FEDERAL BUDGET 2001-02

Stabilization vs Growth

June, 2001

SOCIAL POLICY AND DEVELOPMENT CENTRE

Foreword

The Social Policy and Development Centre is pleased to present the review of the Federal Budget: 2001-02. The analysis has been prepared in the light of the budgetary process in Pakistan since the commencement of the Structural Adjustment Program in 1998. The report has been prepared in a record period of 12 days, with the research team working round the clock. The exercise involved inputting almost the entire budget - Budget in Brief, Demand for Grants and Appropriations, and Public Sector Development Programme - as well as the Pakistan Economic Survey into the computer. In addition, further information had to be obtained from individual industry sources to cross-check sector-wise manufacturing growth rates, from the meteorological department to form qualitative judgements regarding the impact of drought, and so on. Officials of the Ministry of Finance were constantly harassed with phone calls to seek clarifications and explainations. Their patient assistance is gratefully acknowledged. However, all responsibility for this report - errors of omission and commission included - rest with SPDC.

Dr. Kaiser Bengali
Acting Managing Director

The Team

The SPDC Team (in alphabetical order)

Naveed Aamir
Qazi Masood Ahmed
Aurangzeb
Kaiser Bengali
Syed Kalim Hyder
Hari Ram Lohano
Fauzia Mukarram
Mohammad Sabir

Computer Graphics & Designing

Rizwanullah Khan

Contents

1 Introduction . . . 1
2 Macroeconomic developments . . . 1
3 Trends in fiscal variables . . . 3
4 Impact of the drought . . . 6
5 Budgetary performance in 2000-01 . . . 7
6 Feasibility of 2001-02 budgetary estimates . . . 9
7 Implication of the Budget 2001-02 . . . 10
Agriculture . . . 10
Manufacturing . . . 12
Inflation . . . 13
Poverty . . . 13
8 Issues in investor confidence . . . 15
9 Expenditure analysis . . . 17
10 Consistency of mid-term projections . . . 20
11 Conclusions and Recommendations . . . 25

List of Tables

Table 1:	Profile of Macroeconomic Development	2
Table 2:	Trends in Fiscal and Real Variables	4
Table 3:	Economic Impact of the Drought	7
Table 4:	Failure in Resource Mobilization	8
Table 5:	Budget Performance in 2000-01 and 2001-02	9
Table 6:	Analysis of Growth in Federal Tax Receipts	10
Table 7:	Composition of Agriculture: 1988-2001	11
Table 8:	Growth in Large Scale Manufacturing by Industry Group	12
Table 9:	Determinants and Contribution to Inflation in 2000-01	13
Table 10:	Macro-Determinants of Poverty in 2000-01	14
Table 11:	Trends in Investment to GDP Ratio	16
Table 12:	Inflow of Foreign Direct Investment by Economic Group	17
Table 13:	Composition of Foreign Direct Investment	18
Table 14:	Trends in Non-Development Expenditure	18
Table 15:	Financing of the Budget Deficit	19
Table 16:	Trends in Development Expenditure	21-22
Table 17-A:	Medium Term Projection: Consistency Check Scenario 1: Based on Official Investment Projections	23
Table 17-B:	Medium Term Projection: Consistency Check Scenario 2: Based on Official GDP Projections	24
Table 17-C:	Medium Term Projection: Consistency Check Scenario 3: Based on Official Budget Deficit Projections	24

1 Introduction

The Budget is a document, which specifies the sources and heads as well as the quantum of revenues and expenditures. In that sense, it is merely an accounting document. However, it has far reaching impact on all sectors of the economy and on all sections of the population. It allocates and reallocates resources from one sector to another and from one set of pockets to another. It determines the efficiency of resource use and has profound distributional impact. It, thus, merits a detailed analysis.

The present analysis commenced as a review of the Budget 2001-02, but ended up as being an examination of the fiscal and monetary policy package since 1988 when the Pakistan committed to a set of conditionalities under the Structural Adjustment Program of the IMF. The fundamental question that has arisen is of the relative efficacy of stabilization oriented versus growth oriented policies on development and welfare. Admittedly, stabilization and growth are not mutually exclusive and any policy package has to incorporate both the elements. However, the manner in which the policy has been implemented in Pakistan has tended to pursue stabilization at the expense of growth.

The analysis is based on the results obtained from SPDC's 257 - equation Integrated Social Policy and Macroeconomic Planning Model for Pakistan. The paper is organized as follows: section 2 presents a review of macroeconomic developments, section 3 profiles the trends in fiscal variables, section 4 briefly covers the impact of drought, section 5 reviews the budgetary performance of the year 2000-01, section 6 discusses the feasibility of budget estimates for 2001-02, section 7 examines the implications of the 2001-02 budget on real sectors, section 8 outlines the issues in investor confidence, section 9 reviews current and development expenditures, section 10 analyses the mid-term projections provided in the 2001-02 budget, and section 11 presents conclusions and recommendations.

2 Macroeconomic developments

The basic point of the economic policies pursued under various governments since 1988, when the Structural Adjustment Program came into force, is its continuity. The Budget 2001-02 too constitutes a continuation of the same set of policies, albeit with greater vigour. It is, thus, pertinent to conduct the analysis in the light of the performance of key economic indicators during 1988-2001 and examine the Budget 2001-02 accordingly.

The most important feature of the economic policies of the 1988-2001 period is the dominance of stabilization objectives at the cost of growth. This is

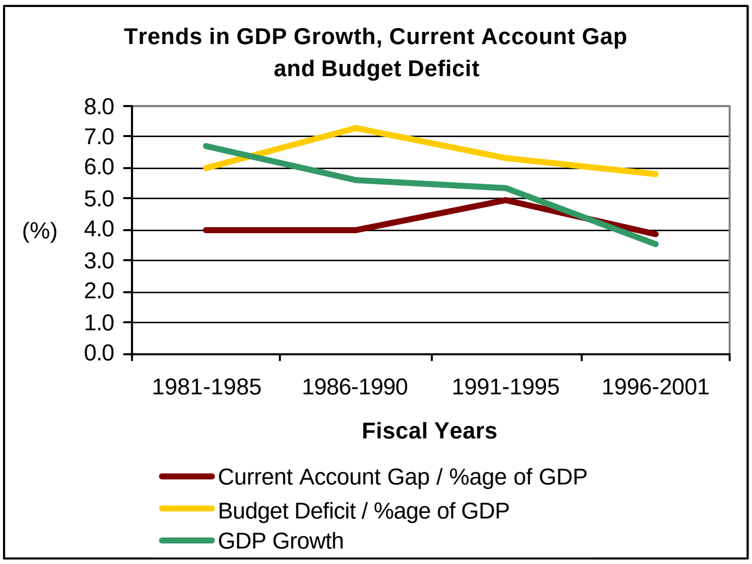
TABLE 1
PROFILE OF MACROECONOMIC DEVELOPMENT

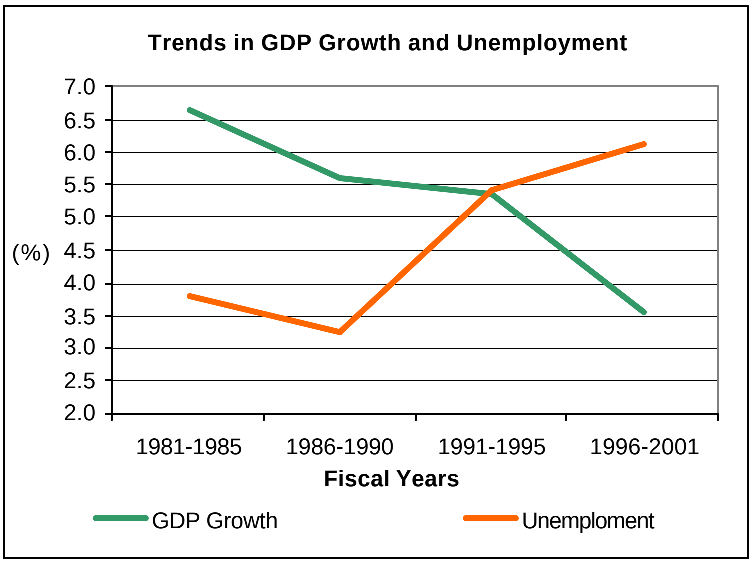
(%)

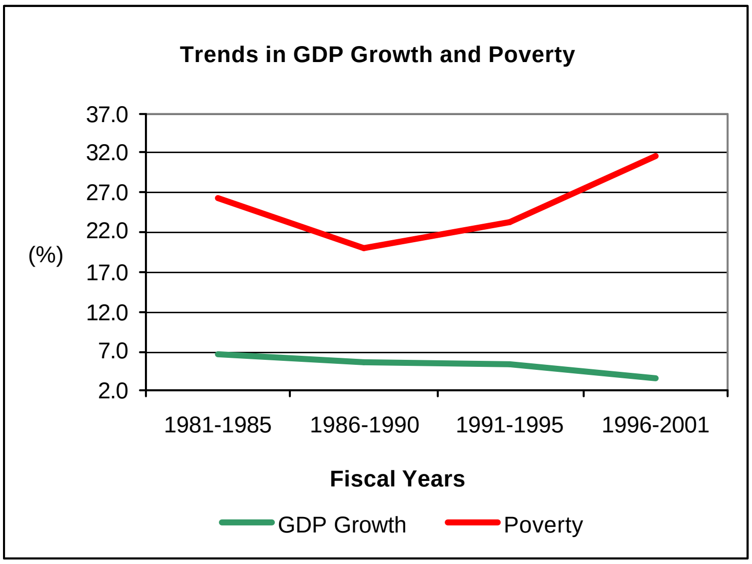
Indicator	1980-81 to 1989-90	1990-91 to 1994-95	1995-96 to 1999-00	1990-91 to 1999-00	1999-00	2000-01
GDP Growth (fc)	6.1	5.1	3.8	4.4	3.9	2.6
GDP Growth(mp)	6.2	4.8	3.1	4.0	4.4	3.3
Agriculture	4.1	4.2	4.9	4.5	6.1	-2.5
Manufacturing	8.2	5.8	2.0	3.9	1.8	7.1
Services	6.6	5.3	3.8	4.6	3.5	3.5
Inflation Rate	7.2	11.7	7.7	9.7	3.9	5.4
Money Supply to GDP Ratio	39.4	43.0	44.2	43.6	44.1	42.5
Fixed Investment To GDP Ratio	17.8	17.0	15.1	16.1	13.9	13.4
Public Investment	9.8	8.7	6.5	7.6	5.9	6.0
Private Investment	8.0	8.3	8.6	8.5	8.0	7.4
Real Exports to GDP Ratio	13.1	17.9	14.7	16.3	14.6	16.3
Real Imports to GDP Ratio	20.3	17.7	16.5	17.1	14.2	13.8
Current Account Gap to GDP Ratio	4.0	4.5	4.4	4.5	1.9	1.1
Budget Deficit to GDP Ratio	6.7	6.4	5.9	6.1	6.6	5.4
Nominal Exchange Rate	15.6	26.8	42.7	34.8	51.7	57.2
Poverty Rate*	23.2	22.8	29.3	26.0	35.9	40.1
Unemployment Rate*	3.5	5.4	6.0	5.7	6.2	6.7

Source: *Pakistan Economic Survey, various issues.*
**SPDC Estimates.*

evident from Table 1, which shows the following: stabilization variables, i.e., Current Account Gap to GDP Ratio and Budget Deficit to GDP Ratio have declined according to objectives dictated by international creditor interests. The Current Account Gap to GDP Ratio has declined from an average of 4.0 - 4.5 percent in the decade of the 1980's and 1990's to 1.9 percent in 1999-00 and further to 1.1 percent in 2000-01. Likewise, the Budget Deficit to GDP Ratio has declined from an average of 6.7 percent in the 1980's to 6.1 percent







in the 1990's and further to 5.4 percent in 2000-01. Growth variables, i.e., GDP Growth Rate and Fixed Investment to GDP Ratio have also declined contrary to objectives dictated by the needs of the people. The GDP Growth Rate has declined from an average of 6.1 percent in the 1980's to 4.4 percent in the 1990's, to 3.9 percent in 1999-2000, and further to 2.6 percent in 2000-01. Likewise, Fixed Investment to GDP Ratio has declined from an average of 16-17 percent in the 1980's and 1990's to 13-14 percent in the last two years, i.e., 1999-01.

The impact of such a policy framework has been borne by the people. Unemployment has increased from an average of 3.5 percent in the 1980's to 5.7 percent in the 1990's, to 6.2 percent in 1999-00, and further to 6.7 percent in 2000-01. Poverty has increased from an average of 23.2 percent in the 1980's to 26.0 percent in the 1990's, to 35.9 percent in 1999-00, and further to 40.1 percent in 2000-01.

3 Trends in fiscal variables

The second aspect of continuity is the persistence of a contractionary fiscal policy despite the rise of recessionary tendencies since the early 1990's. All the budgets in the last decade, including the budgets for 2000-01 and 2001-02, have continued to target the lowering of the fiscal deficit through additional revenue mobilization and cuts in development expenditure. This path has been pursued despite the standard text book fact that when an economy falls into a recession, an expansionary fiscal policy needs to be followed. Expansionary fiscal policy can be attained either through the reduction in the amount of taxes to be paid by domestic producers or consumers and/or through an increase in development and welfare related government expenditures.

Table 2 shows the trends in fiscal policy since 1987-88 and carried up to 2001-02. The growth rate of GDP is, on the one hand, shown to decline

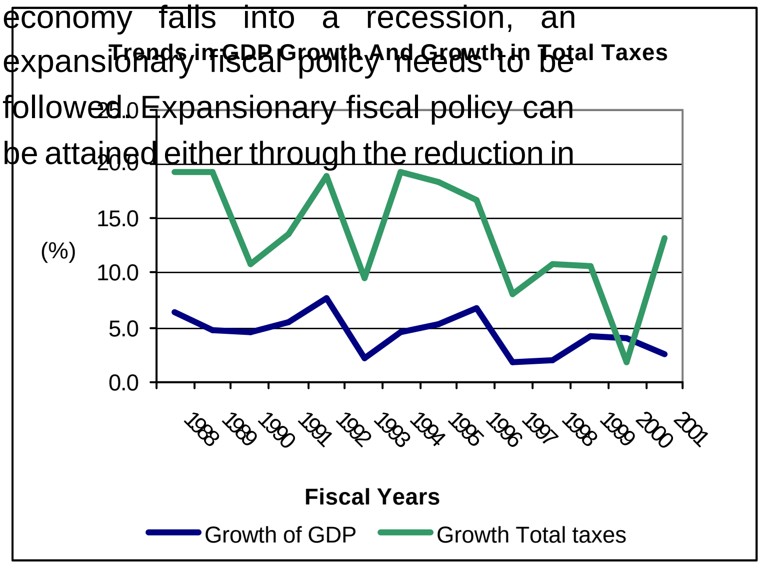


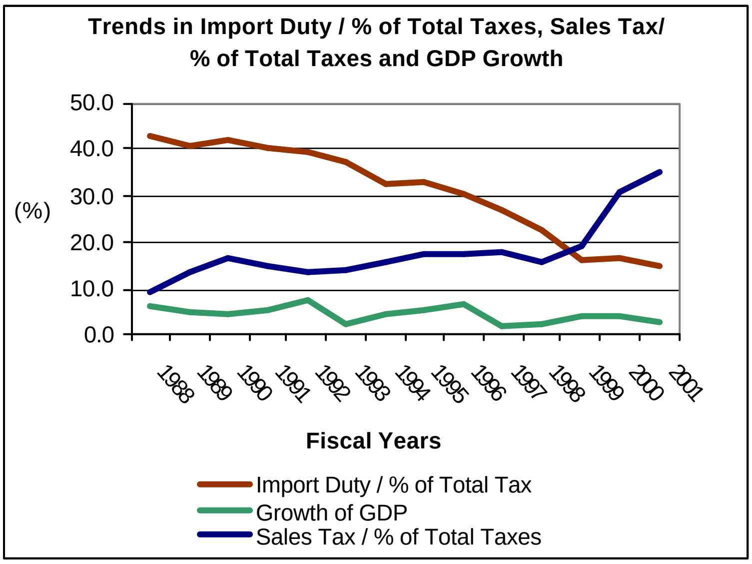
TABLE 2
TRENDS IN FISCAL AND REAL VARIABLES

(%)

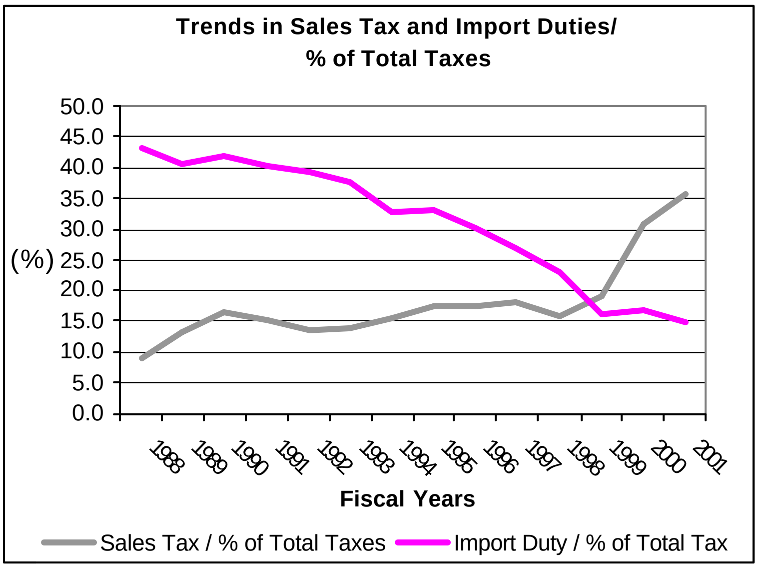
Year	Growth Rate of GDP	Growth of Total Taxes	Growth of Direct Taxes	Growth of Indirect Taxes	Growth of Sales Taxes	Growth of Import Duties	Growth Rate of development expenditure as share of GDP	Growth Rate of Poverty[1]	Growth Rate of Population Below Poverty[2]
1987-88	6.4	19.4	16.4	19.8	43.9	23.6	-5.0	-13.6	-11.3
1988-89	4.8	19.4	15.5	20.0	70.7	12.9	-15.5	11.4	14.3
1989-90	4.6	10.8	18.0	9.8	38.4	14.2	3.1	12.3	15.2
1990-91	5.6	13.7	21.3	12.5	3.2	9.7	-4.0	0.2	2.8
1991-92	7.7	19.0	35.1	16.2	7.5	15.5	5.8	1.2	3.8
1992-93	2.3	9.5	33.3	4.6	11.5	5.0	-20.2	2.3	4.9
1993-94	4.5	19.3	30.9	16.3	33.9	3.6	-9.6	3.5	6.1
1994-95	5.2	18.4	23.1	17.0	34.0	19.1	-7.9	4.8	7.4
1995-96	6.8	16.7	29.7	12.6	16.4	7.6	-6.1	6.2	8.8
1996-97	1.9	8.1	17.0	5.0	11.9	-4.7	-15.0	7.7	10.4
1997-98	2.0	10.8	15.7	8.9	-3.4	-5.2	-3.7	5.7	8.2
1998-99	4.2	10.6	10.0	10.9	34.3	-22.1	-5.3	3.1	5.5
1999-00	3.9	1.9	-2.0	3.5	65.2	5.7	3.9	7.3	9.7
2000-01	2.6	13.2	22.0	9.7	29.8	-0.3	-10.2	22.8	16.1
Average Growth	**4.5**	**13.6**	**20.4**	**11.9**	**28.4**	**6.0**	**-6.4**	**5.4**	**7.3**
2001-02	4.0	14.8	11.9	16.1	18.9	7.7	16.5	5.1	7.6

Source: *Pakistan Economic Survey, various issues.*
Federal Budget in Brief, various issues.

NOTE: [1]*Growth rate of the percentage of population below the poverty line*
[2]*Growth rate of the number of population below the poverty line*

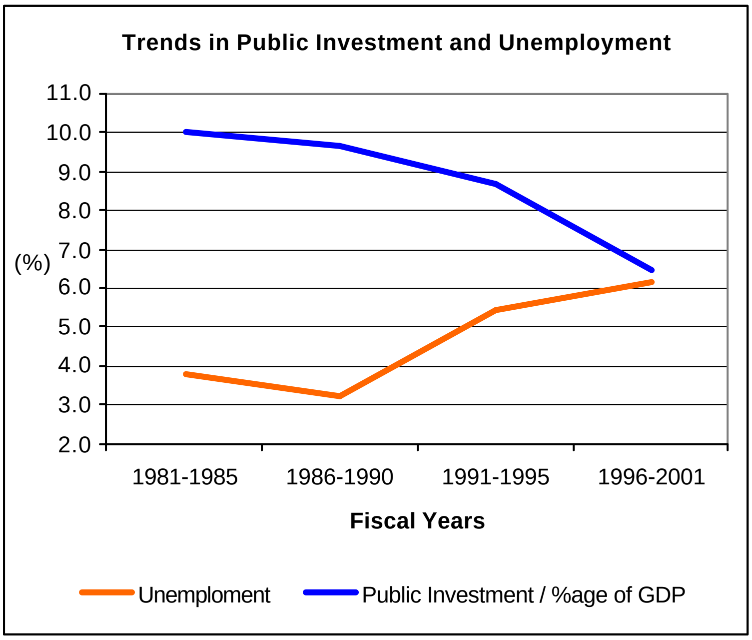


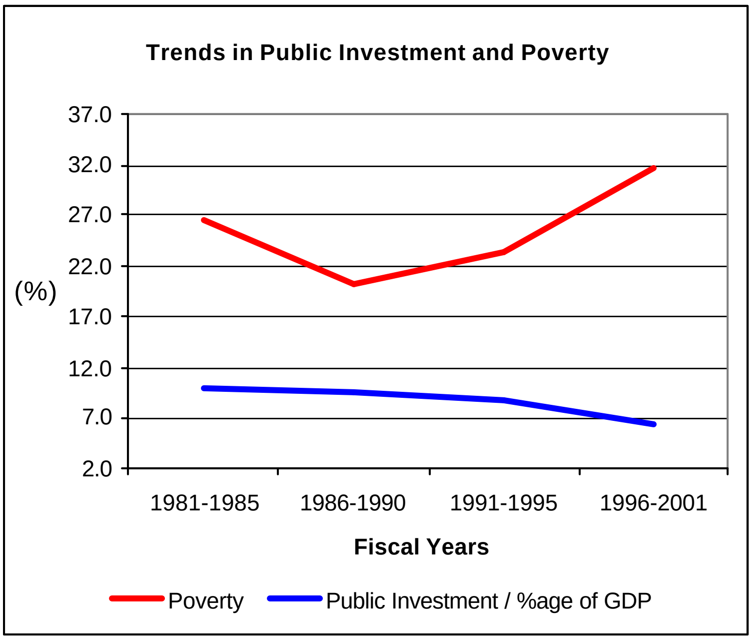
from 6.4 percent in 1988 to 2.6 percent in 2000-01, with average growth over the entire period 1988-2001 being 4.5 percent. On the other hand, total tax revenue has grown at an average of 13.6 percent. Such a high growth rate of taxes



relative to GDP growth is inadvisable in a recessionary period. However, the decomposition of this revenue growth presents a worse picture. Direct taxes have grown at 20.4 percent and indirect taxes at 11.9 percent. Further, while sales taxes have increased at 28.4 percent, import duties have increased by only 6.0 percent; thereby, discriminating against domestic producers relative to competing imports. The growing importance of sales taxes can be discerned from the fact that the contribution of sales taxes in total taxes has increased from 10.8 percent in 1987-88 to 38.3 percent in 2000-01. Correspondingly, the decline of the importance of import duty as a revenue source can be seen from the fact that its contribution to total taxes has fallen from 50.4 percent in 1988 to 15.9 percent in 2000-01.

At the same time, the share of development expenditure in GDP over the period 1988-2001 has on average declined by 6.4 percent; thereby, weakening domestic aggregate demand. The decline in Fixed Investment to GDP Ratio, shown earlier in Table 1, is thus understandable. The result has been growing unemployment and poverty, with poverty increasing on average by 5.4 percent and the population below the





poverty line by 7.3 percent over 1988-2001.

4 Impact of the drought

The situation has been further aggravated by drought conditions, which set in during 2000-01. SPDC estimates, as depicted in Table 3, show that had the drought not occurred, GDP growth would have been in the order of 4.6 percent instead of the actual 2.6 percent and growth in agriculture would have been in the order of 4.0 percent instead of 2.5 percent. The loss in GDP on account of drought has been of the order of Rs. 21.3 billion, of which Rs. 8.9 billion is in the agriculture sector alone. Consequently, the drought has raised the inflation rate by 0.6 percentage points, unemployment by 0.8 percentage points, and poverty by 3.3 percentage points. In absolute terms, the drought has pushed 4.6 million people below the poverty line. It is worth noting that the poverty impact is largely concentrated in the drought affected areas, mostly in Sindh and Balochistan.

As for the year 2001-02, SPDC estimates show that if drought conditions continue to persist the current account deficit is likely to go up by 1.5 percent to US $ 860 million, unemployment is likely to increase by 1.2 percent to 7.3 percent,

TABLE 3
ECONOMIC IMPACT OF THE DROUGHT

(in Billion Rs.)

Indicators	2000-01				2001-02			
	Without Drought		With Drought		Without Drought		With Drought	
	Amount	Growth Rate	Amount	Growth Rate	Amount	Growth Rate	Amount	Growth Rate
Gross Domestic Product	727.8	4.6	706.3	2.6	762.5	4.8	734.6	4.0
Agriculture	185.9	4.0	177.0	-2.5	194.2	4.5	180.7	2.1
Manufacturing	122.2	5.3	123.1	7.1	129.3	5.8	131.0	6.5
Others	419.7	4.6	406.3	3.6	439.0	4.6	422.9	4.1
Inflation Rate	-	4.3	-	4.9	-	5.1	-	5.3
Unemployment Rate	-	5.9	-	6.7	-	6.1	-	7.3
Current Account Gap % of GDP	-	-		1.2	-	-	-	2.7
Poverty Rate	51.8	36.8	56.4	40.1	54.5	37.8	60.7	42.1

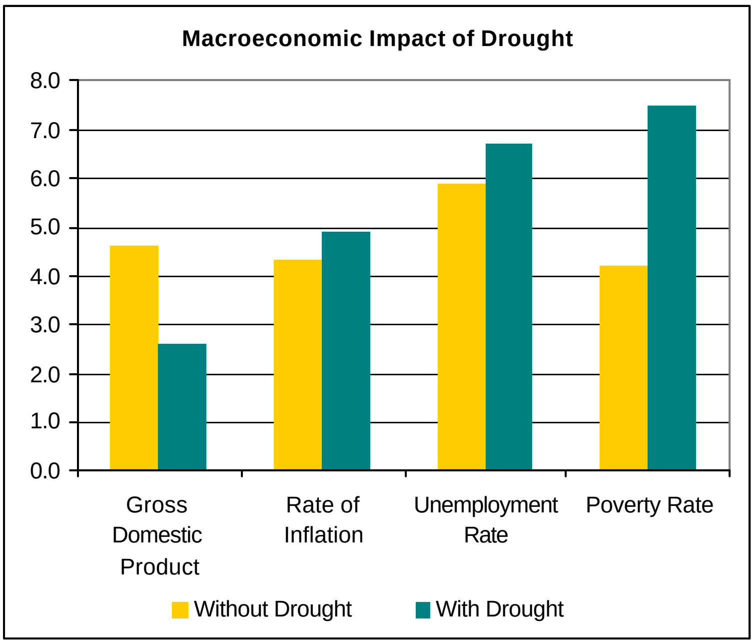
Source: *Pakistan Economic Survey, 2000-01*
SPDC estimates.

TABLE 3-A
LOSS IN GDP ON ACCOUNT OF DROUGHT

(in Billion Rs.)

Indicators	2000-01	2001-02
Total	21.3	27.9
Agriculture	8.9	13.5
Others	13.4	16.1

Source: *Pakistan Economic Survey, 2000-01*



and poverty by 3.6 percent to 42.1 percent. The number of people below the poverty line is likely to increase by another 6.2 million.

5 Budgetary performance in 2000-01

The analysis of the performance of indicators relating to the Federal Budget

TABLE 4
FAILURE IN RESOURCE MOBILIZATION

(in Billion Rs.)

Years	Budget Estimates without Taxation Proposals	Expected Revenues from Taxation Proposals	Budget Estimates Including Revenues from Taxation Proposals	Actual	Shortfall	Shortfall as % of Budget Estimates
1991-92	136.5	16.1	152.7	142.0	10.7	7.5
1992-93	160.5	16.0	176.6	153.2	23.4	13.3
1993-94	176.6	14.0	190.7	172.6	18.1	9.5
1994-95	214.4	45.5	259.9	226.6	33.3	12.8
1995-96	259.3	11.5	270.8	268.0	2.8	1.0
1996-97	296.4	39.9	336.3	282.1	54.2	16.1
1997-98	317.8	6.2	324.0	293.6	30.4	9.4
1998-99	338.2	16.4	354.6	308.0	46.6	13.1
1999-00	356.0	17.9	373.9	346.8	22.3	7.2
Average	**250.6**	**20.4**	**271.1**	**243.7**	**26.9**	**10.0**
2000-01	435.7	-2.8	432.9	406.5	26.4	6.1

Source: *Federal Budget in Brief, various issues.*

2000-01 presents a familiar picture of revenue shortfalls, current expenditure overruns, and development expenditure cuts. Revenue mobilization failure has become an endemic feature of fiscal management in the 1990's and into the twenty-first century. As shown in Table 4, between 1991-92 and 1999-00, budgets have on average targeted a 8 percent increase in revenues from taxation proposals and revenue shortfalls have averaged 10 percent. Budgeted Fiscal Deficit estimate for 2000-01 was Rs 162 billion, while the revised estimate was Rs. 185.6 billion, implying a widening of the budget deficit by Rs. 23.9 billion. Net revenue receipts and self financing of PSDP by provinces recorded a shortfall of Rs 24.0 and 11.1 billion, respectively. Current expenditure exceeded budgetary allocations by a modest Rs. 2.1 billion. The cumulative shortfall of Rs 37.2 billion (24.0+11.1+2.1) has been catered to largely by the cut in development expenditure to the tune of Rs 18.3 billion and cut in transfers to provinces to the tune of Rs 12.7 billion (see Table 5).

In terms of stabilization objectives, economic management in 2000-01 can be said to have been relatively better; given that the fiscal deficit was reduced by a significant 1.2 percent from 6.6 percent in 1999-00 to 5.4 percent in 2000-01. The price of success in stabilization objectives was paid by the sacrifice of growth objectives, with the sharp reduction in development expenditure and, on account of lower receipts from the

TABLE 5
BUDGET PERFORMANCE IN 2000-01 AND 2001-02

(in Billion Rs.)

	Heads	Budget Estimates 2000-01	Revised Estimates 2000-01	Difference	Budget Estimates 2001-02	Projected Growth (%)
	Current Expenditures	577.6	579.7	2.1	621.7	7.2
Plus	Development Expenditures	120.4	102.1	-18.3	130.0	27.3
Minus	Net Revenue Receipts	412.1	388.1	-24	453.8	16.9
Minus	Repayment of Foreign Loans	75.2	72.1	-3.1	69.1	-4.9
Minus	Self-Financing of PSDP By Provinces	31.6	20.5	-11.1	16.9	-17.6
Minus	Recovery of Loans From Provinces	8.7	9.0	0.3	10.0	11.1
Minus	Provincial Surplus	0	0.4	0.4	15.2	-
Plus	Net Lending To Others	8.2	6.0	-2.2	0.2	-
	Fiscal deficit*	162.2	185.6	23.9	186.9	0.7

Source: *Federal Budget in Brief, 2001-02*
**SPDC Estimates.*

federal government, cuts in the provincial development expenditures. Not surprisingly, unemployment is estimated to have increased from 6.2 percent in 1999-00 to 6.7 percent in 2000-01 and poverty from 35.9 percent to 40.1 percent over the same period (see Table 1).

6 Feasibility of 2001-02 budgetary estimates

The Budget 2001-02 represents a continuity of past policy in almost every respect. In line with stabilization objectives, the Budget 2001-02 projects a deficit of Rs 186.9 billion, a marginal increase of 0.7 percent over the deficit of 2000-01. Revenue targets have been enhanced by 14.8 percent, with growth in tax revenues targeted at 12.6 percent and growth in surcharges targeted at 42.4 percent (see Table 5). Within taxes, the major growth of 18.9 percent is targeted for sales taxes, followed by 11.9 percent for direct taxes (income and corporate taxes), 7.7 percent for import duties, and 1.7 percent for central excise duties. The trend of shifting the burden of taxes from import duties to sales taxes appears to continue. This is evident from the fact that the maximum tariff is being reduced from 35 to 30 percent and the number of slabs are being brought down from 5 to 4. The growth in surcharges is expected to accrue almost entirely from petroleum, which is targeted to grow by 77.8 percent (see Table 6).

TABLE 6
ANALYSIS OF GROWTH IN FEDERAL TAX RECEIPTS

(in Billion Rs.)

Heads	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Tax Revenues and Surcharges	309.5	336.5 (8.7)	386.9 (15.0)	388.3 (0.4)	439.5 (13.2)	504.7 (14.8)
Tax Revenues	282.2	293.6 (4.0)	308.5 (5.1)	351.6 (14.0)	406.5 (15.6)	457.7 (12.6)
Income, Corporate and Wealth Tax	85.1	103.2 (21.3)	110.4 (7.0)	109.8 (-0.5)	133.9 (21.9)	149.8 (11.9)
Custom Duties	86.1	74.5 (-13.5)	65.3 (-12.4)	64.8 (-0.8)	64.6 (-0.3)	69.6 (7.7)
Federal Excise	55.3	62.0 (12.1)	60.9 (-1.8)	57.0 (-6.4)	52.2 (-8.4)	53.1 (1.7)
Sales Tax	55.7	53.9 (-3.2)	71.9 (33.4)	120.0 (66.9)	155.8 (29.8)	185.2 (18.9)
Surcharges	27.3	42.9 (57.1)	78.3 (82.5)	36.7 (-53.1)	33.0 (-10.0)	47.0 (42.4)
Natural Gas	4.8	6.4 (32.2)	11.9 (85.9)	10.2 (-14.3)	15.0 (47.3)	15.0 (0.0)
Petroleum	22.5	36.5 (162.4)	66.4 (81.9)	26.5 (-60.1)	23.0 (-32.1)	32.0 (77.8)

Source: *Federal Budget in Brief, various issues.*
Figures in parenthesis are percentage growth.

The growth in tax revenues and surcharges is predicated upon growth in the economy and favourable movement in international oil prices. Both are questionable, which renders the achievement of revenue targets in 2001 - 02 uncertain. The Budget 2001-02 has targeted GDP growth at 4.0 percent. The deepening recession, fuelled by the continuing contractionary fiscal policies, is likely to be a formidable obstacle in the way of achieving the growth target. The elements of a contractionary fiscal policy amidst a recession are present in the context of the Federal Budget 2001-02 as well. As shown in Table 2, GDP is projected to grow at 4.0 percent, total tax revenue at 13.6 percent, sales taxes at 28.4 percent and import duties at 7.7 percent.

7 Implications of the Budget 2001-02

As stated at the outset, the Budget has far reaching impact on all aspects of the economy. This section looks at some of these aspects, i.e., agriculture, manufacturing, inflation, and poverty.

Agriculture

TABLE 7
COMPOSITION OF AGRICULTURE: 1988 - 2001
Value Added Shares

(%)

Sector	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00 (R)	2000-01 (P)
Crops	**65.8**	**66.1**	**65.0**	**65.4**	**66.6**	**62.6**	**62.2**	**63.1**	**59.6**	**58.0**	**60.1**	**59.7**	**60.4**	**57.4**
Major	48.8	48.9	47.5	47.9	50.4	44.9	43.2	44.0	41.7	40.0	41.4	40.6	44.0	40.4
Minor	16.9	17.2	17.5	17.5	16.2	17.7	19.0	19.1	17.9	18.1	18.7	19.1	16.4	17.0
Non-crops	**34.2**	**33.9**	**35.0**	**34.6**	**33.4**	**37.4**	**37.8**	**36.9**	**40.4**	**42.0**	**39.9**	**40.3**	**39.6**	**42.6**
Livestock	29.2	28.9	29.8	29.8	28.8	32.2	32.8	32.3	36.4	37.9	36.0	36.4	35.1	37.8
Fishery	5.8	5.7	6.1	5.9	5.6	6.7	6.4	5.9	5.6	5.8	5.8	5.8	5.9	6.1
Forestry	2.5	2.5	2.7	2.1	1.8	2.1	2.2	2.0	1.5	1.7	1.2	1.1	2.2	3.1

Source: *Economic Survey of Pakistan, 2000-01*
(R) = Revised; (P) = Provisional

The agriculture sector has to date not been directly 'hit' by Structural Adjustment reforms. However, the extension of GST to agricultural inputs removes the 'protection' that the agriculture sector has had to date. The imposition of GST at a time when the agriculture sector performance has been at its lowest in recent history can be questionable. The poor performance is being attributed almost entirely to the drought and, perhaps, rightly so. It, however, needs to be noted that the impact of the drought has been pronounced on account of the narrow base of the agriculture sector. Table 7 shows that the crop sector accounts for 57 percent of agricultural value added, with the non crops sectors accounting for the remaining 43 percent. Within the crop sector, major crops account for 70 percent, with minor crops accounting for the remaining 30 percent. The major crops base is itself narrow, dominated as it is by just four crops: wheat, rice, cotton and sugarcane. Within the non-crop sector, livestock dominates with 89 percent, with fisheries and forestry comprising the remaining 11 percent.

The concentration on major crops has rendered the agricultural economy highly vulnerable to shocks. If any one of the major crops performs poorly, the growth rate for the whole of agriculture and of agriculture related sectors stands adversely affected. This in turn affects other macroeconomic variables, i.e., tax revenues, budget deficit, current account deficit, exchange rate, inflation rate, unemployment, and poverty.

The Federal Budget 2001-02 does not appear to have taken explicit cognizance of the imperative of diversification in agriculture. The Rs 4 billion allocation for new dams and the Rs. 10 billion allocation for drought mitigating projects betrays the usual 'fire fighting' approach of the policy makers, instead of an attempt to correct the underlying structural distortions. The excessive stress on water storage also appears to be misplaced. Dams do not produce water, they merely store it. In the event of a prolonged drought, which is not entirely unlikely given the climate changes underway, dams are likely to remain empty. The imperative is for a parametric shift from storage to conservation, i.e., from high water intensive to low water intensive crops and from flood irrigation practices to various forms of drip irrigation. It is hoped that in future policy makers will take such imperatives into account.

Manufacturing

The large scale manufacturing sector is the one redeeming feature of the economy in 2000-01. The 7.8 percent growth comes in the wake of a low 4.5 percent growth of the sector for the decade of 1990's and 2 percent growth for the second half of the decade, with negative growth in 1996-97 and 1999-00. The low growth of the 1990's can be attributed partly to the restructuring of the industrial sector following reduction in protection and partly to increasing cost of production, recessionary tendencies in the economy, and contractionary fiscal policies. The recovery in large scale manufacturing provides cause for comfort as it is not based on growth in one or two sectors, like sugar or textiles, but is relatively broad based. The growth in

TABLE 8
GROWTH IN LARGE SCALE MANUFACTURING BY INDUSTRY GROUP

(%)

Industry Group	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01
Food Beverage and Tobacco	-4.8	-5.0	33.9	1.1	-19.7	8.8
Sugar	-11.2	-6.4	45.7	-0.1	-24.1	6.4
Textile & Apparel	1.2	-0.5	2.0	-0.8	19.0	2.7
Leather Products	-7.3	-12.1	1.0	-9.2	1.2	9.0
Paper & paper Board	-5.7	15.6	-2.2	0.8	19.8	24.9
Chemical Rubber & Plastic	7.9	-0.7	-3.0	7.5	8.6	8.5
Petroleum Products	9.0	-4.1	3.7	3.9	-0.3	16.6
Tyres & Tubes	25.9	-35.1	29.0	0.4	2.3	0.9
Non-Metallic Mineral Products	15.2	-0.9	-1.2	-0.5	2.0	0.9
Basic Metal Industries	2.1	1.4	-9.1	-10.1	12.5	6.7
Metal Products & Machinery	-2.7	-15.5	-6.6	29.3	16.7	0.2
Automobile	51.6	-4.1	-4.8	7.4	-19.1	23.3
Large Scale Manufacturing	2.8	-2.7	7.4	2.5	-0.2	7.8

Source: *Economic Survey 1999-00 and 2000-01.*

leather and, to some extent, paper is export led. The growth in automobiles is fuelled by domestic demand, thanks to liberal lease financing by leading banks. However, the growth in chemical and petroleum sectors is on account of the commissioning of new production facilities and may not necessarily continue (see Table 8).

A word of caution is in order. The 7.8 percent growth in 2000-01 cannot yet be defined as recovery on the basis of one year's performance alone. There is a danger that the contractionary fiscal regime perpetuated by the Budget 2001-02 is likely to deepen the recessionary tendencies and arrest the momentum of growth in the manufacturing sector. Growth in the manufacturing sector is contingent upon growth in investment, which has performed poorly over time. Issues with respect to investment are taken up in section 8.

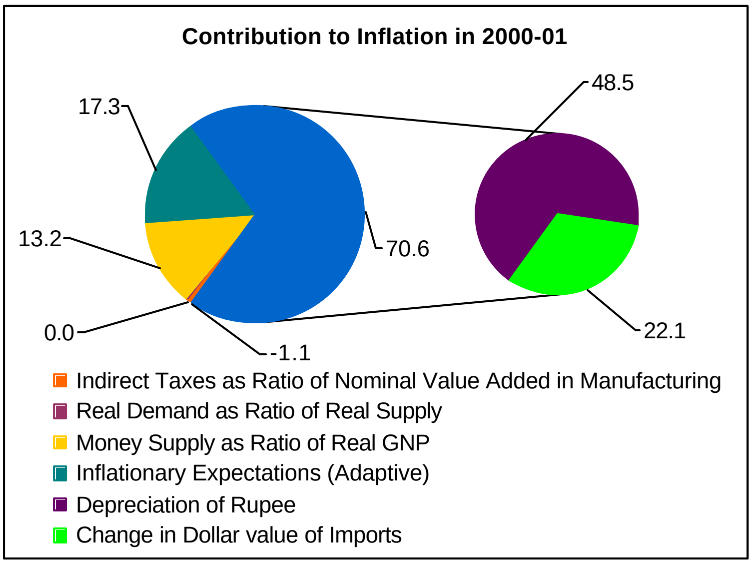


TABLE 9
DETERMINANTS AND CONTRIBUTION TO INFLATION IN 2000-01

Indirect Taxes as Ratio of Nominal Value Added in Manufacturing	-0.06 (-1.1)
Real Demand as Ratio of Real Supply	0.00 (0.0)
Money Supply as Ratio of Real GNP	0.73 (13.2)
Inflationary Expectations (Adaptive)	0.92 (17.3)
Unit Value Index of Imports	3.81 (70.6)
TOTAL	**5.40** **(100.0)**

Source: *SPDC estimates.*

Inflation

The question that has frequently been relevant in Pakistan has been why is the inflation rate high. Ironically, the relevant question today is why is the inflation rate in 2000-01 low at 4-5 percent. SPDC's decomposition of the inflation rate, shown in Table 9, indicates that the contribution to inflation on account of Real Demand relative to Real Supply is zero; confirming the weakening of purchasing power and the presence of recession in the economy. It also shows that over 70 percent of inflation is imported. Given the surge in international oil prices, this is understandable. Further decomposition, however, reveals that of the imported content of inflation, i.e. 70.6 percent, 22.1 per cent (or 31

TABLE 10
MACRO-DETERMINANTS OF POVERTY IN 2000-01

Variables	Percentage points	Million Poor
Level of real per capita income	-3.3	-4.5
Human capital endowments of the labor force	-4.9	-6.8
Level of food prices	9.5	13.0
Level of real per capita home remittances	-0.1	-0.2
Extent of unemployment	2.4	3.3
Total	**3.6**	**4.6**

Source: *SPDC estimates.*

percent) is on account of the increase in the dollar value of oil and oil products and 48.5 percent (or 69 percent) is on account of the massive and continuous depreciation of the rupee, generated to large extent by the State Bank's policy of purchasing dollars from the market.

Poverty

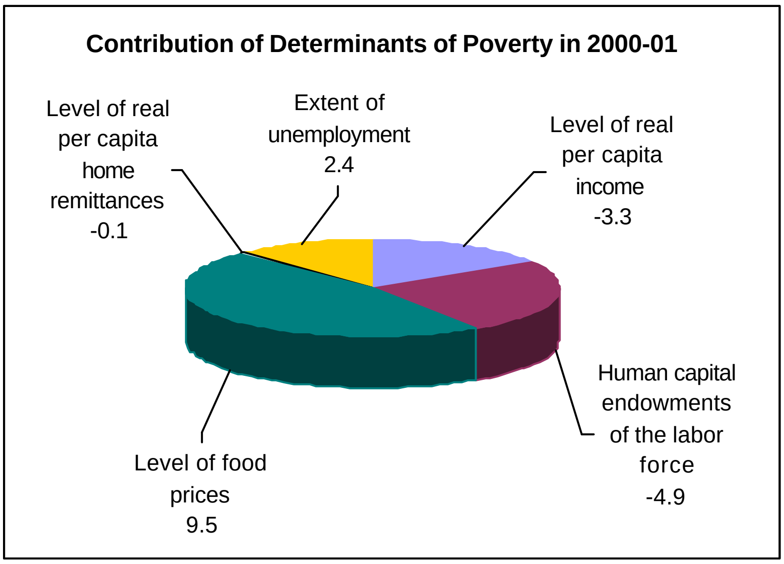
As stated above, as of 2000-01, unemployment has grown to 6.7 percent and poverty to 40.1 percent. Poverty has on average been increasing at the rate of 5.4 percent per annum and the number of people below the poverty line has been increasing at the rate of 7.3 percent annually. The drought has pushed a further 4.6 million people, mostly in Sindh and Balochistan, below the poverty line. If drought conditions persist over 2001-02, unemployment and poverty is estimated to increase to 7.3 and 42.1 percent, respectively, and an additional 6.2 million people are likely to fall below the poverty line.

The Budget 2001-02 does take cognizance of the situation and identifies poverty reduction to be "the supreme objective of [Pakistan's] economic strategy." Thus, there is special focus on social safety nets, i.e., employment generation via a public works programme, entitled Khushaal Pakistan, expanded micro-credit through systems such as the Khushali Bank, an attempt to reach the chronically poor through a food stamp scheme, larger Zakat subventions, and a poverty alleviation fund in an attempt to provide additional micro-financing.

However, it needs to be noted that social safety nets in their poverty mitigating role can only just begin to address the worst manifestations of poverty. The overall outcome in the battle against poverty hinges crucially upon broader macroeconomic developments relating to key determinants of poverty, e.g., growth in real capita income and generation of employment.

An analysis of the determinants of poverty, as shown in Table 10, shows the differential impact on poverty. Growth in per capita income has caused poverty to decline by 3.3 percent and raised 4.5 million people above the poverty line. Improvement in the human capital index has caused poverty to decline by 4.9 percent and raised 6.8 million people above the poverty line. Home remittances have caused a marginal 0.1 percent improvement and raised 0.3 million people above the poverty line. On the other hand, increase in food prices and unemployment has caused poverty to rise by 9.5 and 2.4 percent, respectively, and pushed 13.0 and 3.3 million below the poverty line. The net impact has been a 3.6 percent rise in poverty and an additional 4.6 million people below the poverty line.

The continuing increase in poverty can be attributed to adverse macroeconomic developments during the decade of the 1990's and continuing to date. Thanks to the single minded pursuit of stabilization objectives at the cost of growth objectives, there has been a visible decline in the growth momentum of the economy. Growth in per capita income has tapered off from almost 3 per



cent per annum during the 1980's to a cumulative growth of only one percent in the last five year period, i.e 1996-2000. Unemployment has increased in the 1990's over 1980's by about two percentage points and, while recessionary conditions has kept the overall inflation rate low, food prices have risen from 2.9 percent in 1999-00 to 4.1 percent in 2000-01.

8 Issues in investor confidence

Investment holds the key to sustained economic development, as it provides capital that generates growth and employment in an economy. Investment is a function of investor confidence, which is itself a function of economic and non-economic factors. Non-economic factors include political stability, level of facilitation/harassment by tax authorities, etc. Economic factors broadly comprise cost of production and aggregate market demand. Both are influenced by market and government variables. The former are largely price driven, while the latter include interest, tax, tariff, exchange, etc., rates regimes, utility prices, etc.

In large and varied economies, e.g., the United States, Germany or Japan, cost of production changes are market driven and the competitive nature of economic activity enables firms to adjust accordingly. And, given the determination of aggregate demand through the package of monetary, fiscal, and trade policies, the high level of economic activity and aggregate demand ensures that the private sector is largely self-reliant and self-sustaining. The policy package is necessary and sufficient to ensure that investment occurs as a result of mutually generated demand from within the private sector. The state's role in direct investment is and can be minimal.

In relatively small and narrowly based under-developed economies, e.g., Pakistan, the private sector is under-developed and investment variables are asymmetrically sensitive to macroeconomic policy measures. High interest and tax rates, low tariff rate, dearer foreign exchange, or high utility rates are likely to raise the cost of production and adversely impact profitability and, thus, investment. Conversely, low interest and tax rates, high tariff rates, cheaper foreign exchange, or low utility rates are likely to lower cost of production, which is necessary but not sufficient for private investment to respond positively and significantly. The sufficiency condition is provided, to a significant extent, by state sponsored investment expenditure, which tends to strengthen aggregate demand and crowd-in private investment.

The policy package in Pakistan, particularly over the period 1988-2001, has actually been contrary to the requirements of promoting investment. It has served to raise the cost of production and depress purchasing power and aggregate demand. Additionally, there has been introduced the element of a relatively unfair trade regime. On the one hand, the cost of production has increased through enhancement of utility rates, expansion of indirect taxation, raising of interest rates, and depreciation of the rupee, while excessive lowering of import tariffs has rendered domestic industry uncompetitive. On the other hand, the sustained cuts in development expenditure has weakened aggregate demand. Evidence of weak purchasing power and aggregate demand is provided by the fact that the share of Real Demand relative to Real Supply as a component of inflation is estimated at zero (see Table 9).

The combined impact of increases in production costs, increasingly unfair international competition, and weak aggregate demand has resulted in a loss of investor confidence. Table 11 shows that the investment to GDP ratio has declined from an average of 17.8 percent in the 1980's to 16.1 in the 1990's and further to 13.6 percent during 1999-2001. Public investment declined from 9.8 percent in the 1980's to 7.6 percent in the 1990's and further to 6.0 percent during 1999-2001. Private investment showed a slight improvement of a half a percentage points in the 1990's over the 1980's, but declined to 7.4 percent during 1999-2001.

Foreign investment too shows an erratic trend, with perceptible declines in 1998-99 and 2000-01. As shown in Table 12, foreign investment in non-financial sectors declined by over 37 percent in 1998-99, increased by nearly 21 percent in 1999-00, and then declined again by over 22 percent in 2000-01. Sector-wise,

TABLE 11
TRENDS IN INVESTMENT TO GDP RATIO

(%)

	1980-81 to 1980-90	1990-91 to 1999-00	1999-2001
Fixed Investment	17.8	16.1	13.4
Public	9.8	7.6	6.0
Private	8.0	8.5	7.4
Agriculture	1.7	1.1	0.9
Manufacturing	2.1	2.4	1.7
Others	4.2	5.0	4.8

Source: *Pakistan Economic Survey, various issues.*

TABLE 12
INFLOW OF FOREIGN DIRECT INVESTMENT BY ECONOMIC GROUP

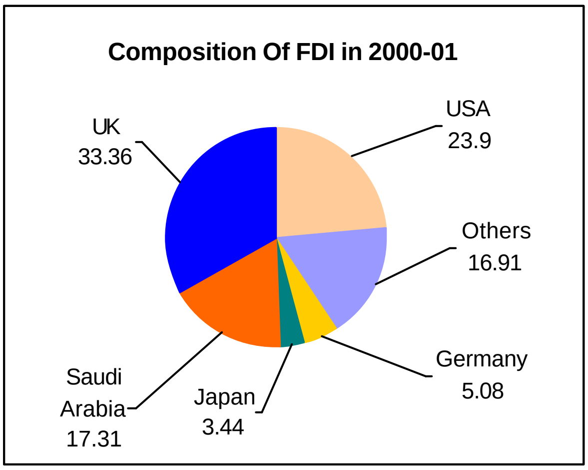
(in million US $)

	1998-99	1999-00	July - March	
			1999-00	2000-01
Power	131.4 (-45.1)	67.4 (-48.7)	56.4	21.8 (-61.4)
Chemical, Pharmaceutical and Fertilizer	54.1 (-25.0)	119.9 (121.6)	107.8	21.3 (-80.2)
Construction	8.3 (-61.4)	21.1 (154.2)	14.0	8.5 (-39.3)
Mining and Quarrying	69.2 (-30.2)	79.7 (15.2)	49.1	60.3 (22.8)
Food, Beverages and tobacco	7.4 (-61.3)	49.9 (574.3)	52.9	44.4 (-16.1)
Textile	1.7 (-93.8)	4.4 (158.8)	2.1	4 (90.5)
Transport and Storage	11.9 (16.7)	31 (160.5)	21.0	60.9 (190.0)
Machinery other than Electrical	0.9 (NA)	3.1 (244.4)	2.8	0.2 (-92.9)
Electronics	1.2 (-55.6)	2.3 (91.7)	1.3	2.5 (92.3)
Electrical Machinery	1.9 (-78.2)	1.5 (-21.1)	1.4	1.3 (-7.1)
Trade	5.5 (-56.4)	7.6 (38.2)	6.0	10.4 (73.3)
Petro-Chemical Refining	38.8 (2325.0)	12 (-69.1)	12.0	7.8 (-35.0)
Metal Products	- NA	1.4 (NA)	1.3	0.1 (-92.3)
Cement	2 (-33.3)	0.1 (-95.0)	-	15.2 (NA)
Others	30.4 (-47.4)	32.2 (5.9)	22.1	12.7 (-42.5)
Total	364.7 (-37.2)	440.3 (20.7)	350.2	272.4 (-22.2)

Source: *Pakistan Economic Survey.*
Figures in the parenthesis are the Percentage Growth.

the positive trend in 1999-00 was fuelled largely by the nearly six fold growth in the food and beverage sector, followed by the two and half times growth in non-electrical machinery, and more than 100 percent growth in chemical, pharmaceutical and fertilizer, textiles, construction, and transport sectors. With the exception of textiles and transport, all these sectors and including power and petrochemicals posted negative growth in 2000-01.

Country-wise, USA and UK have traditionally been the largest foreign investors. However, their respective shares in investment declined from 35.5 percent to 23.9 percent and from 35.9 percent to 33.3 percent, respectively, between 1999-00 and 2000-01. The only country that has effected a major increase of 17 percent in FDI is Saudi Arabia (see Table 13).



9 Expenditure analysis

Expenditure comprises current and development expenditure. Current expenditure, as shown in Table 14, shows that defence and civil administration expenditure is almost constant. This is a very positive move, provided over runs are not experienced over the year. The major expenditure increase is in debt servicing, which is

TABLE 13
COMPOSITION OF FOREIGN DIRECT INVESTMENT

Million US $

	During the 1990's	1999-2000	2000-01*
USA		166.9	55.5
	(38.1)	(35.5)	(23.9)
UK		169.0	77.5
	(19.2)	(36.0)	(33.4)
UAE		5.7	3.7
	(4.2)	(1.2)	(1.6)
Germany		10.5	11.8
	(7.0)	(2.2)	(5.1)
France		1.6	0.7
	(1.9)	(0.3)	(0.3)
Hong Kong		0.8	2.7
	(1.6)	(0.2)	(1.2)
Italy		0.5	1.3
	(0.3)	(0.1)	(0.6)
Japan		17.7	8.0
	(6.2)	(3.8)	(3.4)
Saudi Arabia		28.6	40.2
	(1.8)	(6.1)	(17.3)
Canada		0.2	0.1
	(0.3)	(0.0)	(0.0)
Nether land		10.7	2.9
	(1.5)	(2.3)	(1.3)
Korea		9.3	3.7
	(2.5)	(2.0)	(1.6)
Others		48.4	17.1
	(15.6)	(10.3)	(10.4)
Total		469.9	232.3
	(100.0)	(100.0)	(100.0)

**Nine months data*
Source: *Economic Survey 2000-01*
Figures in the parenthesis are percentage share of FDI

proposed to go up by nearly 7 percent. And the brunt of this increase is proposed

TABLE 14
TRENDS IN NON-DEVELOPMENT EXPENDITURE

(in Billion Rs.)

	2000-01 B.E.	2000-01 R.E.	2001-02 B.E.	Percentage Growth 2000-01 to 2001-02
Debt Servicing	305.6	308.1	329.2	6.8
Defence	133.5	131.6	131.6	0.0
Civil Administration	80.2	80.2	80.6	0.5
Grants	44.2	36.8	49.3	34.1
Unallocable	2.3	0.3	10.3	-
Subsidies	11.8	22.7	20.7	-8.9
Total	**577.6**	**579.7**	**621.7**	**7.3**

Source: *Federal Budget in Brief 2001-02.*

to be borne by cut of almost 9 percent in subsidies. Another interesting feature of the 2001-02 Budget is that there is likely to be no increase in domestic debt. Rather, an amount of about Rs. 5 billion is available for partial debt retirement. This in itself is a positive move. However, this surplus for partial debt retirement has been made possible by external borrowing. The bulk of the revenue and expenditure difference is proposed to be covered by resort to external borrowing. Specifically, the revenue and expenditure difference in 2001-02 is Rs 298 billion, of which Rs 261 billion, or 87 percent, is proposed to be made available from external sources (see Table 15). In other words, internal deficits are proposed to be financed out of external debt. The shift is likely to have far reaching implications on the future of the country's economy.

Development expenditure is billed at Rs. 131 billion, almost at par with defence expenditure. This too is a positive move, provided the traditional cuts are not applied to development expenditure. The analysis of development expenditure, as shown in Table 16, shows that the thrust of development is in the water and power and transport sectors, which have received over 55 percent of the total allocation. Of this, water and power, including WAPDA, has received 29 percent. Of this again, water has received 25 percent and power 75 percent. Of the amount allocated to water, 40 percent is provided for dams.

The development expenditure is proposed to be indigenously funded to the extent of 63 percent, with foreign project loans amounting to Rs. 49 billion accounting for 37 percent. About 2 percent of foreign project loans is earmarked for new projects and 50 percent is for ongoing schemes. The remaining 48 percent of foreign project loans is earmarked for provincial ADPs, the new versus on going distribution of which is not known. Self-reliance in financing new development projects is a positive move.

10 Consistency of mid-term projections

An interesting addition to the Budget 2001-2000 is the presence of medium term projections for the period

TABLE 15
FINANCING OF THE BUDGET DEFICIT
(in Billion Rs.)

	2000-01 R.E.	2001-02 B.E.
BUDGET DEFICIT	**185.6**	**186.9**
Net External Resources	**144.7**	**192.0**
Gross External Resources	216.8	261.1
Repayment of Foreign Loans	-72.1	-69.1
Domestic Resources	**40.9**	**-5.1**
Non-Bank Borrowings*	80.3	-15.6
Bank Borrowings	-39.4	10.5

Source: *Federal Budget in Brief 2001-02.*
**Excluding Net lending to others and Repayments of Loans by*

2002-2004 of key macroeconomic variables: growth rates of real GDP and its components, public and private investment, inflation, revenue collection, and budget deficit. The official projections for, say, the terminal year, i.e., 2003-04, forecasts growth in Total Fixed Investment, Real GDP, Inflation, Revenue collection, and Budget Deficit at 15.0 percent, 5.2 percent, 5.0 percent, Rs. 600 billion, and 3.6 percent, respectively. The stated purpose of the projections is to help policy makers and the private sector in their planning. Since, however, the projections will provide a basis for future planning, it is important to see whether they are internally consistent. SPDC has carried out such an analysis, using its 257-equation macroeconomic model.

Three different scenarios are tested or, in other words, the internal consistency of the projections has been checked via three routes. In the first scenario, the official investment projection has been kept constant and the corresponding estimates for GDP growth, inflation, revenue collection, and budget deficit obtained. In other words, given the stated level of investment, the model estimates the corresponding rates of GDP growth, inflation, required revenue collection, and budget deficit. In the second scenario, the official GDP growth projection has been kept constant and the corresponding estimates for investment, inflation, revenue collection, and budget deficit obtained. In other words, given the stated level of GDP growth, the model estimates the corresponding required rate of investment and the corresponding rates of inflation, required revenue collection,

TABLE 16
TRENDS IN DEVELOPMENT EXPENDITURE

(in Billion Rs.)

PSDP Outlays by Divisions	Budget 2001-02	Share (%)	New Expenditure	Share (%)	On-Going Expenditure	Share (%)
Social Sectors Divisions	**7.7**	**10.3**	**2.0**	**26.1**	**5.7**	**73.9**
Education & Training	2.5	3.3	1.6	62.6	0.9	37.4
Health & Nutrition	2.5	3.3	0.1	2.7	2.5	97.3
Population Welfare	1.7	2.3	0.0	0.0	1.7	100.0
Labour Manpower & O.P.Div.	0.1	0.1	0.0	0.0	0.1	100.0
Information & Media Development	0.2	0.3	0.2	74.3	0.1	25.7
Culture,Sports,Tourism & Youth	0.3	0.4	0.2	74.8	0.1	25.2
Women Div. & Social Welfare	0.1	0.2	0.0	0.0	0.1	100.0
Law & Justice	0.1	0.1	0.0	0.0	0.1	100.0
Religious Affairs, Zakat & Usher	0.0	0.0	0.0	0.0	0.0	100.0
Narcotics Control Div.	0.2	0.2	0.0	11.6	0.1	88.4
Economic Infrastructure Divisions	**25.5**	**33.9**	**9.4**	**37.0**	**16.1**	**63.0**
Water & Power	9.0	11.9	4.1	45.8	4.9	54.2
Railways	6.4	8.5	0.0	0.0	6.4	100.0
Communication	1.1	1.4	1.0	92.5	0.1	7.5
Information Technology & Telecommunication	4.3	5.8	3.0	69.3	1.3	30.7
Commerce Div.	0.1	0.2	0.0	0.0	0.1	100.0
Works	0.2	0.3	0.0	14.9	0.2	85.1
Science & Technology	2.5	3.3	1.2	46.5	1.3	53.5
Statistics, Planning & Development	0.2	0.3	0.0	0.9	0.2	99.1
Environment & Local Government	1.3	1.8	0.1	6.2	1.2	93.8
PAEC	0.4	0.5	0.0	12.2	0.3	87.8
Productive Divisions	**7.7**	**10.2**	**2.0**	**26.3**	**5.7**	**73.7**
Food,Agriculture & Livestock	0.7	0.9	0.5	75.9	0.2	24.1
Industry & Investment	0.3	0.4	0.0	0.0	0.3	100.0
Petroleum & Natural Resources	6.7	8.9	1.5	22.6	5.2	77.4
Other Divisions	**2.3**	**3.0**	**0.1**	**2.0**	**2.2**	**98.0**
Finance	0.8	1.1	0.0	0.0	0.8	100.0
Chief Executive Secretariat	0.1	0.1	0.0	0.0	0.1	100.0
Cabinet Div.	0.0	0.0	0.0	0.0	0.0	100.0
Establishment Div.	0.0	0.0	0.0	27.5	0.0	72.5
Interior Div.	1.0	1.3	0.0	3.7	1.0	96.3
Others	0.3	0.4	0.0	0.4	0.3	99.6

TABLE 16 *(Contd...)*
TRENDS IN DEVELOPMENT EXPENDITURE

PSDP Outlays by Divisions	Budget 2001-02	Share (%)	New Expenditure	Share (%)	On-Going Expenditure	Share (%)
KA & NA, States & Frontier Regions	**5.0**	**6.7**	**0.0**	**0.0**	**5.0**	**100.0**
Levies, Khasadars & F.C.	0.0	0.1	0.0	0.0	0.0	100.0
Special Areas	**5.0**	**6.6**	**0.0**	**0.0**	**5.0**	**100.0**
Azad Kashmir	2.6	3.4	-	-	-	-
Northern Areas	1.2	1.6	-	-	-	-
FATA	1.0	1.4	-	-	-	-
FATA-DC	0.1	0.2	-	-	-	-
Special Programmes	**0.2**	**0.2**	**0.0**	**0.0**	**0.2**	**100.0**
Afghan Refugees Programme	0.2	0.2	-	-	0.2	-
Corporations	**26.8**	**35.7**	**6.3**	**23.6**	**20.5**	**76.4**
WAPDA	**13.0**	**17.3**	**1.4**	**10.6**	**11.7**	**89.4**
Village Electrification	0.5	0.7	0.0	0.0	0.5	100.0
NHA	13.3	17.7	5.0	37.2	8.4	62.8
Total Federal Programmes	**75.2**	**100.0**	**24.6**	**32.8**	**50.6**	**67.2**
Provincial Programmes	**54.8**	**100.0**	-	-	-	-
Provincial ADPs	30.0	54.8	-	-	-	-
Khushal Pakistan Programme	7.0	12.8	-	-	-	-
Drought Relief Programme	10.0	18.3	-	-	-	-
Special Programmes	4.8	8.7	-	-	-	-
Devolution Plan	3.0	5.5	-	-	-	-
TOTAL PSDP	**130.0**	-	**24.6**	**19.0**	**105.4**	**81.0**

Source: *Federal PSDP 2001-02.*

and budget deficit. In the third scenario, the official Budget Deficit projection has been kept constant and the corresponding estimates for GDP growth, investment, inflation and revenue collection obtained. In other words, given the stated level of Budget Deficit, the model estimates the corresponding required rate of GDP growth, investment and revenue collection and the corresponding rate of inflation. The results are summarized in Tables 17-A to 17-C, which show that the official projections are all mutually inconsistent for all the years, 2001-02 to 2003-04.

For the initial year 2001-02, given the stated investment rate of 15.0 percent, GDP growth is estimated to be lower at 3.3 percent against the official projection of 4.0 percent, inflation is estimated to be higher at 5.7 percent against the official projection of 5.0 percent, required revenue collection is estimated to be lower at Rs. 443 billion against official projection of Rs. 458 billion, and budget deficit is estimated to be higher at 5.6 percent of GDP against official projection of 4.9 percent.

For the initial year again, given the stated GDP growth rate of 4.0 percent, inflation is estimated to be higher at 5.8 percent against the official projection of 5.0 percent, required revenue collection is estimated to be lower at Rs. 439 billion against the official projection of Rs. 548 billion, and budget deficit is estimated to be higher at 5.7 percent of GDP against official projection of 4.9 percent.

TABLE 17-A
MEDIUM TERM PROJECTION: CONSISTENCY CHECK
SCENARIO 1: BASED ON OFFICIAL INVESTMENT PROJECTIONS

	2000-01	2001-02		2002-03		2003-04	
	Actual	Official	SPDC	Official	SPDC	Official	SPDC
Fixed Investment % of GDP	13.4	13.6	13.6	14.2	14.2	15.0	15.0
Public	6.0	5.7	5.7	5.8	5.8	6.0	6.0
Private	7.4	7.9	7.9	8.4	8.4	9.0	9.0
GDP Growth(%)	2.6	4.0	3.3	4.7	3.1	5.2	3.0
Budget Deficit (%) of GDP	5.4	4.9	5.6	4.3	5.5	3.6	5.8
Inflation Rate (%)	5.4	5.0	5.7	5.0	6.6	5.0	7.5
Tax Revenue (billion Rs.)	407	458	443	523	502	600	544

Source: *Federal Budget in Brief 2001-02*
SPDC estimates

TABLE 17-B
MEDIUM TERM PROJECTION: CONSISTENCY CHECK
SCENARIO 2: BASED ON OFFICIAL GDP PROJECTIONS

	2000-01	2001-02		2002-03		2003-04	
	Actual	Official	SPDC	Official	SPDC	Official	SPDC
GDP Growth(%)	2.6	4.0	4.0	4.7	4.7	5.2	5.2
Fixed Investment % of GDP	13.4	13.6	13.8	14.2	14.9	15.0	16.6
Public	6.0	5.7	5.9	5.8	6.1	6.0	6.5
Private	7.4	7.9	7.9	8.4	8.8	9.0	10.1
Budget Deficit (%) of GDP	5.4	4.9	5.7	4.3	5.1	3.6	5.0
Inflation Rate (%)	5.4	5.0	5.8	5.0	6.3	5.0	6.6
Tax Revenue (billion Rs.)	407	458	439	523	528	600	610

Source: *Federal Budget in Brief 2001-02*
SPDC estimates

TABLE 17-C
MEDIUM TERM PROJECTION: CONSISTENCY CHECK
SCENARIO 3: BASED ON OFFICIAL BUDGET DEFICIT PROJECTIONS

	2000-01	2001-02		2002-03		2003-04	
	Actual	Official	SPDC	Official	SPDC	Official	SPDC
Budget Deficit (%) of GDP	5.4	4.9	4.9	4.3	4.3	3.6	3.6
GDP Growth (%)	2.6	4.0	4.9	4.7	5.2	5.2	6.4
Fixed Investment % of GDP	13.4	13.6	13.9	14.2	15.1	15.0	16.9
Public	6.0	5.7	6.0	5.8	6.2	6.0	6.6
Private	7.4	7.9	7.9	8.4	8.9	9.0	10.3
Inflation Rate (%)	5.4	5.0	4.7	5.0	5.2	5.0	4.7
Tax Revenue (billion Rs.)	407	458	485	523	578	600	697

Source: *Federal Budget in Brief 2001-02*
SPDC estimates

Investment estimates appear to be close to the official projections.

And, for the initial year again, given the stated Budget Deficit target of 4.9 percent, the required GDP growth is estimated to be higher at 4.9 percent against the official projection of 4.0 percent and required revenue collection is estimated to be higher at Rs. 485 billion against official projection of Rs. 458 billion. The investment and inflation estimates appear to be close to the official projection.

The variance between the official and SPDC's model generated estimates appear to be growing over time. Thus, for the terminal year 2003-04, given the stated investment rate of 15.0 percent, GDP growth is estimated to be lower at 3.0 percent against the official projection of 5.2 percent, inflation is estimated to be higher at 7.5 percent against the official projection of 5.0 percent, required revenue collection is estimated to be lower at Rs. 544 billion against official projection of Rs. 600 billion, and budget deficit is estimated to be higher at 5.8 percent of GDP against official projection of 3.6 percent.

For the terminal year again, given the stated GDP growth rate of 5.2 percent, required investment is estimated to be higher at 16.6 percent of GDP against the official projection of 15.0 percent, inflation is estimated to be higher at 6.6 percent against the official projection of 5.0 percent, and budget deficit is estimated to be higher at 5.0 percent of GDP against official projection of 3.6 percent. Revenue collection estimate appears to be close to the official projections.

And, for the terminal year again, given the stated Budget Deficit target of 3.6 percent, the required GDP growth is estimated to be higher at 6.4 percent against the official projection of 5.2 percent, required investment is estimated to be 16.9 percent of GDP against the official projection of 15.0 percent, and required revenue collection is estimated to be higher at Rs. 697 billion against official projection of Rs. 600 billion. The inflation estimate appears to be close to the official projection.

The above analysis shows rather clearly that the official projections are seriously problematic on account of across the board internal inconsistencies. On inquiry, official explanations have attributed the inconsistencies to the use of particular Incremental Capital-Output Ratios (ICOR), assumed in the official projections at 3.12 for 2001-02, 2.73 for 2002-03, and 2.62 for 2003-04. This appears to be unrealistically low. Moreover, the declining ICORs assumed in the official projections is counter to the trend in the last twenty years. Computation of actual five-year average ICORs over 1981-2000 clearly shows a rising trend. The actual ICORs for the period 1981-85 stands at 2.97, which has risen to 3.31 in the period 1986-90, further to 4.57 in the period 1991-95, and further to 8.21 in the period 1996-00 . SPDC's model generated ICORs, used to obtain the estimates for the years 2002-2004 are 4.2, 4.5, and 5.0 for the years 2001-02, 2002-03, and 2003-04, respectively.

11 Conclusions and Recommendations

The thrust of economic policy since 1988, as reflected in the annual Budgets, has been to pursue stabilization objectives at the cost of growth objectives. The mechanism for this policy has been a contractionary fiscal policy, including cuts in development expenditure. In our view, the policy has been counter-productive. It has dampened investment and curtailed purchasing power, leading to a recessionary situation. It has contributed directly to the increase in unemployment and poverty. That the policy continues to be pursued with greater vigour is unfortunate.

We propose a fundamental shift in policy. The principal objective should be growth, with stabilization being a secondary objective. The contractionary fiscal policy regime needs to be relaxed, with a shift from revenue mobilization to current expenditure reduction. Development expenditure, however, needs to be enhanced even further, in order to create the crowd-in effect for investment, for the growth in employment, income, and purchasing power and for poverty to be reduced in absolute terms. The preoccupation with curtailing fiscal deficits needs to be reviewed. We believe that fiscal deficits can be positively employed if the amounts thus generated are devoted to investment in productivity enhancing infrastructure and in employment generating projects.

We believe that the policy of opening up the economy more than what is required by WTO standards is inadvisable. In the past, domestic producers enjoyed unfair advantage relative to imports. A level playing field is perhaps in order. However, a new trade regime is now emerging, where imports are beginning to enjoy an unfair advantage relative to domestic producers. The cost of such a trade regime to the country's industry and economy and to the people in terms of unemployment and poverty is likely to be extremely high.

We believe that the policy of substituting domestic debt by external debt is inherently dangerous, with serious implications for national economic and political sovereignty. The fact that a negligible proportion of foreign project loans is proposed to be utilized for new projects, at least for federal projects, is commendable. However, it would be more appropriate if this element of foreign funding is eliminated altogether and the Rs 49 billion is made available through cuts in current expenditure. We believe that it is possible to undertake this cut without affecting the efficacy of the sectors concerned.