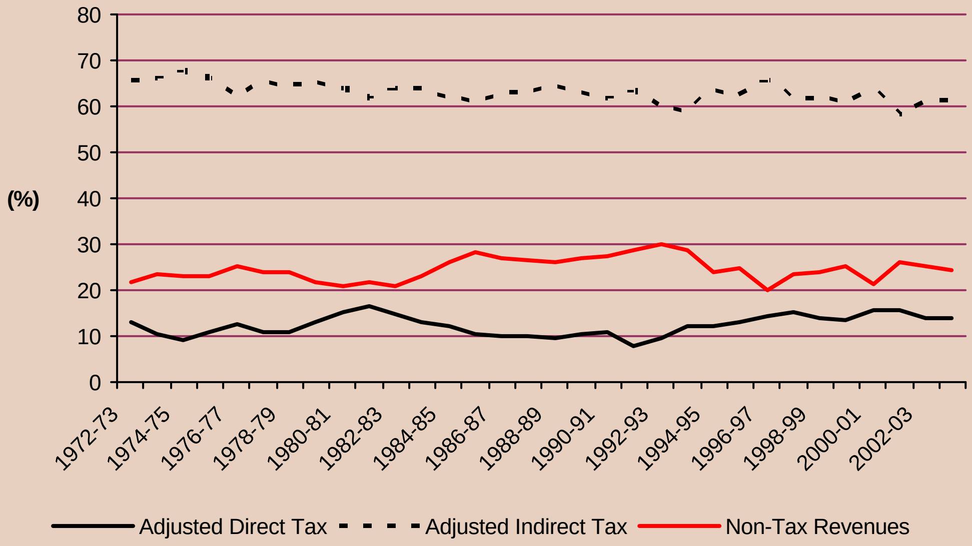
CASE FOR POLICY SHIFTS:

Budgets are an annual phenomena. So are evaluations of the budgets. A longer term 30 year view of budgets shows that the basic structure of revenues and expenditures has remained more or less constant [see chart 4]. As a percentage of total gross revenue receipts, direct tax revenues (adjusted for indirect element of withholding taxes) has consistently been between 10 to 20 percent, indirect tax revenues (adjusted for indirect element of withholding taxes) has ranged between 60 to 70 percent, and non-tax revenues has ranged between 20 to 30 percent. And as a percentage of total expenditures, the period FY1974-1977 saw the share of current expenditure declining and that of development expenditure increasing. FY1977 was a unique year in which development expenditure exceeded current expenditure. From FY1978, however, current expenditure has remained above development expenditure. Moreover, the share of current expenditure has also constantly risen and that of development expenditure fallen. Since about FY1997, the respective shares of current and development expenditures are constant at 80-90 percent and 10-20 percent, respectively [see chart 5].

While budgets are debated variously as being 'investment-oriented', 'growth-oriented', 'pro-poor', and so on, unemployment and poverty has continued to rise, income and asset distribution have become more unequal - inter-personally and inter-regionally -, and access to housing, health and education for the poor has tended to stagnate. The state of affairs renders the entire gamut of exercises in analyzing and debating the budget and its nuances meaningless for the bulk of the population and, in particular, for the poor.

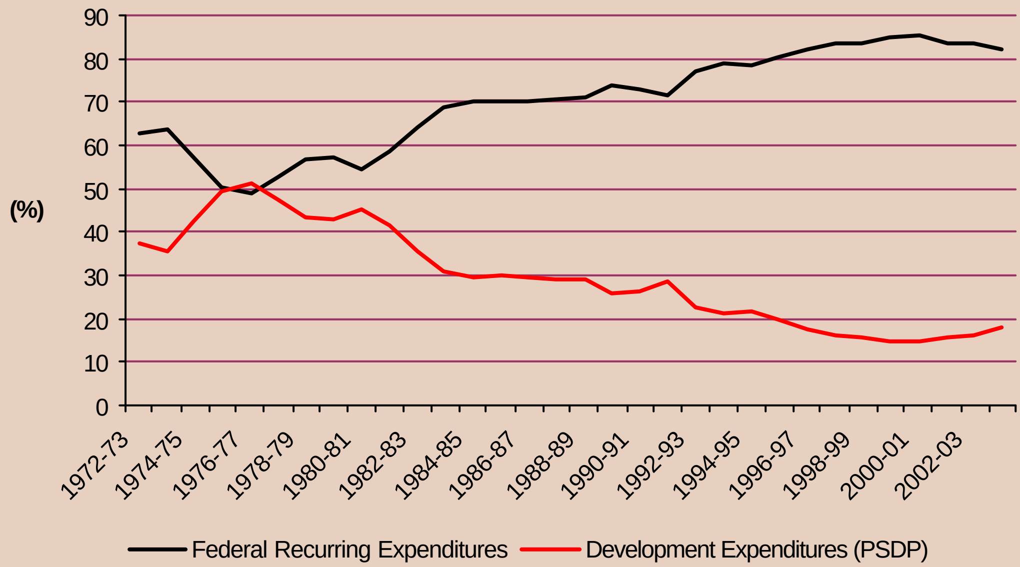
It may, therefore, be necessary to consider a parametric shift in the manner

CHART 4
TREND IN COMPOSITION OF REVENUE RECEIPTS



Source: Federal Budget in Brief (various issues)

CHART 5
TREND IN COMPOSITION OF EXPENDITURE SHARES



Source: Federal Budget in Brief (various issues)

allocations of tax burdens and expenditures are made. It is not possible here to present definite positions. However, some indicative measures can be suggested with the objective of initiating a debate and with a view to rendering the budgets and budgetary exercises meaningful for the bulk of the population and, in particular, the poor. Three hitherto under-budgeted sectors are outlined herewith.

There is empirical evidence to link rural poverty with asset ownership. While effective land reforms to reduce rural landlessness needs to be re-introduced on the national agenda, several supplementary measures can be taken to alleviate poverty. These include development of livestock and dairy industry and other off-farm economic opportunities across the country. A special development plan needs to be developed and the required resources allocated to this end.

The high cost of private housing, particularly land, has escalated rental values and rendered a roof over one's head unaffordable for most middle and lower middle class families. The poor, who generally reside in katchi abadis, have a high proportion of home ownership; but have to contend with abysmally poor quality of housing services. The chronically poor have to contend with temporary thatched huts that do not even provide them adequate protection from the elements of nature. The high monetary and non-monetary cost of housing and the consequential sense of personal insecurity is a major factor in impoverishment. Given the magnitude and severity of the problem, it is perhaps an opportune time to suggest that housing be considered a basic right and legislation introduced to render it incumbent for the state to provide minimal housing to every family. Clearly, sufficient resources will have to be allocated to this end.

The complete absence of health coverage for all, except the privileged few that can afford private health care, constitutes a major drain on the resources of families where a member (or members) is afflicted with a serious medical problem and require surgery and/or long-term treatment. There is evidence to show a rapid rate of asset depletion and descent into poverty for these families. There is also evidence to show that the very poor do not even consider obtaining medical care and simply resign themselves to the impending death of their loved one. There is an urgent need for a comprehensive health insurance scheme to cover chronic disease cases at the least. Clearly, sufficient resources will have to be allocated to this end.

CONCLUSIONS:

The verdict on the economic performance during FY2004 and on the Budget for the year FY2005 is mixed. Clearly, the higher than targeted GDP growth rate, particularly the stellar growth in large-scale manufacturing, is commendable. This is the first time since FY1996 that the GDP growth rate has surpassed 6 percent and the manufacturing growth rate is a record. Imports and exports have both picked up appreciably and tends to corroborate manufacturing growth data. One particular bright spot is the emergence of engineering goods on the export front. Revenue receipts have again exceeded the target. Net of debt repayment, current expenditures have also been on target. The pre-payment of expensive foreign debt is a positive move and correspondingly reduces the economic as well as the political burden on the national economy.

Most importantly, there appears to be a welcome change from the trend prevailing in the last few years, i.e., a tentative move away from an almost exclusive concern with stabilization goals and an acknowledgement of the importance and urgency of growth objectives. This is evident from the fact that the development allocation for FY2004 has been utilized to the extent of over 96 percent, that there is an over 30 percent increase in development expenditure over revised expenditure of FY2004, and that it is for the first time since FY1993 that the allocation for development has exceeded that for defence; albeit marginally.

There are concerns too, beginning with questions regarding the data, which raises unease relating to transparency, plausibility and reliability. There are instances of one set of data failing to corroborate another set of data. For example, the higher than targeted GDP growth rate is not matched by higher than targeted tax revenue collection; the significantly higher manufacturing growth rate is not matched by a corresponding increase in industrial energy consumption; customs duty receipts for several commodities increase at the same rate and this phenomenon continues for 3 years in a row; targeted and actual direct and indirect tax collections are exactly the same; and so on.

There are other concerns too. Agricultural growth is disappointing. That growth is low in *all* sub-sectors points towards serious underlying problems - technical, economic and institutional - in the agrarian economy. In manufacturing, the challenge now is to broaden and sustain the growth momentum. And the critical factor here is to build or enhance the capacity of the traditional as well as the newly emerging industries to enter the export market. Herein, arises the issue of the cost efficiency of the manufacturing sector, in order to enhance the competitiveness of the sector. The Budget does not appear to have taken due cognizance of these fundamental problems facing the two principal commodity-producing sectors.

While the economy has performed relatively well in FY2004, it also needs to be kept in mind that certain macroeconomic indicators, i.e., current account balance, appears to be positive on account of net receipts from outside the economy rather than the performance of the domestic economy.

A disturbing aspect of economic performance is that there appears to be what may be described as jobless growth. Despite the high GDP growth and even higher large-scale manufacturing growth, unemployment has risen. This is not surprising given the composition of industrial growth; i.e., the high growth industries are largely capital-intensive and assembly or packaging type operations.

A glaring deficiency of the Economic Survey 2003-04 is the absence of any meaningful reference to the issue of income distribution, including regional disparity. There is now clear evidence that inter-personal inequality has risen and a north-south divide has emerged in the country. Yet, poverty is stated to have decreased. However, given the low growth in agriculture, where over 40 percent of the country's labour force resides, increased unemployment, and the rise in inter-personal as well as inter-regional inequality, the reported decline in poverty is counter-intuitive. An examination of the methodology by which the estimate has been made shows that it is conceptually and statistically flawed on a number of points. By the same token, the results on living conditions and selected social indicators, based on HCES 2004, are equally open to question.

The Budget 2004-05 deserves to be commended on several points. The inhibition regarding allowing the budget deficit to rise appears to have been shed. However, the most outstanding feature is the projected Rs. 13.2 billion or 2 percent decrease in current expenditure over the revised expenditure of FY2004. On the down side, the combined share of the two power utilities in total subsidies amounts to 68 percent in FY2004 and increases to 73.7 percent in FY2005 It appears that WAPDA and KESC, which have received significant write-offs of accumulated deficits over the last 2-3 years, are continuing to hemorrhage the public treasury. Further, the continuing decline in the share of direct taxes has distributional implications. Moreover, the Budget does not appear to make meaningful allocations for direct efforts to generate employment or reduce poverty.

Budgets and budget evaluations are annual phenomena. However, a longer term 30 year view of budgets shows that the basic structure of revenues and expenditures has remained more or less constant. At the same time, unemployment and poverty has continued to rise, income and asset distribution have become more unequal - inter-personally and inter-regionally -, and access to basic opportunities and services for the poor has tended to stagnate. It may, therefore, be necessary to consider a parametric shift in the manner allocations of tax burdens and expenditures are made. At the very minimum, at least 5 percent of GDP needs to be allocated for development expenditures; implying a minimum allocation of Rs. 255 billion in FY2004 prices; with employment generation, housing, health and education being treated as priority sectors for allocation of development funds.

Social Policy and Development Centre
15-Maqbool Co-operative Housing Society
Block 7 & 8, Karachi 75350, Pakistan
Tel: (92-21) 111-113-113
Fax: (92-21) 4534285
E-mail: spdc@cyber.net.pk
http://www.spdc-pak.com

Foreword

The Social Policy & Development Centre is pleased to present its annual review of the state of the economy in the light of the Economic Survey 2003-04 and the Federal Budget 2004-05. SPDC and other independent economists have over the last 3 years highlighted the pitfalls - with respect to economic revival and impact on the poor - of according excessive weight to stabilization vis-à-vis growth; leading to a debate in the media and among public representatives. The first sign that this viewpoint had begun to find a voice within the economic decision making corridors was when the State Bank of Pakistan's Annual Report 2003 echoed the position regarding increasing poverty, the challenge of job creation, the need to shift policy focus towards human resource development and infrastructure, the imperative of utilizing the fiscal space for financing pro-poor budgetary expenditures, and the role of public investment to crowd-in private investment. That the Budget 2004-05 also signals a tentative move in these directions is testimony to the role that civil society organizations can play in ensuring that governments at least begin to address the concerns of the populace and, in particular, the poor.

The Review is an effort to objectively present the situation with respect to the state of the economy. It acknowledges the gains made over the year, but also identifies the areas where weaknesses are pronounced and where policy shifts are called for. And in line with SPDC's perspective, the Review highlights the equity, employment-generation and poverty reduction aspects of macroeconomic and fiscal policies.

Dr. Kaiser Bengali
Managing Director

SPDC Team

Research

Kaiser Bengali
Qazi Masood Ahmed
Haroon Jamal
Kalim Hyder
Muhammed Sabir
Iffat Ara
Tabinda Areeb
Farhan Sami Khan
Haider Hussain

Editing

Themrise Khan

Computer Graphics & Designing

Rizwanullah Khan
Zakir Husain

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