

FEDERAL BUDGET 2003-04

**STATE OF THE
ECONOMY:**

BEHIND THE AGGREGATES

June, 2003

Foreword

The Social Policy and Development Centre is pleased to present the review of the Economic Survey: 2002-03 and the Federal Budget: 2003-04. The report has been prepared in a record period of 12 days, with the research team working round the clock. The exercise involved inputting several sections of the Economic Survey and the Budget into the computer. Additional information had to be obtained from a variety of non-governmental sources. For example, individual industry sources were contacted to cross-check sector-wise manufacturing trends. Officials of the Ministry of Finance were constantly harassed with phone calls to seek clarifications and explanations. Their patient assistance is gratefully acknowledged. However, all responsibility for this report -- errors of omission and commission included -- rests with SPDC.

The report 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 cautions against certain misleading and, consequently, overly optimistic judgements. It identifies the areas where weaknesses are pronounced and where policy shifts are called for in order for the process of economic revival to be generated and sustained. And in line with SPDC's perspective, the report highlights the equity, employment-generation and poverty-reduction aspects of macroeconomic and fiscal policies.

Dr. Kaiser Bengali
Managing Director

(i)

SPDC Team

Research Team

Dr. Kaiser Bengali
Dr. Qazi Masood Ahmed
Zehra Aftab
Muhammad Sabir
Aurangzeb

Composing and Graphics Designing

Kamran Shaikh
Rizwanullah Khan

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MACROECONOMIC ANALYSIS

Economic policy making over the last three years has been mired in controversy. Policymakers have claimed that achieving macroeconomic stability is the essential pre-requisite for sustained growth. Critics have disagreed. The disagreement has not been over the necessity of stability, but over the sequencing of stabilization and growth paths, the cost at which stabilization objectives are achieved, and the distribution of the costs of reform and adjustment. The past is history, however. And prudence requires that the issue of stabilization versus growth, at the least, be considered water under the bridge for the time being. The quest now should be to rapidly move towards growth objectives, so that an increase in employment and reduction in poverty can be achieved.

How has the economy performed?

The Economic Survey: 2002-03 and the Federal Budget: 2003-04 as well as statements by leading policymakers have tended to convey the impression that the harsh stabilization policies have been successful in creating conditions for growth and that the economy is now poised for "take-off". Significant improvements are cited in GDP, per capita income, remittances, current account balance, the manufacturing sector, exports, and revenue generation. Aggregate macroeconomic indicators do tend to support the official optimism. Admittedly, there are some successes. After all, the Pakistani economy has time and again displayed strength and resilience to recover from troughs. However, prudence is called for again and requires a closer look at what lies behind the aggregates.

Key questions in this respect are: What is the conceptual basis of the growth strategy? What is the actual magnitude of growth and to what extent is the data, upon which growth claims are based, consistent and reliable? What are the sources of growth? How broad-based and sustainable is the growth process? And what has been the impact of the growth process on employment, income distribution and poverty?

What is the conceptual basis of the growth strategy?

The issue of stabilization versus growth has been a subject of dispute. Recent statements have, however, raised new issues that are conceptually contentious. It has been alluded that public sector investment has been allowed to be reduced to provide space for the private sector. Clearly, policymakers have ignored empirical evidence for developing economies that establishes the paramount role of public investment in 'crowding-in' private investment. Investment is not merely a function of a corruption-free environment, but is a function of a number of economic factors. One important factor is the cost of investment, which is shown to be rising. Another equally important factor is market demand, which can be strengthened by public investment.

Statements have also been made to the extent that growth will create employment opportunities. This appears to be a throw back to the discredited and discarded 'trickle-down' theory. The fact is that growth need not automatically create more jobs. If growth is achieved on account of enhanced efficiency obtained through increased capital

intensity, employment opportunities are likely to actually decrease; at least in the short run. And if labour has been displaced by imported capital, then the employment multiplier will operate in the capital-exporting country rather than locally.

What are the actual magnitudes of growth?

The Economic Survey 2002-03 reports GDP growth at a relatively impressive 5.1 percent. The last year when GDP growth was above 5 percent was in FY1996, when it stood at 6.6 percent. Coming in the wake of rather poor performance of the economy in the last 5 years, the whiff of recovery is welcome.

There are questions, though, with respect to the consistency and reliability of data upon which growth rates are based. The Economic Survey provides provisional figures for the current year and revised figures for the preceding year. The provisional figures are estimated on the basis of 9 or 10-month data that is available at the time the Survey is finalized for publication. Likewise, the Economic Survey 2001-02 provided provisional figures for the year 2001-02, which have been updated and presented as revised figures in the Economic Survey 2002-03.

That provisional figures are annual estimates, based on 9 or 10-month data, renders it understandable that the revised figures will vary somewhat. Relatively greater variations can be accepted in crop agriculture, on account of crops that are harvested in the last quarter of the fiscal year, and whose output projections can go awry because of natural factors. For other sectors however, estimates for 2-3 months are

unlikely to change too widely from the provisional figures that are based on 9 or 10-months data. Yet, the tables showing the "Growth Performance of Components of Gross National Product"¹ indicate substantial variation between the provisional and revised growth rates for the year 2001-02 (see Table 1).

Upward revisions of base year figure result in a lower growth rate and downward revisions result in a higher growth rate in the following year. For the year 2001-02, growth rates have been revised upwards in the case of 3 sectors and downwards in the case of 5 sectors/sub-sectors.² The upward revisions are shown in Construction, Electricity & Gas Distribution, and Transport, Storage & Communications. Growth in Construction is revised upwards from 0.9 percent to 4.3 percent, in Electricity & Gas Distribution from -2.8 percent to 8.5 percent and in Transport, Storage & Communications from 0.1 percent to 1.1 percent.

The most significant downward revision appears in Public Administration & Defence, where the provisional growth of 18.2 percent in 2001-02 is revised downwards by about two-thirds to 6.5 percent. Downward revisions are also shown in Major and Minor Crops, Fishing, and Forestry. In Fishing, positive 4 percent provisional growth is revised downwards to a 12 percent decline. Consequently, positive 1.4 percent provisional growth in Agriculture is revised downwards to a 0.1 percent decline.

Given that the estimates for the previous year constitute the base for calculation of the growth rate for the current year, the upward or downward revision of the base year estimates lead

TABLE 1
GROWTH PERFORMANCE OF GNP
(At Constant Factor Cost: 1980-81)

	2001-02 (provisional)	2001-02 (revised)	2002-03 (provisional)
			(%)
Commodity Producing Sectors	2.1	2.7	4.4
Agriculture	1.4	-0.1	4.2
Major Crops	-0.5	-1.8	5.8
Minor Crops	1.0	-1.8	0.4
Livestock	3.4	3.7	2.9
Fishing	4.0	-12.0	16.6
Forestry	1.1	-1.3	8.9
Mining & Quarrying	3.8	3.7	9.5
Manufacturing	4.4	5.0	7.8
Large Scale	4.0	4.9	8.7
Small Scale	5.3	5.3	5.3
Construction	0.9	4.3	3.4
Electricity & Gas Distribution	-2.8	8.5	-3.9
Services Sectors	5.1	4.1	5.3
Transport, Storage & Communications	0.1	1.1	3.1
Wholesale & Retail Trade	2.2	2.3	7.3
Finance & Insurance	3.8	8.1	-1.4
Ownership of Dwellings	5.3	5.3	5.3
Public Administration & Defence	18.2	6.5	5.2
Services	6.5	6.5	6.5
GDP	3.6	3.4	5.1
GNP	5.4	5.3	8.4

Source: Economic Survey 2001-02 (Table 1.4) and Economic Survey 2002-03 (Table 1.2)

to the raising or lowering of the current year growth rate. For example, the FY2003 growth rate in Public Administration & Defence turns out to be negative 5.2 percent based on the provisional base and positive 5.2 percent based on the revised base. Substantial revisions from provisional figures raise questions about the credibility of the data. And if base year data is held to be unreliable, then questions arise about the authenticity of the current year data and the claimed growth rates based on it.

The Economic Survey 2002-03 reports a 5.1 percent GDP growth rate based on the revised estimates for FY2002. Calculations based on the provisional estimates for 2001-02 show

the GDP rate for FY2003 to be 4.6 percent. It is likely that the FY2003 GDP growth rate is above 4.6 percent, but certainly below 5 percent (see Table 2).

The Federal Budget for FY2004 presents problems of its own. The questions arise not for what it reports, but for what it does not report. On the receipts side, 'Defence Receipts' of Rs. 56 billion is reported for FY2003, of which Rs 49 billion is shown as 'Miscellaneous'. Lack of accounting for such large amounts is a matter of concern.

Analysis of per capita income growth

The Economic Survey 2002-03 reports that per capita income (derived from GNP at market prices) has

TABLE 2
GROWTH ESTIMATES FROM DIFFERENT BASES

(At Constant Factor Cost: 1980-81)

(Rs. million)

	2002 Provincial	2002 Revised	2003 Provincial	Growth (%)	
				On Revised Base	On Provisional Base
Agriculture	166,289	163,731	170,523	4.1	2.5
Major Crops	66,722	65,500	69,297	5.8	3.9
Minor Crops	27,847	27,005	27,117	0.4	-2.6
Livestock	63,880	64,357	66,241	2.9	3.7
Fishing	6,017	5,093	5,936	16.6	-1.3
Forestry	1,823	1,776	1,932	8.8	6.0
Mining & Quarrying	3,254	3,265	3,576	9.5	9.9
Manufacturing	121,738	123,171	132,616	7.7	8.9
Large Scale	85,466	86,899	94,418	8.7	10.5
Small Scale	36,272	36,272	38,198	5.3	5.3
Construction	22,581	23,326	24,115	3.4	6.8
Electricity and Gas Distribution	24,735	25,615	24,606	-3.9	-0.5
Transport, Storage & Communication	69,782	68,837	70,936	3.0	1.7
Wholesale and Retail Trade	104,064	104,237	111,870	7.3	7.5
Finance and Insurance	15,749	17,740	17,488	-1.4	11.0
Ownership of Dwellings	42,804	42,804	45,064	5.3	5.3
Public Admin & Defence	50,217	45,256	47,590	5.2	-5.2
Services	68,400	68,400	72,867	6.5	6.5
GDP (fc)	689,613	686,382	721,251	5.1	4.6

Source: Economic Survey 2001-02, 2002-03

increased over the year by 12.3 percent in nominal terms and at 6.6 percent in real terms. There is an attempt to publicize the nominal growth rate, given that it is in double-digits. However, nominal growth rates are not very meaningful. Nominal double-digit growth in per capita income have also occurred, during the last decade and a half, in FY1988, 1989, 1991, 1992, 1994, 1995, and 1997. However, if the rate of inflation is higher during a period of high nominal growth and lower during a period of low nominal growth, it is likely that the latter growth may be higher in real terms. This was the case in FY1997 (see Table 3).

There are questions, though, regarding the treatment of data for estimation of per capita income. Per capita income is estimated from Gross

National Product (GNP), which is defined as Gross Domestic Product (GDP) plus/minus Net Factor Income from Abroad. The major item in Net Factor Income from Abroad in the year FY2003 is remittances. Till FY2001, remittances were received in two forms: through formal banking channels and informally through *hundi*. The State Bank of Pakistan mopped up the funds received through *hundi* by resorting to kerb-market purchases. These purchases did not figure in the Net Factor Income from Abroad, which were thus under-estimated. Post-FY2001, the difference between the official and kerb market rates narrowed and has virtually disappeared.³ Overseas workers remitting funds to Pakistan have largely switched from *hundi* to official channels (see Table 4).

TABLE 3
GROWTH RATES OF PER CAPITA INCOME

Years	GNP (mp) per capita (in current prices)	GDP (mp) per capita (in current prices)	Growth Rates (%)	
			GNP (mp) per capita (in constant prices: 1980-81)	GDP (mp) per capita (in constant prices: 1980-81)
1987-88	12.7	15.0	2.2	4.9
1988-89	10.2	11.0	1.5	2.2
1989-90	9.0	8.3	2.0	1.7
1990-91	14.4	16.6	1.0	2.7
1991-92	13.7	15.2	4.0	5.0
1992-93	7.6	7.9	-1.0	-0.8
1993-94	13.7	14.2	0.7	1.2
1994-95	17.2	16.6	2.9	2.4
1995-96	9.7	10.9	1.3	2.3
1996-97	11.3	11.8	-1.8	-1.4
1997-98	7.5	7.7	0.0	0.1
1998-99	7.3	7.2	1.4	1.3
1999-00	4.2	4.8	1.6	2.0
2000-01	6.3	6.4	0.3	0.3
2000-02	6.3	3.8	2.5	0.7
2000-03	12.3	8.4	6.6	3.6

Source: Economic Survey; Various Issues

This is evident from the fact that official workers' remittance receipts have shown a sharp increase from US \$ 1.1 billion in FY2001 to US \$ 2.4 billion in FY2002 and is expected to cross the US \$ 4 billion mark in FY2003. However, a part of the increase is merely a switch from what was earlier reported as State Bank's purchases. This is again evident from the fact that State Bank's purchases have declined from a peak of US \$ 2.2 billion in FY2001 to US \$ 1.4 billion in FY2002 and to zero currently.

In this context, estimation of GNP and per capita income based on the face value of remittances data leads to overestimation of the growth rate of GNP and per capita income in the post-2001 years. Adjustments are in order; whereby, the State Bank's purchases are treated as part of Net Factor Incomes from Abroad for the preceding years. For example, workers' remittances in the third quarters (Q3) of FY2002 and FY2003 were Rs. 1.6 and 3.2 billion dollars, respectively. During

TABLE 4
COMPOSITION OF CURRENT TRANSFERS

	(US\$ million)						
	FY98	FY99	FY00	FY01	FY02	FY02 (Q3)	FY03 (Q3)
Current Transfers (Net)	3,430	2,468	3,197	4,737	5,724	4,221	6,028
Private Transfers (Net)	3,210	2,274	3,061	3,898	4,255	3,008	4,215
of which:							
Workers' Remittances	1,490	1,060	983	1,087	2,389	1,630	3,231
FCA (Residents)	1,476	539	322	534	285	185	-86
Outright Purchases	0	531	1,634	2,157	1,376	1,069	0
Official Transfers	220	584	927	839	1,469	1,213	1,813

Source: State Bank of Pakistan Annual and Quarterly Reports; various issues

	FY02 (July-March)	FY03 (July-March)
Trade Balance	-206	-610
Export	6,658	7,761
Import	6,864	8,371
Services	-1,788	-1,043
Transportation	-611	-610
Investment income	-1,615	-1,544
Interest Payments	-1,016	-779
Profit and Dividend	-599	-765
Others	437	1,112
Transfers (Net)	4,221	6,028
Private Transfers (Net)	3,008	4,215
Workers Remittances	1,630	3,231
Resident FCA	185	-86
Purchases	1,069	0
Official Transfers	1,213	1,813
Current Account Balance	2,227	4,375

Source: State Bank of Pakistan

the same period, the State Bank's outright purchases of foreign exchange, transferred through *hundi*, were Rs. 1.0 billion and zero, respectively. The growth in workers' remittances appears to be 100 percent. However, if the outright purchases in Q3 FY2002, representing *hundi* transfers, are added to workers' remittances of the same period, the growth rate drops to 19.7 percent.

Such an adjustment shows that the actual GNP growth rate in FY2003 stands reduced from the reported 14.7 percent to 12.1 percent and the corresponding actual growth rate of per capita income stands reduced from the reported 12.3 percent to 9.7 percent. In constant prices of 1980-81, the growth rate of GNP stands reduced from 8.9 percent to 5.9 percent

and that of per capita income stands reduced from 6.6 percent to 3.7 percent.

What are the sources of growth?

The analysis of economic performance over FY2003 reveals that the sources of growth are rooted in exogenous factors rather than in factors endogenous to the economy. The foregoing analysis of per capita income growth has indicated the primary role of foreign remittances. The analysis of the Current Account confirms this view.

The improvement in the Current Account Balance continued in FY2003 with an almost 100 percent increase over the year. Relevant data for FY2003 is available for the July-March period only; as such, the analysis is shown relative to the corresponding period for FY2002. For the corresponding periods, the Current Account Balance increased from US\$ 2,227 million in FY2002 to US\$ 4,375 million. This is indeed commendable.

An analysis of the components of the Current Account shows that the improvement is attributable exclusively to exogenous factors (see Table 5 and

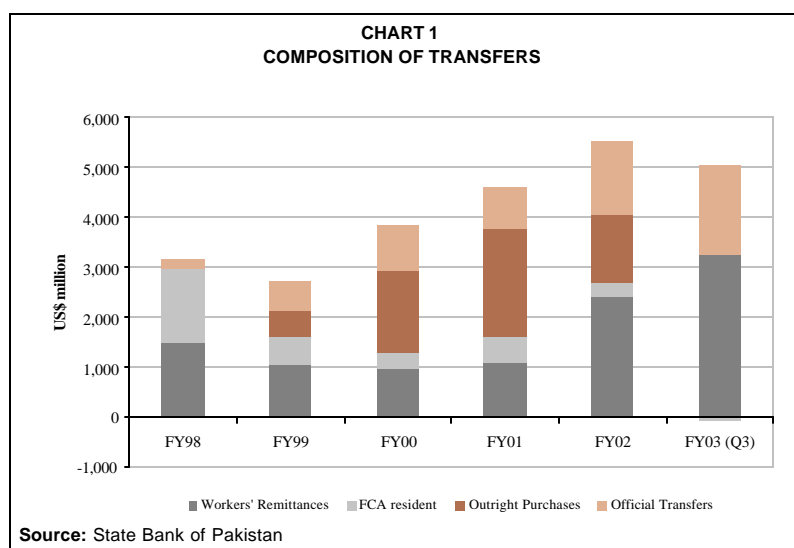


TABLE 6
TRENDS IN SAVINGS AND INVESTMENT

	1980's	1990's	1999-00	2000-01	2001-02	2002-03
TOTAL INVESTMENT	18.7	18.3	16.0	15.5	14.7	15.5
Change in Stock	-	-	1.6	1.6	1.6	2.4
FIXED INVESTMENT	17.0	16.6	14.4	13.9	13.1	13.1
Public Investment	9.2	7.5	6.0	5.5	4.8	4.5
Private Investment	7.8	9.1	8.4	8.4	8.4	8.6
NATIONAL SAVINGS	14.8	13.8	14.1	14.7	17.0	19.5
Domestic Saving	7.7	14.0	15.6	16.1	16.1	14.7

Source: Economic Survey 2002-03

Chart 1). While exports increased by 16.6 percent, imports rose by 22 percent. Resultantly, the Trade Balance worsened by US\$ 610 million. The Services account shows a significant improvement, but remains negative at US\$ -1,043 million. Investment Income, a component of Services, remains more or less constant (a modest decline of 4 percent from US\$ 1,615 million to US\$ 1,544 million) on account of the decrease in Interest Payment (from US\$ 1,016 million to US\$ 779 million) being cancelled out by increased outflow of Profit and Dividend (from US\$ 599 million to US\$ 765 million). Thus, the Trade Balance and the Services account both contributed negatively to the Current Account Balance.

The only positive contribution is provided by Transfers and, therein, by Remittances and Official Transfers. Remittances almost doubled by US\$ 1,601 million and accounts for 75 percent of the increase in the Current Account Balance. Official Transfers from foreign governments increased by 50 percent from US\$ 1,213 million to US\$ 1,813 million.

A few words on Official Transfers may not be out of place. It is noteworthy that Official Transfers averaged US\$ 419 million per annum between FY1988 and FY1999 and dropped to as low as US\$

220 million in FY1998. During FY2000 and FY2001, Official Transfers jumped to an average of US\$ 883 million and, during FY2002 and FY2003, almost doubled again to an average of US\$ 1,641 million.

Savings and Investment analysis

The exogenous source of the increase in the Current Account Balance has implications for interpretation of Savings statistics as well. National Savings is defined as Domestic Savings plus/minus Net Factor Income from Abroad. National Savings as a percent of GDP has risen from 17 percent in FY2002 to 19.5 percent in FY2003, which is commendable. However, this increase is on account of the improvement in Net Factor Income from Abroad. The improvement is not matched by Domestic Savings, which is an indicator of endogenous factors in the economy and shows a decline from 16.1 percent to 14.7 percent of GDP (see Table 6).

Total Investment is shown to have increased from 14.7 percent to 15.5 percent of GDP, which appears to be commendable. However, Gross Fixed Investment has remained constant at 13.1 percent of GDP. The difference in Gross Fixed Investment and Total Investment is attributable to Changes in Stock, which has risen sharply from

about 1.6 percent of GDP for the last several years (except in FY1998) to 2.35 percent of GDP in FY2003. The stocks are reported to be in terms of wheat and sugar stocks. Wheat stocks constitute an asset in the form of food security; however, sugar stocks may constitute a liability, given that retaining the stock is likely to create storage problems when the next sugar-cane crop is harvested and processed. And exporting the stock is likely to require an expensive subsidy imposing a fiscal cost on the economy.

The stagnation in Fixed Investment is visible in public as well as private investment. Given the rise in savings, this is surprising. Bank-lending rates have fallen to single digit levels, but are still high in real terms and in comparison to international rates. Further, it needs to be added that reducing the cost of capital is a necessary determinant of investment. It is, however, not sufficient. There are a number of other economic and non-economic factors that influence investor decisions. These include market demand, either local or foreign, availability of skilled labour, etc. Political uncertainties, as obtaining currently, certainly do not create a conducive environment for investment.

That GDP growth is picking up despite lack of investment growth implies that growth is propelled by utilization of excess capacity. This is indicated by the fact that of the Rs. 68 billion increase in private sector credit disbursement, the share of working capital is over 80 percent and that of project financing less than 20 percent. However, once capacity is exhausted, accelerated Fixed Investment would become imperative. Thereupon, given that private investment is shown to be largely driven by public investment, the

policy of cutting back on development expenditure will be exposed as counter-productive and will have to be reversed. The distribution of the credit - 63 percent to the Textile sector and 26.5 percent to Trading - again highlights the narrow and narrowing base of the economy.

How broad-based and sustainable is the growth process?

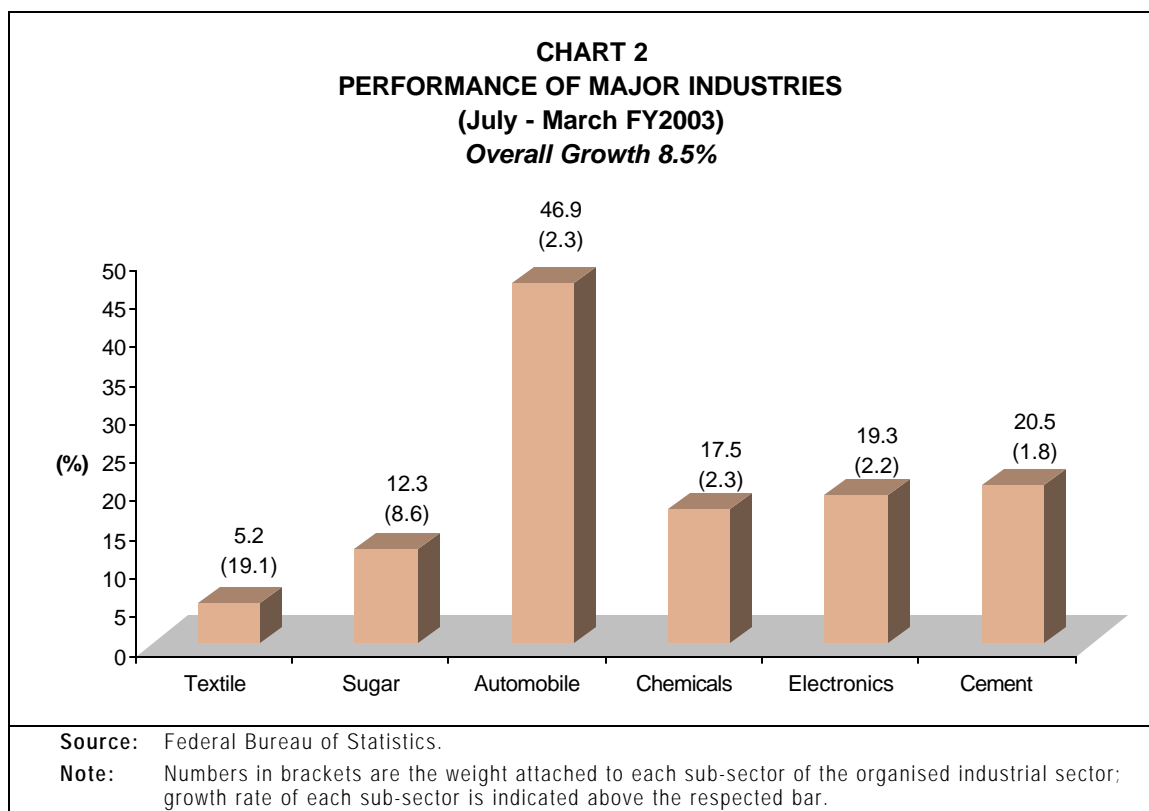
An analysis of manufacturing and export performance reveals the narrow base of the economy and the fragility of the growth path. Clearly, claims of recovery are premature. An aggregate view shows that the large-scale manufacturing sector has posted impressive growth at 8.7 percent. And it is particularly encouraging that this is the third consecutive year when the sector has grown at above 5 percent to record average growth at 7.7 percent. The growth is led by Textiles and Sugar, which together account for nearly one-fifth of the sector, and have grown at 5.2 and 12.4 percent, respectively. Other sectors, which command less than 3 percent weight each, and less than 10 percent cumulatively in the large-scale manufacturing sector, but have posted high double-digit growth are Automobiles, Cement, Electronics, and Chemicals. Growth in these industries has been recorded at 46.9, 20.5, 19.3 and 17.5 percent, respectively (see Chart 2).

While the large-scale manufacturing sector appears to have acquired a degree of momentum, there is a need to take a closer look in order to identify underlying problems with a view to strengthening the long-term prospects for growth in the sector. A look behind the aggregates shows that the large-scale manufacturing sector is rather

narrowly based. This can be seen from the fact that if the Textiles, Sugar and Automobiles industries are excluded, the sectoral growth rate stands reduced from 8.7 to 5.6 percent.

Clearly, the manufacturing base will need to be diversified and broadened as well as deepened. Other industries -- Automobiles, Electronics, Chemicals,

driven by enhanced efficiency obtained from BMR (Balancing, Modernization and Replacement) investments. The investment process was triggered by the decision of the government in 1998 to permit accelerated depreciation at 90 percent. These investments are critical to achieving a higher level of international competitiveness in view of



Metals, and Engineering - will need to post double-digit growth for at least a decade for them to acquire meaningful weight in the manufacturing sector. Significant policy and industry level support will have to be extended to enable these industries to develop thus. Some efforts do appear to be under way, particularly in Engineering, and are welcome.

A more detailed industry-wise look shows that the growth in Textiles is

the elimination of quotas in 2005. That the industry is responding to the investments bodes well for the looming challenge two years hence.

The growth in Sugar is driven by the fortunes of the sugar-cane crop. A bumper crop does lead to higher sugar production and contributes to higher manufacturing growth rate. There is a downside, however. Pakistan does not command a consistent comparative advantage in sugar-cane production,

except in southern Sindh. In the years when the world price of sugar declines, the domestic price of sugar tends to be higher than the price of imported sugar. In the event of two consecutive good crops and production in excess of domestic demand, the sugar industry ends up facing a storage problem. Exporting the surplus sugar is an option. However, if the world price is lower, the export has to be subsidized, imposing a fiscal cost on the economy. Currently, the price of imported sugar is about 15 percent lower than that of domestically produced sugar. Growth in the sugar industry is, thus, not an unmixed blessing.

Automobile production has registered phenomenal growth and augers well for the development of a modern industrial base in the country. The highest growth is in production of trucks (118 percent) followed by light commercial vehicles (58 percent). To the extent that this growth is driven by civilian demand, it appears to be promising for the development of the transport sector. Cars and jeeps have registered a growth of 52 percent. This expansion is fuelled largely by the introduction of consumer banking, enabling credit for leasing of vehicles. There is a sustainability factor in the growth in automobile demand. Given the narrow base of asset and income accrual in the country, the population base that can afford to lease cars is rather small. As such, the demand for cars is likely to be exhausted sooner than later and revert the industry to normal growth.

The Cement industry's growth is rooted in endogenous factors: domestic demand and, to some extent, export demand from Afghanistan. Domestic

demand has originated from two sources. One, the large number of Nazimeens at the district, tehsil and union council levels have launched road repair and other projects. Individually, these are small projects, but cumulatively exert a large demand on inputs such as cement. Two, the inflow of remittances from North America is directed largely towards housing purchases, which has stimulated private housing construction. Thus, the increased demand for cement and higher growth in the Cement industry.

Exports and Imports

In line with other indicators, exports have also registered impressive growth and is reported to have crossed the US\$ 10 billion mark. Data for the July-March period shows exports to have grown at 20 percent over the year (see Table 7). That this expansion has been achieved in the face of a general slowdown of the world economy is even more striking. A word of caution is in order here. Such spurts in export growth have been witnessed before as well. It is only if double-digit growth is sustained over a period of 3 to 5 years that Pakistan's exports can be said to have acquired a competitive edge in world markets.

The major items that have contributed to the growth are rice (21 percent), raw cotton (238 percent), wheat (121 percent), cotton made-ups (17 to 36 percent), petroleum products (34 percent), and chemicals and pharmaceuticals (88 percent). Export growth of traditional products like cotton yarn is stagnant at 2 percent and declines have been registered in leather and leather manufactures, surgical and medical instruments, and molasses. The

TABLE 7
MAJOR EXPORTS

	July-March 2002		July-March 2003		(US\$ million)
	Value	%Share	Value	%Share	Growth Rate (%)
Primary Commodities	783.5	12.0	933.1	11.9	19.1
Rice	332.2		401.3		20.8
Raw cotton	13.1		44.3		238.2
Leather	168.9		170.2		0.8
Wheat	47.9		105.9		121.1
Others	221.4		211.4		-4.5
Textile Manufactures	4,178.6	63.9	5,074.8	64.6	21.4
Cotton yarn	682.3		694.5		1.8
Cotton fabrics (woven)	805.9		948.7		17.7
Hosiery (Knitwear)	602.3		791.5		31.4
Bed wear	659.4		896.2		35.9
Towels	189.4		239.9		26.7
Cotton bags and sacks	11.8		12.8		8.5
Readymade garments	636.2		794.8		24.9
Tarpaulin & other canvas goods	37.7		50.4		33.7
Others	553.7		553.7		0.0
Other Manufactures	1,084.8	16.6	1,212.0	15.4	11.7
Carpets, carpeting rugs & mats	174.5		163.0		-6.6
Leather manufactures	294.7		288.4		-2.1
Surgical and medical instruments	106.5		105.6		-0.8
Chemicals and pharmaceuticals	102.1		191.7		87.8
Molasses	50.3		33.7		-33.0
Others	356.7		429.6		20.4
Others	491.2	7.5	635.5	8.1	29.4
Total	6,538.1		7,856.0		20.2

Source: Federal Bureau of Statistics

decrease in molasses export is to the extent of 33 percent.

The most important contribution to export growth has, however, been made by textile manufactures. The total increase in exports amounts to US\$ 1,318 million, out of which US\$ 895 million or 68 percent is contributed by textile manufactures. Consequently, the share of textile manufactures in total exports has increased by one percentage point at the cost of the shares of all other categories of exports. The textile factor highlights the narrow base of exports.

Imports have grown at 23 percent and, perhaps, reflects the fact that the economy is beginning to shed its

recessionary tendencies (see Table 8). That the highest growth has occurred in the machinery group (40 percent), with 161 percent growth in agricultural machinery and implements and 76 percent growth in electrical machinery and apparatus is indicative of investment activity picking up in agriculture as well as industry. High growth in fertilizer imports also reflects higher level of agricultural activity. Petroleum, which constitutes the single largest import group at 27 percent of imports, registered a 24 percent growth on account of higher prices during the US invasion of Iraq. Sugar import virtually ceased during the year and wheat imports declined by 34 percent, reflecting higher domestic production of wheat and

**TABLE 8
MAJOR IMPORTS**

	July-March 2002		July-March 2003		(US\$ million)
	Value	%Share	Value	%Share	Growth Rate (%)
Food Group	607.1	8.3	744.0	8.2	22.5
Milk, cream incl. milk food for infants	11.3		14.6		29.2
Wheat unmilled	43.7		28.7		-34.3
Edible oil	279.4		439.9		57.4
Sugar	22.8		1.4		-93.9
Others	249.9		259.4		3.8
Machinery Group	1,457.2	19.8	2,046.0	22.7	40.4
Power generating machinery	138.6		203.3		46.7
Office machinery	154.7		143.6		-7.2
Textile machinery	309.6		379.5		22.6
Construction & mining machinery	82.8		70.8		-14.5
Electrical machinery & apparatus	89.2		156.7		75.7
Railway vehicles	22.7		35.8		57.7
Road motor vehicles	219.1		354.8		61.9
Aircraft, ships and boats	45.3		57.3		26.5
Agricultural machinery & implements	9.9		25.8		160.6
Other machinery	385.4		618.0		60.4
Petroleum group	1,954.8	26.6	2,419.0	26.8	23.7
Textile group	139.3	1.9	169.0	1.9	21.3
Agriculture & other chemicals	1,356.7	18.4	1,506.0	16.7	11.0
Fertilizer	155.7		211.8		36.0
Others	1201.0		1293.8		7.7
Metal group	322.5	4.4	361.0	4.0	11.9
Others / Miscellaneous	1,517.2	20.6	1,785.5	19.8	17.9
Total	7,354.8		9,030.0		22.8

Source: Federal Bureau of Statistics

sugarcane.

What is the impact of growth on employment, income distribution and poverty reduction?

The economic performance during FY2003 is being billed a success in purely growth terms. These claims are -- with some exceptions - questionable on account of consistency and reliability of data, essentially exogenous sources of growth, and the narrow base of the growth sectors. No attention is, however, made to the income distributional impact of the pattern of growth. Earlier analysis has shown that income distribution over 1988-1999 has worsened; with real incomes of the top 10 percent of

households increasing by 27 percent and that of the bottom 10 percent decreasing by 16 percent. It has also been shown that a combination of natural factors (i.e, drought) and policy factors (i.e, macroeconomic policy) pushed 7 million people below the poverty line over 1999-2001. More recent developments on the exogenous front (i.e, remittances) and endogenous front (i.e, manufacturing and exports) can be assumed to have worsened the situation further.

Remittances

The growth in remittances is one of the high points of the economy. Interestingly, the composition of the

origin of remittances has shown significant changes in the last few years. Perusal of data between FY2000 and FY2003 shows that while there has been absolute increase from all regions, remittances from the Middle East have increased 3-fold, while those from North America have risen 15-fold (see Table 9). In FY2000, the Middle East and North America accounted for 69.3 and 8.5 percent, respectively, of remittances.

Post-2001, the share of Middle East began to drop and that of North America began to rise. For the period July-April 2002-03, the share of the Middle East has declined to 45.3 percent and that of North America has grown to 29.4 percent (see Chart 3). The increase in remittances from the Middle East is, perhaps, largely on account of the shift in transfers from hundi to official banking channels, while the upsurge in remittances from North America is assumed to be largely on account of post-September 2001 insecurities

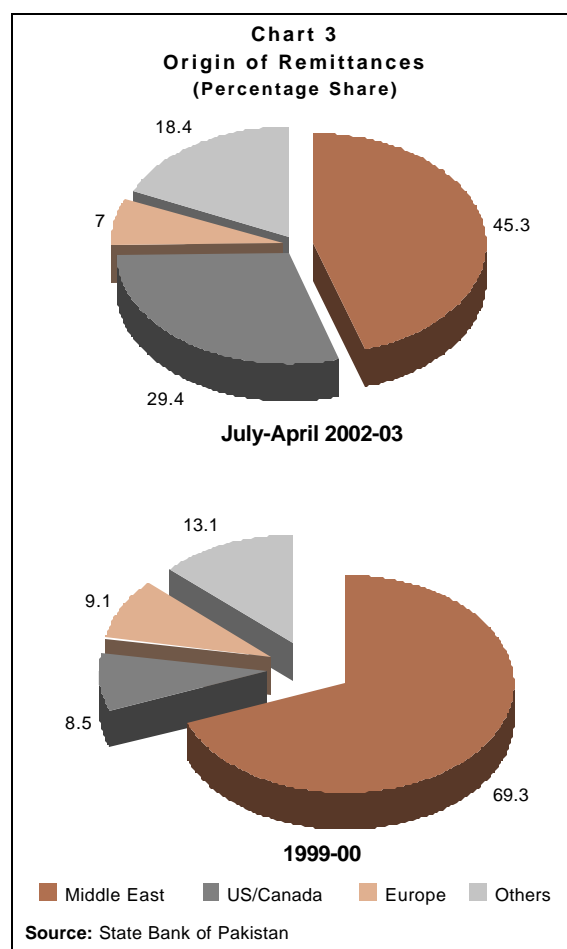


TABLE 9
WORKERS' REMITTANCES

Country	1999-00	2000-01	2001-02	(US\$ million)	
				July-April 2001-02	2002-03
Middle East	681.96	693.22	1,070.12	854.75	1,601.18
Share (%)	69.32	63.80	44.79	45.82	45.27
Growth (%)	-	1.65	54.37	-	87.33
North America	83.82	139.71	799.50	593.14	1,038.99
Share (%)	8.52	12.86	33.47	31.80	29.38
Growth (%)	-	66.68	472.26	-	75.17
Europe	89.34	96.33	171.92	136.55	246.66
Share (%)	9.08	8.87	7.20	7.32	6.97
Growth (%)	-	7.82	78.47	-	80.64
Other countries	56.79	88.40	293.28	233.46	609.06
Share (%)	5.77	8.14	12.28	12.52	17.22
Growth (%)	-	55.66	231.76	-	160.88
Others	70.24	64.98	48.26	43.15	33.80
Share (%)	7.14	5.98	2.02	2.31	0.96
Growth (%)	-	-7.49	-25.73	-	-21.67
Total	983.73	1,086.57	2,389.05	1,865.41	3,536.93
Growth (%)	-	10.45	119.87	-	89.61

Source: State Bank of Pakistan

among the Pakistani community in the US.

The compositional change has significant distributional effect. Hitherto, it has been assumed, and rightly so, that remittances play a direct positive role in poverty reduction. Macro-econometric analyses also indicated the remittance variable to have a positive and significant impact on poverty reduction. Henceforth, this straightforward assumption is no longer valid. While remittances from the Middle East can continue to be assumed to have a positive impact on poverty reduction, remittances from North America are likely to have a positive impact on investment, particularly in the construction sector; and, thereby, on employment and poverty reduction.

Given that the bulk of the Pakistani workers in the Middle East hailed from lower, lower-middle and middle income groups, their remittances benefited these groups and served to alleviate poverty. Given, further that the increase in remittances from the Middle East is, perhaps, more in the nature of a shift of transfers from *hundi* to official banking channels, it cannot be expected to have any additional poverty alleviation impact. The enhanced remittances from North America are also not likely to have any meaningful poverty alleviating impact, given that these remittances are in the nature of risk-hedging investments and likely to benefit the upper-middle and upper income groups. Rather, these remittances are likely to further skew the distribution of income in the country. The improvement of the macroeconomic and investment environment on account of enhanced foreign exchange inflows is, however, likely to post gains for the economy as a whole.

Manufacturing and Exports

The driving element in manufacturing and export growth is provided by the Textile industry. Without any attempt to take the shine away from the performance of the textile industry, it needs to be stated that there is a downside as well to developments in the sector. BMR investments are by definition labour displacing in the short-run and contribute to unemployment, unless other sectors are growing at a sufficient rate to absorb the displaced labour. This is clearly not the case at present.

Given that the modernization process is labour displacing, the development is likely to raise the share of profits and lower that of wages. The distribution of income is likely to have become skewed even more. Due attention is called for to ensure generation of employment opportunities in other sectors.

The automobile industry is another major contributor to manufacturing growth. Demand for cars has been fuelled by the growth of consumer financing and lease financing of car purchases. The distributional implications of this growth needs to be noted. Bank leasing for cars require the applicant to have an income or salary of at least Rs. 20,000 per month. This provision ensures that the beneficiaries of car leasing are from upper-middle or upper income groups only. Given that the automobile industry consists largely of assembly plants and are capital-intensive, the employment and income multipliers are likely to be small. Some employment and income is likely to be created from backward and forward linkages on account of local production of components and the growth of service

stations, repair workshops, etc., but is not significant. Although expansion of a non-traditional, capital goods industry is likely to post gains for the economy as a whole, the poor appear to be excluded from the benefits of growth in the automobile industry.

Growth in the Electronics industry too is largely attributable to consumer financing. Further, the industry comprises of assembly plants as well. Thus, while growth in the sector augers well for the manufacturing sector and for the economy, the distributional impacts are disturbing. Given the absence of strong backward and forward linkages and the low income and employment multipliers therein, the poor appear to be excluded from the benefits of growth in the Electronics industry.

FISCAL ANALYSIS

The budget is an important policy document. It sets forth the priorities of the government and the directions that the economy is desired to be taken towards. The desired directions are a function of state policy. Unfortunately, the Federal Budget for FY2004 appears to be bereft of an identifiable policy framework. The pursuit of stabilization goals continues to be the cornerstone of macroeconomic policy, with persistent stress on enhancement of revenues and reduction of fiscal deficit. Prioritization of growth areas is not very clearly specified. Directions for investment and social sector development are particularly lacking.

Fiscal Deficit

The Budget FY2004 reports the fiscal deficit for FY2003 at 4.5 percent.

This, however, appears to be an underestimate. The difference can, perhaps, be explained by what may be called the KESC factor.

The Budget reports a receipt of Rs.57.7 billion under the head "Recovery of Investment from KESC". On the expenditure side, it also shows an entry for about Rs. 57 billion under "Unallocables". Enquiries have revealed that these are merely accounting entries and cancel each other out. Neither has KESC returned this amount to the government, nor has the government incurred this expenditure during FY2003. There is, thus, no accounting impact on the budget.

The implication of these entries is, however, meaningful. Essentially, the entry on the receipts side has absolved KESC of its liabilities to the government to the extent of Rs. 57.7 billion. By showing a corresponding entry on the expenditure side, the government has effectively written off KESC's losses. The correct procedure would have been to just have one entry on the expenditure side. In the event, the fiscal deficit would have risen to 5.6 percent; which is the actual fiscal deficit for FY2003 (see Table 10).

Moreover, the government, had in the previous year's budget, put forth the concept of "overall" and "actual" fiscal deficits, which were stated to be 6.6 and 4.6 percent, respectively. One included the subsidy to WAPDA and KESC and the other did not. The subsidy was then explained as a one-time expenditure and, as such, justified for non-inclusion in calculating the actual fiscal deficit. The largesse to WAPDA and KESC in FY2003 is even larger, given that an amount of Rs 49.8 billion is stated under the Subsidy head, almost half of which is

TABLE 10
BUDGET PERFORMANCE IN 2002-03 AND 2003-04

Heads		Budget Estimate 2002-03	Revised Estimate 2002-03	Difference	(Rs. billion) Budget Estimate 2003-04
	Current Expenditures	608.0	673.3	65.4	645.2
Plus	Development Expenditures	134.0	120.0	-14.0	160.0
Minus	Net Revenue Receipts	481.4	508.8	27.4	513.5
Minus	Repayment of Foreign Loans	44.8	45.6	0.8	46.0
Minus	Self-Financing of PSDP by Provinces	28.7	28.7	0.0	30.0
Minus	Recovery of Loans from Provinces	15.7	18.8	3.1	11.8
Minus	Provincial Surplus	17.0	16.6	-0.5	28.0
Minus	Net Lending to others	-8.2	5.2	13.4	-11.1
	Fiscal Deficit A	162.5	169.7	7.2	187.1
	Fiscal Deficit as % GDP	4.0	4.2	-	4.2
Minus	Estimated Operational Shortfall in PSDP	-	-	-	8.0
	Fiscal Deficit B	162.5	169.7	7.2	179.1
	Fiscal Deficit as % GDP	4.0	4.2	-	4.0
Plus	Recovery of Investment from KESC	0.0	57.3	57.3	0.0
	Fiscal Deficit C	162.5	227.0	64.5	179.1
	Fiscal Deficit as % GDP	4.0	5.6	-	4.0

Source: Federal Budget in Brief 2003-04

Note: According to government revised estimates the fiscal deficit 2002-03 is 4.5% of GDP due to higher value of development expenditure

devoted to the two entities. Under the circumstances, a few questions arise and merit credible explanations from the government.

One, if the previous year's subsidy was presented as a one-time expenditure, why has KESC been provided the subsidy for the second time?

And two, why has the cost of this write-off been imposed on the taxpayer?

And three, why has the National Accountability Bureau (NAB), created in late 1999 with the professed objective of "recovering looted wealth", failed to call to account those who caused KESC to fall into financial decline for years.

The Budget has set a target fiscal

deficit of Rs. 187.1 billion for FY2004. If the Operational Shortfall of Rs. 8 billion in PSDP is taken into account, the fiscal deficit declines to Rs. 179.1 billion. The Budget uses the latter figure of Rs. 179.1 billion to estimate the fiscal deficit/GDP ratio of 4 percent. Given that revenues are projected to grow at a reasonable rate of 11 percent and current expenditures are projected to decline modestly by 4 percent, it does appear that - to this extent -- the projected fiscal deficit is achievable. However, the sharp 69 percent increase in Provincial Surplus from Rs. 16.6 billion to Rs. 28 billion is unrealistic and, perhaps, unachievable. Thus, assuming that there are no shortfalls in revenue, no increase in current expenditure, and no further cuts

in development expenditure, it is likely that -- even after incorporating the Rs. 8 billion Operational Shortfall in PSDP -- the fiscal deficit may still stand at between Rs. 185 to Rs. 190 billion.

Revenues

The Budget reports several notable improvements on the revenue front during FY2003. Net Revenue Receipts have been 4 percent higher than

TABLE 11
COMPARISON OF TARGET AND ACTUAL FEDERAL RECEIPTS

	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03*
<i>(Rs. billion)</i>							
Gross Revenue Receipts							
Target	413.2	450.2	502.1	560.9	594.6	643.8	674.9
Actual	384.3	433.6	467.2	531.0	536.7	622.5	701.6
Actual as % of Target	93.0	96.3	93.1	94.7	90.3	96.7	104.0
Tax Revenues							
Target	296.4	317.8	338.2	356.0	435.7	457.7	460.6
Actual	282.1	293.6	311.4	346.8	393.9	403.9	458.9
Actual as % of Target	95.2	92.4	92.1	97.4	90.4	88.2	99.6
Direct Taxes							
Target	86.3	100.5	114.8	127.0	137.5	149.8	148.4
Actual	85.1	103.2	103.5	109.5	127.4	142.6	145.0
Actual as % of Target	98.5	102.7	90.1	86.2	92.7	95.2	97.7
Indirect Taxes							
Target	210.1	217.3	223.4	229.0	298.2	307.9	312.2
Actual	197.1	190.4	207.9	237.3	266.5	261.3	313.9
Actual as % of Target	93.8	87.6	93.1	103.6	89.4	84.9	100.5
Import Duties							
Target	98.2	87.0	88.9	65.5	73.0	69.6	56.5
Actual	86.1	74.5	78.7	63.9	64.5	48.1	69.6
Actual as % of Target	87.7	85.6	88.5	97.6	88.4	69.1	123.2
Federal Excise Duty							
Target	55.2	65.0	69.5	67.0	52.6	53.1	50.0
Actual	55.3	62.0	60.6	56.6	49.2	46.9	46.5
Actual as % of Target	100.2	95.4	87.1	84.5	93.5	88.3	93.0
Sales Tax							
Target	56.7	65.3	64.9	96.5	172.6	185.2	205.7
Actual	55.7	53.9	68.7	116.8	152.8	166.3	197.8
Actual as % of Target	98.2	82.6	105.8	121.0	88.5	89.8	96.2
Surcharges							
Target	26.3	30.2	43.4	63.3	38.0	47.0	60.5
Actual**	27.3	49.9	78.3	38.9	30.5	53.9	66.9
Actual as % of Target	103.9	165.4	180.6	61.5	80.3	114.7	110.5
Non-Tax Revenues							
Target	90.5	102.3	120.5	141.7	120.9	139.1	153.8
Actual	74.8	90.1	77.5	145.3	112.3	164.7	175.8
Actual as % of Target	82.7	88.1	64.3	102.5	92.9	118.4	114.3

Sources:

Target and Revised Estimates are from 'Federal Budget in Brief', various Issues
Actual from State Bank of Pakistan Annual Report, Various Issues; and SBP Website.

*Revised Estimates for the year 2002-03

** Includes arrears of 5.768 Billion

TABLE 12
ANALYSIS OF GROWTH IN TAX COLLECTION

	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
	Actual	Actual	Actual	Actual	Actual	Actual	RE	BE
TAX REVENUES	282.1	293.6	311.4	346.8	393.9	403.9	458.9	510.0
Growth (%)		4.1	6.0	11.4	13.6	2.5	13.6	11.1
Direct Taxes	85.1	103.2	103.5	109.5	127.4	142.6	145.0	161.1
Growth (%)		21.3	0.3	5.8	16.4	11.9	1.7	11.1
<i>Share in Tax Revenue</i>	<i>30.1</i>	<i>35.1</i>	<i>33.2</i>	<i>31.6</i>	<i>32.3</i>	<i>35.3</i>	<i>31.6</i>	<i>31.6</i>
Indirect Taxes	197.1	190.4	207.9	237.3	266.5	261.3	313.9	348.9
Growth (%)		-3.4	9.2	14.1	12.3	-2.0	20.1	11.2
<i>Share in Tax Revenue</i>	<i>69.9</i>	<i>64.9</i>	<i>66.8</i>	<i>68.4</i>	<i>67.7</i>	<i>64.7</i>	<i>68.4</i>	<i>68.4</i>
Custom Duties	86.1	74.5	78.7	63.9	64.5	48.1	69.6	78.1
Growth (%)		-13.5	5.6	-18.7	0.9	-25.4	44.7	12.2
Federal Excise Duties	55.3	62.0	60.6	56.6	49.2	46.9	46.5	47.7
Growth (%)		12.1	-2.3	-6.5	-13.1	-4.7	-0.9	2.6
Sales Tax	55.7	53.9	68.7	116.8	152.8	166.3	197.8	223.1
Growth (%)		-3.1	27.3	70.0	30.9	8.8	18.9	12.8

Source: State Bank of Pakistan and Federal Budget in Brief 2003-04

budgeted and tax revenue collection almost equaled the target for the first time since FY1997; the shortfall being a mere 0.4 percent. In terms of growth, tax revenues have increased by 13.6 percent. This is a significant improvement over the previous year, FY2002, when tax revenues grew by only 2.5 percent. The growth is explained largely by the nearly 45

percent increase in customs duties, which again is a sizeable recovery over the previous year's negative 25 percent growth. Sales taxes have grown at 19 percent, 58 percent of which is attributable to enhanced imports (see Tables 11 and 12).

A caveat is necessary here. About half the growth in gross customs duty receipts is contributed by POL products

TABLE 13
SHARE OF WITHHOLDING TAXES IN DIRECT TAXES

	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Tax Heads						
Direct Taxes	85.1	103.2	103.5	109.5	127.4	142.6
Withholding Taxes	61.3	68.6	74.5	75.2	79.2	78.9
Indirect Withholding Taxes	31.8	34.2	41.4	40.4	47.4	46.6
Share in Direct Taxes (%)						
Withholding Taxes	72.0	66.5	72.0	68.7	62.1	55.3
Indirect Withholding Taxes	37.3	33.2	40.0	36.9	37.2	32.7
Share in Withholding Taxes (%)						
Indirect Withholding Taxes	51.8	49.9	55.6	53.7	59.8	59.1

Source: CBR Annual; Various Issues

Box 1**Impact of Withholding Taxes on Direct and Indirect Tax Shares**

Withholding taxes were introduced in the early 1990's as a means to boost revenues. These revenues were included as part of direct taxes. The result was that, as revenues through withholding taxes rose rapidly, the share of direct taxes in total taxes increased significantly. An effort has, however, been made to decompose the direct and indirect elements of withholding taxes on the basis of income by nature of economic activities (see Table Below).

Direct tax elements

Salary Income
Interest on Government Borrowing
Interest on Bank Deposits
Dividend Income
Income from Bank Transactions
Payment to Non-residents
Income from Transport

Indirect tax elements

Payments to Contractors & Suppliers
Income from Imports and Exports
Electricity Billing

It appears that for the average of the last 5 years, direct taxes comprised 33 percent of total tax revenues. However, if the indirect element of withholding taxes is excluded, the share of direct taxes stands reduced to 21 percent. Similarly, if the indirect element of withholding taxes is included in indirect taxes, its share in total tax revenues rises from 67 to 79 percent.

IMPACT OF WITHHOLDING TAXES ON DIRECT AND INDIRECT TAX SHARES					
(%)					
Year	Total Taxes (Rs. Billion)	Share in			
		Direct Taxes		Indirect Taxes	
		With Indirect Withholding Taxes	Without Indirect Withholding Taxes	With out Indirect Withholding Taxes	With Indirect Withholding Taxes
1996-97	282.1	30.1	18.9	69.9	81.1
1997-98	293.6	35.1	23.5	64.9	76.5
1998-99	311.4	33.2	19.9	66.8	80.1
1999-00	346.8	31.6	19.9	68.4	80.1
2000-01	393.9	32.3	20.3	67.7	79.7
2001-02	403.9	35.3	23.8	64.7	76.2
Average		33.0	21.0	67.0	79.0

Source: SPDC estimates based on CBR Annual Report, Various issues

and Vehicles. Net customs duty receipts are higher largely on account of a sharp reduction in Refund and Rebates. About 80 percent of growth in sales taxes is contributed by POL products and Services (including telephones and electricity). Sales tax receipts from cotton yarn and cement have registered a decline. It appears, therefore, that the sources of growth in customs duties and

sales taxes lie in 'non-real' sectors of the economy and raise questions about the claimed recovery of the economy.

Overall, indirect tax revenues increased by 20 percent. By comparison, direct tax revenues grew by less than 2 percent. Given that 55 percent of direct taxes are derived from withholding taxes and 59 percent of withholding taxes are

of an indirect nature, it may not be unreasonable to conclude that direct tax revenues have actually declined (see Table 13). This is inexplicable, given the robust growth in textiles, automobiles and banking and finance sectors. Clearly, the tax documentation and other tax administration reforms executed in the last three years have failed to enhance the effectiveness of tax collection, particularly from firms and households in upper income brackets. The pattern of tax revenue growth, thus, does not bode well for the distribution of income.

Current Expenditure

However, expenditure management has not been as successful. Current expenditures exceeded budgeted amount by 11 percent, despite the fact that expenditure on Debt Servicing has declined. An aspect of questionable priorities is that Development Expenditure was 10 percent below the budgeted amount (see Table 14).

An analysis of the composition of Current Expenditure since FY2000 shows that the share of Debt Servicing in total Current Expenditures has

TABLE 14
COMPARISON OF BUDGETED AND ACTUAL EXPENDITURES

(Rs. billion)

	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02*	2002-03*
Current Expenditures							
Budget Estimates	395.4	461.9	499.7	491.1	577.6	621.7	608.0
Actual	395.0	466.5	501.9	571.3	572.9	648.6	673.3
Actual as % of B.E.	99.9	101.0	100.4	116.3	99.2	104.3	110.7
Defence							
Budget Estimates	131.4	134.0	145.0	142.0	133.5	131.6	146.0
Actual	127.4	136.2	143.5	152.8	131.2	151.7	160.1
Actual as % of B.E.	97.0	101.6	98.9	107.6	98.3	115.2	109.7
Debt Servicing							
Budget Estimates	186.1	247.9	275.6	287.4	305.6	329.2	289.7
Actual	204.1	255.6	290.7	335.4	308.1	320.1	257.4
Actual as % of B.E.	109.7	103.1	105.5	116.7	100.8	97.2	88.9
Subsidies							
Budget Estimates	8.3	7.4	4.0	2.4	11.8	20.7	20.8
Actual	6.8	6.3	9.5	20.4	14.7	25.6	49.8
Actual as % of B.E.	82.7	84.8	238.8	841.7	124.2	123.7	239.4
Other Current Expenditures							
Budget Estimates	69.7	72.6	75.2	59.3	126.6	140.2	151.4
Actual	56.7	68.5	58.2	62.8	118.9	151.2	206.0
Actual as % of B.E.	81.4	94.4	77.4	105.9	93.9	107.9	136.0
Public Sector Development Program (PSDP)							
Budget Estimates	104.8	90.1	110.6	116.3	120.4	130.0	134.0
Actual	85.5	104.1	98.3	95.6	92.5	124.7	120.0
Actual as % of B.E.	81.6	115.5	88.9	82.2	76.8	95.9	89.6
Total Expenditure							
Budget Estimates	500.2	552.0	610.3	607.4	698.0	751.7	742.0
Actual	480.5	570.6	600.2	666.9	665.4	773.3	793.3
Actual as % of B.E.	96.1	103.4	98.3	109.8	95.3	102.9	106.9

* Revised Estimates

Source: Actual from State Bank of Pakistan Annual Report; Budget estimates from Federal Budget in Brief, Various issues.

TABLE 15
SECTORAL SHARES IN CURRENT EXPENDITURES

	1999-00	2000-01	2001-02	2002-03	2003-04
	RE	RE	RE	RE	BE
General Administration	4.5	8.6	7.9	8.2	9.1
Defence	25.1	22.7	23.4	23.8	24.8
Debt Servicing	54.9	53.2	49.4	38.2	39.7
Interest on Domestic Debt	32.2	32.0	29.7	25.5	26.4
Interest on Foreign Debt	8.8	8.7	9.4	5.9	6.1
Repayment of Foreign Debt	13.9	12.4	10.3	6.8	7.1
Law and Order	1.6	1.7	1.6	1.7	1.9
Community Services	1.1	1.2	1.1	1.2	1.3
Social Services	1.8	1.8	1.9	2.0	2.5
Economic Services	0.5	0.5	0.6	0.6	0.7
Subsidies	2.5	3.9	3.9	7.4	10.0
Grants	7.2	6.3	10.2	8.3	9.6
Unallocable	0.9	0.1	0.0	8.6	0.3
TOTAL	100.0	100.0	100.0	100.0	100.0

Source: SPDC estimates based on Federal Budget in Brief, Various issues

consistently declined from 54.9 percent in FY2000 to 38.2 percent in FY2003, but is projected to increase to 39.7 percent in FY2004. The savings in Debt Servicing, it appears, have been utilized to enhance expenditures on other Current Expenditure heads, except Defence. Increases are recorded in General Administration from 4.5 percent in FY2000 to 8.2 percent in FY2003 and projected to grow further to 9.1 percent in FY2004. Apparently, efforts at 'right-sizing' the civil service have failed to bear fruit (see Table 15).

Development Expenditures

Tax revenue collection in FY2003 was almost on target and net revenue receipts exceed budgeted target by 6 percent. Thus, there appeared - for the first time, perhaps --no rationale for cuts in development expenditure on grounds of resource constraint. Yet, development expenditure (PSDP), budgeted at Rs. 134 billion was reduced to Rs. 120

billion. Given that the development expenditure in the preceding year, FY2002, was Rs. 124.7 billion, the expenditure in FY2003 constitutes a decline even in nominal terms. The contraction of public investment does not bode well for the unemployed and the poor.

The decrease in development expenditure is particularly meaningful, given that current expenditure was increased by 11 percent over budgeted amounts. The persistence of development expenditure shortfalls reveals an ideological predilection with the stabilization agenda and, perhaps, insufficient political commitment to the imperative of reducing unemployment and poverty.

Debt Servicing

The Budget FY2004 also reports a continuing decline in Total Debt as a percentage of GDP; which stood at 52.6

percent in FY2001, fell to 48.4 percent in FY2002, and has further decreased, as of March 2003, to 44.1 percent (see Table 16). This is commendable. However, it is noteworthy that the reduction in debt has been made possible to some extent by a windfall.

The international sanctions imposed on Pakistan in mid-1998 led to an abrupt decline in foreign exchange reserves.

for indirect taxes - customs duties and sales taxes - are rather modest compared to actual achievement in FY2003. Nevertheless, the major contributor to customs duties in FY2003 was POL products, the prices of which was then high. POL prices are likely to be lower in FY2004 and place difficulties in meeting customs duties targets. With respect to sales tax, it appears that the expansion of the base has, by and large,

TABLE 16
DOMESTIC DEBT PROFILE

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03 (End March)
Total Domestic Debt	1199.7	1452.9	1641.4	1799.2	1757.6	1770.6
Growth (%)		21.1	13.0	9.6	-2.3	0.7
Total Debt as % of GDP	44.8	49.4	52.2	52.6	48.4	44.1
Growth (%)		10.3	5.7	0.8	-8.0	-8.9

Source: Economic Survey 2002-03

The then government responded to the dire situation by deciding to make all payments relating to external debt servicing in Pakistan rupees at the prevailing exchange rate. The rupee amounts were deposited in a new account titled 'Special Account-Debt Repayment' under the main head 'Other Deposits' opened on July 21, 1998. In July 2001, the IMF allowed access to the funds lying in the said account, amounting to Rs. 194.6 billion, which was used to retire treasury bills valuing Rs. 193.03 billion and markup thereon of Rs. 1.64 billion.

Prospects for FY2004

The Federal Budget for FY2004 projects an 11 percent growth in tax revenues. The target of 11 percent growth for direct taxes, given past records, will require considerable effort and political will to achieve. The targets

been completed and the expectation hereon is for normal growth.

Given the performance of FY2003, the revenue targets do appear to be achievable. However, the claim of a no-tax budget cannot be borne out. Given that the target is about 2 to 3 percent above the projected nominal GDP growth rate, new taxation of about Rs. 25 to 30 billion will be necessary, if the target is to be achieved.

On the expenditure front, Defence expenditure has been capped at the previous year's expenditure of Rs. 160 billion. Debt servicing is also more or less constant, with a 0.6 percent decline. In real terms, therefore, expenditure on both Defence and Debt Servicing is expected to decline. General Administration expenditure is projected to grow by 6 percent, perhaps on account of the 15 percent raise awarded to government employees. Expenditures

on Economic and Social Services are shown to grow at a healthy 15 and 20 percent, respectively. The largest increase of 30 percent is on Subsidies, devoted largely to covering the losses of WAPDA and KESC.

The Development Expenditure for FY2004 is budgeted at Rs. 160 billion. Development Expenditures are usually subject to cuts. However, these are always ex post phenomena. A unique feature of the Budget for FY2004 is that an ex ante provision of budgetary cut, labeled as 'Operational Shortfall' of Rs. 8 billion is provided for. The actual size of the projected PSDP, thus, stands at Rs. 152 billion.

The federal component of the PSDP for FY2004 has allocated Rs. 90.3 billion or 80 percent of the total amount for on-

going projects and Rs. 22.7 billion or 20 percent new projects. This amounts to a meager 0.5 percent of the estimated GDP. About half (51 percent) of the new allocation is dedicated to water, power and highways. While the composition of the new allocations show that the priorities are, by and large, correct, the amount allocated is too meagre for it to have a meaningful impact in terms of employment generation and even, perhaps for 'crowding-in' private investment. There is an urgent need to raise development expenditure to at least 5 percent of GDP, i.e., Rs. 200 billion. This may be considered the minimum necessary for steering the economy out of the low level equilibrium that it is now trapped in, generate jobs, and reduce poverty to some extent (see Table 17).

TABLE 17
DISTRIBUTION OF DEVELOPMENT EXPENDITURE 2003-04

(Rs. billion)

Ministry/Division/Agency	Budgeted	Share (%)	New Expenditures	Share (%)	On-Going Expenditures	Share (%)
A. Social Sectors Divisions	20.8	13.0	4.7	22.5	16.1	77.5
B. Sustainable Development	17.5	10.9	4.2	23.9	13.3	76.1
Water and Power (Water Sector)	14.7	9.2	2.6	17.8	12.1	82.2
Others	2.8	1.8	1.6	1.0	1.2	0.7
C. Infrastructure Development	47.9	30.0	10.2	21.2	37.8	78.8
Water and Power (Power Sector)	17.3	10.8	4.7	27.1	12.6	72.9
NHA	18.4	11.5	4.2	22.9	14.2	77.1
Others	12.1	7.6	1.3	0.8	11.0	6.9
D. Governance	6.3	3.9	1.5	24.4	4.7	75.6
E. Special Programmes	6.6	4.1				
F. Other Divisions	4.5	2.8	2.1	47.5	2.4	52.5
G. KA & NA and SAFRON Division	9.4	5.9				
Total Federal Programmes	113.0	70.6	22.7	20.1	90.3	79.9
Provincial Programmes	47.0	29.4				
TOTAL PSDP	160.0	100.0	22.7	14.2	137.3	85.8

Source: PSDP 2003-04

Conclusion

The economy appears to have performed relatively better during FY2003. Aggregate indicators show that growth in GDP and per capita income, remittances, exports, imports, savings, investment, private sector credit disbursement, current account surplus, and revenues have been higher and the fiscal deficit and inflation is lower. The build-up of Foreign Exchange reserves continues. However, a closer look behind the aggregates raises several questions and places the issue of sustainability of the growth momentum in sharp focus. The analysis shows that while the economy of the government has recovered, the economy of the people has yet to see meaningful improvement. While the Pakistan economy has time and again proved its strength and resilience, the current growth impetus appears to be emanating largely from exogenous factors and stands on a rather narrow and narrowing base. Clearly, any notion of having reached the 'take-off' stage is premature.

End Notes

- ¹ Table 1.4 in the Economic Survey 2001-02 and Table 1.2 in the Economic Survey 2002-03
- ² These sectors/sub-sectors account for 17 and 24 percent of the economy, respectively.
- ³ On occasions, the official rate has been slightly higher than the kerb rate.
- ⁴ Export and import growth rates differ between State Bank and Federal Bureau of Statistics data.