FOREWORD

In Pakistan as in other South Asian countries, the budget is a reflection of the government's fiscal priorities and policy objectives for the forthcoming year. Unlike its recent predecessors, this year's budget assumes added significance for economic analysts and researchers in the country. Coming on the heels of a fairly depressing overall macro economic scenario of 1996-97, the budget's fiscal projections and consistent framework are expected to facilitate transition to a respectable and sustainable growth path. Secondly, through the use of various fiscal instruments, its numbers document and confirm the shift in the policy regime announced by the newly elected government in March'97. Traditional demand management policies have been replaced by a reliance on supply-side responses.

Social Policy and Development Centre, which focuses on policy analysis, in particular social sector policy, has analysed the budget. These analysis cover a wide spectrum of issues and impacts. Debt management, consistency between policy instruments and targets, the budgetary outcome 1996-97, NFC Award 1996 and impact of budgetary allocations on social sector development and poverty are some of the areas looked into by our researchers.

This report is a compilation of these articles. We hope that our analyses will represent an objective appraisal of the economy and the Budget of 1997-98 and will be of some use to readers.

FRAMEWORK

BUDGET 1997-98:
A Dilemma for Policy Makers
by
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Many analysts in their exuberance may declare that this "people -friendly"budget is at least not following the diktat of the World Bank/IMF as its predessors. On a closer look this perception is likely to be misplaced. As in the previous years the deficit target of 5% necessary for negotiating ESAF combined with an optimistic growth rate target of 6.0 percent is the basis for entire budget making exercise. Moreover retaining the lower tariff regime as announced in the PM's economic incentive package of March'97 also goes to the liking of the international institutions. Thirdly nominal increase (less than inflation) in non-development expenditures would also please the donors. I guess the macro diktat ends here. The approach for achieving the objective of short-run stabilisation is radically different than what the World Bank/IMF would have wished. This budget by reinforcing and strengthening the supply-side gift to the nation given in March'97, is an explicit admission that nothing can be done to enhance the tax base significantly or to further reduce the non-development expenditures in the short-run. Theoretically there is also inconsistency in assigning policy instruments to policy objectives. Simply put we have three objectives in the short to medium run:- a) Increase output/reduce inflation i.e., eliminate stagflation, b) reduce budget deficit (internal balance) and c) control current account balance (external balance). Two policy instruments have been used:- ambiguous fiscal policy and announced tight monetary policy. Interestingly how tight the monetary policy turns out to be will only be known at the end of the year. In other words assigning two instruments for three objectives will always leave one objective unfulfilled. The following discussion will focus on the weaknesses in this ambitious and novel approach to resolving what is popularly known in the macro literature as the "Assignment Problem" in the context of short-run economic stabilization.

As matter of record, the last time we experimented with the "business and people -friendly" budget was in 1995-96. Inspite of relying on the well-tested demand management approach by increasing taxes on the petroleum products and raising few other taxes, Moody downgraded us in matter of three months, reserves fell drastically and we had to devalue our currency in Oct'95 by 7.5 percent. Moreover World Bank/IMF refused to continue with the ESAF lendings. Are our leading economic indicators in a better position as compared to 1995-96 to avoid the replay of Oct'95?. It would be hard to dispute that with 45% percent of expenditures and 53% of revenues going to debt servicing, our economy is now much more fragile than in 1995-96.

Let us dissect our fiscal policy. Is it really expansionary, contractionary or ambiguous?. Theoretically a expansionary (lower taxes and/or increase expenditure) fiscal policy is advocated to boost demand and thereby domestic production to overcome the problem of stagnant output. Interestingly on paper we have a contractionary fiscal policy. Federal revenue receipts are estimated to grow by 30 percent while expenditure will grow by 14 percent. Domestic production is unlikely to receive a boost from the increase in consumption expenditures in the

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domestic economy. Assuming less tax evasion by existing tax payers and enlargement of income tax returns to say even 1.5 million in September 1997, recorded disposable income will fall. If the revamped tax machinery can expand the production tax base, it implies improved forward shifting at smaller rates, leaving less money in the pocket of domestic consumers to save or even producer to spend on unrecorded investment. However due to lower rates price increases will be moderate, implying less inflation more real income in the hands of the consumers and thereby encouraging expenditure. Fiscal policy can turn expansionary if enlargement in tax base is not sufficient to outweigh the fall in revenues due to reduction in rates. How? Income and production tax base revenues are only expected to increase by 13 percent marginally less than the growth in federal expenditures. A modest expected increase of Rs.8 billion i.e., 9.6 percent increase in trade related taxes improves the likelihood that fiscal policy will turn expansionary. Overshooting of expenditures is a historical reality. In 1996-97, inspite of absolute reduction in PSDP our total expenditures at Rs.398.2 billion were marginally higher than the budgeted figure of Rs.395.4 billion. Apparently the government now has little control over the rapidly devouring debt servicing expenditures. In fact the 14 percent nominal increase in federal expenditures is mainly due to increase in debt servicing and defense expenditures. Thus instruments of fiscal policy ex-ante inconsistent with the objective of fighting stagflation will turn out to be ex-post consistent, and promote consumption demand thanks to our non-tax paying culture, inefficient tax machinery and debt overhang.

The inflationary impact of ex-ante contractionary or ex-post expansionary fiscal policy will be moderate due to lower sales tax and custom duty rates. To fight stagflation one also needs to implement a tight monetary policy? What are the signals that have emanated so far? In fact we are moving towards an expansionary monetary policy. Under fiscal exigencies statutory reserve ratio was lowered by 5 percentages from 30 to 25 percent few days before the budget. Apparently interest rates are being lowered under political directives, thereby distorting the uncovered real interest rate parity. Moreover with a large debt overhang, monetary policy has already lost most of its effectiveness. Combined with expected increases in administered prices during the year and ex-post loose monetary policy we are unlikely to end up achieving the policy makers favorite number of 9 percent for inflation.

This expected expansionary fiscal policy will not be enough to double the GDP growth rate to 6 percent next year. Investment and export demand are the two other components of GDP. In fact the present government is banking on increased investment demand to contribute to higher growth rate. To the extent that public investment leads the revival of private investment activity, former's decline in real terms may dampen private initiatives in long-term productive investment. The impact of other measures, i.e., removal of CED on loans, tax holidays for food processing industry and solar equipment manufacturers, and lower duties on import of machinery for export oriented industries will only have a marginal impact on raising investment demand. Other instruments introduced in the budget are biased towards strengthening the capital market thereby directly encouraging speculative and portfolio investment. These measures will also facilitate the disposal of public enterprises at reasonable prices. In the short-run stock market boosting measures only have an indirect and small impact on the private productive investment demand.

The third component on which the Nawaz Sharif government is relying on is a miraculous increase in export demand. Ours is a cotton economy and therefore supply constrained. Exportable surplus is less a function of production costs than cotton output in any given year.

Moreover non-traditional exports constitute a small portion of our total exports although their growth rate in the last few years has been encouraging. Lower tariffs will reduce the anti-export bias these exports face and may further improve their growth rates. Whether the ambitious overall export target will be met by say even doubling of non-traditional exports in the next year is questionable?. Even if the manufacturing sector responds to favorable indirect tax rates and produces exportable surplus, it can only be exported if there is demand for it. The economies of our South-East Asian partners have slowed down in the last few years thereby affecting the demand for our exports. Most of them are coming out of recession gradually and we might see a exogenous increase in exports in the latter half of the year. Europe, another one of our partners is also in a recession and continues to impose non-tariff barriers on one pretext or the other to protect jobs and output from competition. Thus revival of export demand critically depends on cotton output for the next year and strength of recovery of our major trading partners.

The above discussion implies that ex-post we might end up with serious inconsistency between the targeting of policy instruments and objectives. In fact one might be tempted to argue that ex-ante there is little economic rationale in fighting stagflation with ambiguous fiscal and loose monetary policy. That leaves us with the objectives of stabilizing internal and external balance. If ex-post fiscal policy turns out to be contractionary, it will stabilize the internal balance, i.e., reduce budget deficit, and by slowing down the growth of import demand also stabilize current account balance. If ex-post fiscal policy is expansionary we will see a higher growth rate, may be slightly lower inflation rate but a higher than projected budget deficit and current account deficit. These imbalances in presence of debt overhang will push up the domestic interest rates and call for increased domestic and foreign borrowings. Consequently inspite of denials, managed exchange rate policy would have to be used to control current account deficit, still leaving the objective of lower budget deficit unattended..What are the implications on internal and external balance of combining a contractionary fiscal policy with loose monetary policy? It will stabilize the budget deficit but accentuate external imbalances assuming imperfect mobility of international capital. For the short-run stabilization of current account and budget deficits we need to aim for ex-post contractionary fiscal and tight monetary policy which unfortunately can be in conflict with our objective of higher growth if not smaller inflation.

Policy Inertia on Debt Management: Can We Continue in this Stalemate?

by

Dr. Asad Sayeed[*]

The recently published Economic Survey vividly demonstrates the bottomless pit in which the country's economy is tumbling. The growth rate of GDP has taken a nose dive to a level not experienced in the last two decades except for one year in the previous Nawaz Sharif government. Other important indicators such as the rate of inflation, the rate of growth of the commodity producing sectors and exports, the budgetary and the current account deficits, etc. have all fared worse than the previous year. The more worrying fact is that a significant economic downturn has become the feature of the decade of the 1990s. As a result, poverty has increased substantially, employment opportunities are steadily receding and real wages are increasingly eroding.

It is expedient for the present government to blame the Benazir administration for the abysmal economic performance in the last fiscal year. However, the fact remains that responsibility has to be shared by all three administrations that have ruled the roost in the previous fiscal year, or by all those who have been at the helm of affairs since the beginning of the decade. One could have put last year's performance behind us if there was complete confidence that the strategy adopted and the measures undertaken by the present government would reverse this deleterious trend. Unfortunately, however, the present policy regime does not inspire such confidence.

The much touted supply-side policy regime is promised to bring about a reversal of fortunes. By definition, any supply side package can only yield dividends in the medium to long run. The government itself has bought a grace period of 18-24 months for its reforms to yield dividends. But as the State Bank's report to the parliament and numerous other analyses indicate, without a coherent strategy to overcome short term structural impediments, the probability of inducing manufacturing sector led growth seems, at best, a flight of fancy.

A crucial structural bottleneck that has afflicted the economy is deceleration in public sector investments for physical and social infrastructure. Whereas in the 1980s, the Annual Development Plan of the federal government would amount to 8% of GDP, it has now fallen to roughly 3.5% in recent years. According to theory as well as past evidence, it is unambiguously clear that public sector investments have a crowding-in effect for private investments. For an infrastructure starved economy, therefore, long-run growth as envisaged in the supply side package is virtually unthinkable without higher levels of public sector investment, no matter how much money has been put back in the pockets of the capitalists through tax breaks.

Public sector investments also play an important welfare function. In a highly iniquitous society such as ours, public sector investment in education, health, water supply, communications and electrification plays an important role in providing a level playing field for the disadvantaged.

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Add to the slash in public investments, escalating prices of utilities, a continuous decline in food subsidies and large doses of regressive taxation, the list of anti-welfare measures of the Pakistani state assume a massive dimension. The convenient alibi always is the high budget deficit and the consequent need for 'austerity'. However, if one stretches one's memory to about 10-15 years ago, the country was running budget deficits in the vicinity of 8% of GDP, but inflation was low, growth was high and public investment averaged around 8% of GDP rather than the measly 3% in the last few years. What is it that has made budgetary deficits so unsustainable?

A combination of changing exogenous circumstances and some self inflicted wounds by the state itself has made the deficit the mother of all economic problems in the country. Increasing debt both on the domestic and international fronts is the *prime mobile* in creating this unsustainability of budgetary deficits. In the fiscal year 1997-98, debt servicing will consume 45% of total government expenditure, roughly 70% of net tax revenues and 8.57% of GDP. To make the picture more vivid, since the beginning of this decade, debt servicing has been the fastest growing item in government expenditure (at a rate of 21% per annum) whereas all other expenditure heads have either declined or remained stagnant in real terms. Moreover, a simple measure of debt sustainability is that its growth should match the growth in GDP. Whereas debt servicing has grown at the rate mentioned above, GDP growth in this decade has been a meager 5% per annum. The unsustainability of debt is, therefore, unambiguous.

In this context, it is indeed surprising that whereas the government has announced a plethora of packages, it is completely mum on a strategy for debt management. It is clear without a pale of doubt that no matter how successful all these packages are, the debt overhang will continue to pull down the economy and effectively neutralise all the expected gains from the above packages.
Domestic debt is the fastest growing item on the expenditure side, increasing at a rate of 24% per annum every year. This is clearly a self inflicted wound borne out of Financial Sector Reforms carried out in 1991. Up until that period the Government of Pakistan would borrow from the banks at a rate of 6%. Now it borrows at rates ranging between 16 and 19%. This means that for every rupee that the government borrows it pays 10-13 paisa more interest than it used to. Financial sector liberalisation would have still been worthwhile if the government was the only loser. But in fact with almost negative returns on deposits in real terms and exorbitant rates for private sector in the range of 22-26%, neither the saver nor the investor is benefiting. The only beneficiary of these reforms seems to be the banking sector, which is making a killing at the cost of all other sectors of the economy.

The only manner in which the impact of this borrowing can be reduced and brought down to a sustainable level is if the differential between lending and deposit rates is narrowed through State Bank Regulation. Both industrial investors and the government will benefit from such a policy and the debt servicing component in the budget will start declining. It seems that reluctance on this count is borne out of nothing else but an ideological predilection towards sticking to market prices, irrespective of the havoc it wreaks for the economy in general and particularly for the poor via cuts in welfare measures.

The large and burgeoning foreign debt is another potential time bomb. Its unsustainability is increasingly becoming visible as the current account deficit has reached a level of 7% of GDP. With stagnant exports, mostly a result of the narrow export base and virtually inelastic imports, there is little hope in the near future of the trade deficit narrowing down. In the past large inflows of remittances were able to cushion the impact of a high trade deficit to a great extent. With remittance income a continuously declining phenomenon, this deficit can only be reduced through more short-term borrowing at high interest rates in order to pay back low interest debt incurred in the past. If this was a one-off move, it would be understandable, but to pursue this as a routine prescription amounts to behaving as an arsonist rather than a fire fighter. It is no longer unrealistic to expect the government to be in such a tight spot vis-a-vis its external debt as to devalue the currency by a large amount to curtail imports. Not only will this bring the much touted supply side policy of the government to a grinding halt, but will also ensue inflationary pressures in the economy as never experienced by this hapless country before.

The first response by the Nawaz Sharif government to this lingering problem was the National Debt Retirement Programme (NDRP). The Finance Minister can call it a 'spectacular success', but in fact with only $250 million in government coffers as yet, it is a resounding failure. Now hopes are pinned on a new ESAF agreement with the IMF and proceeds from privatisation. Rather than the $15 billion expected form privatisation receipts, as stated by the Prime Minister recently, some analysts point out that government will be lucky to raise even $ 1billion. The ESAF also amounts only $3.1 billion over a period of three years. A significant shortfall still remains to be met for the burgeoning debt servicing cost for the next fiscal year.

In any case, both the strategies demonstrate no new thinking by the government and more importantly are symptomatic of the government's warped priorities. If privatisation is to yield desired revenues, then these public sector entities have to be first turned into lean, mean corporate outfits. But if these entities are transformed accordingly, then is there any good reason to privatise these national assets? Apart from an ideological aversion to the public sector, there appears to be no other good reason. The ESAF agreement, on the other hand, is not enough to get out of the mire of the debt overhang alone, as mentioned earlier. Moreover, if past dealings with the IMF are anything to go by, sooner or later they will ask for a pound of flesh whenever the going gets rough. This will essentially mean further indirect taxation, further reduction in tariffs and further reductions in development expenditure. The sense of deja vu is palpable.

With such limited options, why is the issue of a negotiated debt reschedule such a taboo in government circles? For a country with a 100% track record in meeting its debt obligations for the last 50 years, heavens will not fall if a debt reschedule is sought from the country's large creditors. In the words of one economic analyst, this is 'normal business practice'. Moreover Pakistan will not be the first to ask for such a reschedule, many Latin American countries have gone in for a variety of such rescheduling arrangements, as enunciated recently in the press

But it seems the government is not interested in lending its ear to any independent advice, steeped as it is in neo-liberal ideology - which in turn is assuming theological proportions. Meanwhile poverty and inequality continues to increase, real incomes erode and growth plummets. As argued earlier, since much of the sorry sate of economic affairs is largely self inflicted and there is no willingness to take hard decisions, the role of civil society ought to focus on outcomes only, rather than providing alternative solutions which land on deaf ears.

We therefore do not ask how the government goes about achieving the following ends, only that it should do so;

- Create employment opportunities in the economy

- reduce inflation so that the erosion in real wages witnessed in the recent past is reversed,

- Increase development expenditure, so that the physical and social infrastructure of the economy is improved

- Impose the agriculture income tax; not only for purposes of revenue generation but also as a matter of economic justice.

If the government shows a discernible trend of moving in this direction, then it does not matter as to what the size of the fiscal deficit is and how is it being financed; what resources are being gobbled up by the political-bureaucratic-military nexus and whether the Prime Minister and his cronies travel in a Mercedes or a Margalla. But if they don't then it will become increasingly difficult for the state to solicit the cooperation of the populace. For too long the people of this country have given their pound of flesh to the state. It is now time to turn the famous dictum by John F. Kennedy on its head and ask: 'what can the country do for us?'

Implications of New Revenue Sharing Arrangements National Finance Commission Awards 1996

by

Abdul Rauf Khan
Rafia Ghaus[*]

Introduction

Inter-governmental transfers mandated by the National Finance commission Award are of great importance to provincial governments in Pakistan. The fiscal status in the medium run of provincial governments hinges crucially on the nature of NFC awards. The tenure of the last National Finance Commission (NFC) award ends in June 1996. However, transfers continued to take place according to the provision of the 1990 NFC award till the 1997-98 Budget due to the lack of consensus on new revenue sharing arrangements. The President has constituted the new NFC award and now it will be implemented from 1st July 1997. The main objective of this article is to examine the new arrangements with respect to previous awards and its implication on both the federal and provincial finances.

Before we proceed to comment on the new NFC award, it is obligatory to trace the changes through the evolution of revenue sharing arrangements in the country. Table 1 gives the composition of the divisible pool taxes which were shared between the two levels of government

TABLE 1
EVOLUTION OF DIVISIBLE POOL* IN VARIOUS AWARDS

Divisible Pool Taxes	Raisman 1951	NFC 1961-62	NFC 1964	NFC 1970	NFC 1974	NFC 1990	NFC 1996
Taxes on Income**	50%	50%	65%	80%	80%	80%	37.5%
Other Direct Taxes	--	--	--	--	--	--	37.5%
Taxes On Sales	50%	60%	65%	80%	80%	80%	37.5%
Federal Excise (Excl 7% of Gas)	--	--	--	--	--	--	37.5%
Excise on Sugar	--	--	--	--	--	80%	--
Excise on Tobacco	100%	60%	65%	80%	--	80%	--
Excise on Tea	100%	60%	65%	80%	--	--	--
Excise on Betalnut	100%	60%	65%	80%	--	--	--
Taxes on International Trade	--	--	--	--	--	--	37.5%
Export Duty on Cotton	--	100%	65%	80%	80%	80%	--
Export Duty on Jute	100%	100%	65%	80%	--	--	--
Estate & Succession Duties	--	100%	--	100%	--	--	--
CVT on Immovable Properties	--	100%	--	100%	--	--	--

** Excluding collection charges*

*** Excluding taxes on income consisting of remuneration paid out of federal consolidated fund.*

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and the proportion by which these were shared among the provinces. It emerges that, except for the 1974 award, all subsequent aeards increased the provincial share in revenues up until the new NFC award. In the 1990 NFC award, revenue transfers were increased through inclusion of new taxes, specifically excise duty on sugar and tobacco in the pool and inclusion of surcharge on natural gas and royalty on crude oil under the head of straight transferes, with limited provision for non-obligatory grants. New NFC award has adopted a completely different criterion of revenue sharing by expanding the base from 58 percent to 100 percent of federal taxes and reducing the provincial share from 80 percent to 37.5 percent. The distribution of straight transferes are kept the same as that under the NFC 1990.

Aims and Objectives of 1996 National Finance Commission Award

The purpose of formulation of new revenue sharing formula is based on three major factors, firstly, to minimize the overall budget deficit which is growing with an alarming pace. Secondly, to protect the priority expenditures of federal and provincial governments. The term priority expenditure depicts allocations made to social sectors especially the Social Action Programme, debt servicing, defence and development expenditure of both the federal and provincial governments. Lastly, emphasis on greater resource mobilisation at all level of governments.

The latest revenue-sharing formula is designed as such which gives particular consideration to prevailing economic conditions. For this purpose a concept of National Resource Picture is introduced. With the help of national resource picture a careful analysis for revenue, borrowings and expenditure pattern by different level of governments is undertaken, thereby determining the level of fiscal transfers on the bases of provincial governments expenditure needs which cannot be financed through their own revenues. Such a methodology will also give a handle in determining and controlling the targeted national fiscal budget deficit. Unlike previously, the newly designed revenue sharing formula will also finances 50 percent of the development expenditure of the provinces, thereby eliminating the need for access to high cost domestic borrowings. Consequently, any adjustment or reduction in current expenditure will now result in curtailing the non-priority expenditures only.

As far as, the sharing among provinces is concern the methodology is the same as 1990 NFC i.e. on the basis of population. Unfortunately, as the population census has not been undertaken, therefore, 1981 population shares are used in allocating the transfers to the provinces. Straight transfers are shared on the basis of collection.

Futhermore, within the new NFC the province of NWFP and Balochistan will also get special grants, which will be adjusted in line with actual the rate of inflation. Another important segment of the 1996 NFC is that they have given due attention to incentive criteria by allowing provision for matching grant for fiscal effort equal to the magnitude of resource mobilisation of the provinces upto a maximum of Rs. 500 million each for Punjab and Sindh and maximum of Rs. 100 million each in the case of NWFP and Balochistan.

Implications of National Finance Commission

As already mentioned the overall size of pool has increased from 58 percent to 100 percent of the federal taxes. Nevertheless, the fact remains that the federal government is reluctant to share tax revenues according to the 1990 NFC criteria with the provinces because of the prevailing state of federal finances and the high and rising budget deficit. Under the 1990 NFC the share of divisible pool transfer as percentage to total federal tax revenues increased at a rate of almost 3 percent per annum (see Table 2). The share in the initial year was 38 percent which increased to 44 percent in the terminal year i.e. 1996-97. This growing trend is attributable to the two most buoyant and fast growing taxes in the divisible pool. Given the revenue sharing arrangements 80 percent of the benefit of federal fiscal effort were transferred to the provinces. Implying that any reforms brought within income and sales tax to reduce the budgetary deficit would not respond the way it would have otherwise.

The decline in share to 37.5 in the 1996 NFC is a consequence of the prevailing disparity the previous NFC for the federal government. This lead to the overall decrease in size of the divisible pool from Rs. 12 billion in 1996-97 to about Rs. 11billion in 1997-98. However, the size of the pool would be Rs. 14 billion if the old approach i.e. the 1990 NFC would had been continued. The economic package announced by government has made reduction in rates of import duty, income tax and sales tax which may further result in the contraction in magnitude of the divisible pool.

TABLE 2
COMPARATIVE TREND OF DIVISIBLE POOL TAXES

[Rs. in Million]

Heads	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97 [R]	1997-98 [B]
Gross Tax Revenue*	**125305**	**144295**	**163827**	**202073**	**235254**	**272967**	**296298**
Divisible Pool Transfers as % of Federal Tax Revenues	***38.0***	***37.7***	***42.3***	***41.9***	***45.0***	***43.7***	***37.5***
Divisible Pool Transfers to Provinces	**47593**	**54402**	**69366**	**84605**	**105946**	**119162**	**111256**
Taxes on Income**	19417	25462	33714	40682	54623	62857	33681
Other Direct Taxes	--	--	--	--	--	--	1463
Taxes On Sales	16340	18224	24396	32680	38023	42560	23263
Federal Excise (Excl. 7% of Gas)	--	--	--	--	--	--	21854
Excise on Sugar	3450	3874	4161	4356	4180	3800	--
Excise on Tobacco	6840	6462	6764	6887	9120	9945	--
Taxes on International Trade	--	--	--	--	--	--	30994
Export Duty on Cotton	1546	380	331	0	0	0	--

* Exclusing collection charges, share of gas in excise duty and taxes on income consisting of remuneration paid out of federal consolidated fund.
** Taxes on income consisting of remuneration paid out of federal consolidated fund.

Impact of 1996 NFC On The Provinces

On the whole, the provinces have lost Rs. 18 billion due to the introduction of the new NFC (see Table 3). This would substantially effect the fiscal position of the provinces. Consequently, provinces will either have to enhance their own revenues substantially or depend on federal grants from the federation or both. According to the 1996 NFC only the province of NWFP and Balochistan receives a grant of Rs. 3 and 4 billion respectively. An other common practise of controling the fiscal gap is the reduction in expenditure, which in-turn adversely effects the performance of provincial governments in provision of social and economic services which are their prime responsibility.

Table 3 indicates a shortfall of Rs. 14 and Rs. 6 billion in the case of Punjab and Sindh respectively, which is a large magnitude, provinces are expected to put in a very high level of resource mobilisation effort which is not realistic as some of the most buoyant and broad base taxes have been pre-empted by the federal government. The federal government has a tendency of encroaching on tax bases which fall under the domain of the provincial government, e.g. sales taxation of services, etc.

TABLE 3

FEDERAL TRANSFERS TO THE PROVINCES

1997-98 BUDGET ESTIMATES

[Rs in million]

	Punjab	Sindh	NWFP	Balochistan	Total
UNDER 1996 NFC AWARD	**66012**	**32315**	**18374**	**14869**	**131570**
Divisible Pool Transfers	64395	25900	15064	5897	111256
Straight Transfers	1617	6415		4893	12925
Grants			3310	4080	7390
UNDER 1990 NFC AWARD	**80527**	**38153**	**18460**	**12119**	**149259**
Divisible Pool Transfers	78910	31738	18460	7226	136334
Straight Transfers	1617	6415		4893	12925
Grants	0	0	0	0	0
TOTAL DECREASE IN TRANSFERS	**-14515**	**-5838**	**-86**	**2750**	**-17689**
Decrease in Divisible Pool Transfers	-14515	-5838	-3396	-1329	-25078
Decrease in Straight Transfers	0	-0	0	-0	-0
Grants	0	0	3310	4080	7390

Source: *Explanatory Memorandum of the Budget, 1997-98.*

The only areas left for the provincial governments is agriculture sector, which is a progressive base. On the other hand much room exist for development of property tax in the case of Punjab and Sindh, while, NWFP and Balochistan can sustain their position through special grants.

Conclusion

From the foregoing analysis, it is clear that provincial governments stand to lose as a result of the 1996 NFC award. The presumption on the part of the federal government is that if a resource crunch is created for the provincial governments, it will push them towards a more aggressive effort towards resource mobilisation. The danger, however, is that if the provincial governments are either unwilling or unable to generate resource, then the ultimate casualty will be the social sectors, which are exclusively provincial subject.

PERFORMANCE AND PROPOSALS

The Budgetary Outcome : 1996-97
by
Zafar H. Ismail, Ajaz Rasheed and Mohammad Asif Usman[*]

The budget 1996-97 had planned that the budget deficit would be 4% of the GDP. To achieve this fiscal measures proposed additional taxation worth Rs. 39.9 billion. This was met with resistance from all segments of civil society, thus forcing the government to withdraw the bulk of these taxes. However, to avail loans to meet balance of payments shortfalls, a mini-budget was introduced during the year. The total additional taxes proposed were Rs. 13 billion. Thus the total new imposts during the year were of the order of Rs. 40.8 billion. This does not end the story of a mismanaged economy. The Government fell in October, 1997 and the caretaker government imposed cuts in expenditure and downsized government. This was followed by elections which brought Nawaz Sharif to the helm of affairs. There followed a spate of reliefs and adjustments to help revive a very sick economy. This flux resulted in revenue shortfalls of Rs. 51.6 billion in taxes and Rs. 13.8 billion in non-tax receipts. Thus the year is expected to end with a budget deficit increasing to 6.2% of the GDP.

TABLE 1
FEDERAL TAX RECEIPTS

(Rs.Billion)

	1996-97 Budget	1996-97 Revised	Shortfall	
			Amount	Percent
Total Revenues	454.1	388.7	65.4	14.4
Tax	362.6	311.0	51.6	14.2
Non-Tax	91.5	77.7	13.8	15.1
Major Shortfalls in				
Import duties	105.8	83.0	22.8	21.6
Sales Tax	82.5	56	26.5	32.1
Interest	51.2	45.4	5.8	11.3
Profits of SBP	17.0	10.2	6.8	40.0

During 1996-97 tax revenues were budgeted at Rs. 336.3 billion. Expected revenues by the year-end are estimated to be about Rs. 51.6 billion or 14.23 percent lesser (see Table 1). This is due to a shortfall of Rs. 26.5 billion in sales tax (32.12%) and of Rs. 22.8 billion in import duties (21.5%). Imports grew by 18 percent in value terms and industrial output grew by 1.8 percent in real terms. This should have been accompanied by a consequential increase in the taxes on import and on domestic production. This did not happen. The decline can be attributed only to a failure of tax administration. Import clearances were diverted from Karachi to the dry ports where the skills of appraisal and valuation are weaker. But the decline of over 21 percent cannot be attributed to this alone. The question that needs to answered is : *Are the dry port borders porous or are there other, more obvious (sic!!) reasons*? Coupled to this decline is the large slippage of 31 percent in revenues from sales tax. The Finance minister implicitly attributes this to the apathy displayed by the tax administrator. Input tax credit

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amounting to 75 percent (only 35% traditionally) speak eloquently of improper audit, absence of cross-verification, lax procedures and other related factors.

Non-tax revenue declined by Rs 13.8 billion (15.1%). The bulk of the shortfall is due to a decline of Rs. 6.8 billion in the profits from State bank and of Rs. 5.8 billion in the income from interest. The shortfall in SBP profits may be due to a narrowing of the lending-borrowing margin and the costs of intervention in foreign currency dealings to mitigate the impact of speculation by private sector investors.

In June 1996, the government projected that its current expenditure would be 12.74 percent higher than the revised estimates for the preceding fiscal year at Rs. 395.4 billion. During the year it planned to decrease current expenditures by Rs. 7 billion. However, the revised estimates indicate that the year will end with current expenditure outstripping the budgeted amount by about Rs. 2.8 billion. An analyis of the expenditure profile shows that most expenditures were below target levels. Commendably the defence services were able to restrain their expenses to within 3 percent of their budgetary allocations. However, as may be seen from Table 2, this is due to an increase in the costs of debt servicing. The slippage of over 6.6 percent may be due to an inordinate increase in short-term borrowing to overcome the balance of payments difficulties faced.

TABLE 2
FEDERAL CURRENT EXPENDITURE

(Rs. Billion)

	1995-96 Revised	1996-97 Budget	1996-97 Revised	Growth	Slippage
FEDERAL CURRENT EXPENDITURE	353.2	395.4	398.2	1.74%	0.71%
General Administration	19.4	22.3	21.1	8.76%	-5.4%
Defence	115.3	131.4	127.4	10.49%	-3.0%
Law and Order	7.4	7.6	7.6	2.70%	0%
Community Services	5.1	5.4	5.1	0%	-5.5%
Social Services	8.7	8.9	8.9	2.3%	0%
Economic Services	3.4	3.1	2.6	-23.5%	-16.13%
Subsidies	10.5	8.3	7.6	-27.6%	-8.4%
Debt Servicing Of Which:	164.6	186.1	198.5	20.6%	6.6%
Interest on Domestic Debt	97.8	113.1	115.8	18.40%	2.38%
Interest on Foreign Debt	26.8	28.1	29.8	11.2%	6.05%
Repayment of Foreign Debt	40	44.8	53.0	32.5%	18.3%
Grants and Unallocable	19.1	22.3	19.3	1.05%	-13.45%

As a result of the resource crunch, caretaker government imposed a massive cut of Rs. 20 billion (about 19%) in the development outlays planned by Ms. Bhutto's government. The sectors which faced the brunt of this were those related to the building of economic infrastructure. SAP and other donor funded projects were, however, protected.

Presently, the single most important factor distorting the fiscal system in Pakistan is the huge amount of borrowing that is being incurred to finance the budgetary gap. In the beginning of the year it was expected that the overall fiscal deficit would be Rs. 100.9 billion (4% of GDP). However, due to a massive shortfall in revenue receipts the year is expected to end with a budget deficit of about Rs. 155 billion or 6.2 % of GDP. In historical terms this is not the worst performance.

Implications of The Budget 1997-98
by
Zafar H. Ismail, Nazia Bano and Naveed Hanif[*]

The Federal Budget 1997-98 has been designed ostensibly to overcome the economic crisis faced by the country. Successive budgets in the last several years have increased the tax burden substantially. Relying on the principles of supply side economics, the Nawaz government has proposed a budget which does not rely on the traditional instrument for overcoming large budget deficits, namely, additional taxation. It has in fact laid stress on improving the administration of taxes, particularly in the direct tax arena and a widening of the tax base of indirect taxes through removal of anomalies and exemptions. Moreover, by reducing the interaction between the tax collector and the tax payer through self-assessment procedures and voluntary compliance, the budget makers have taken a risk. Will this result in an increase in revenues as expected (see Table 1 for details)?.

TABLE 1

	1995-96	1996-97	1997-98 Without measures	1997-98 With measures	1995-96 to 1996-97	1996-97 to 1997-98
	Rupees in Billion				Growth Rates (%)	
Gross Revenue	381.9	388.7	450.2	460.0	1.8	15.8
Tax Revenue	*287.6*	*311.0*	*348.0*	*354.2*	*8.1*	*11.9*
Direct Taxes	75.2	88.0	100.5	104.3	17.0	14.2
Indirect Taxes	212.4	223.0	247.5	249.9	5.0	11.0
Non Tax Revenue	*94.3*	*77.7*	*102.3*	*105.9*	*-17.6*	*31.7*
Net Revenues*	260.6	257.1	326.1	335.9	-1.3	26.8
			As % of GDP			
Gross Revenue	17.6	15.5	15.6	16.0		
Tax Revenue	*13.2*	*12.4*	*12.1*	*12.3*		
Direct Taxes	3.5	3.5	3.5	3.6		
Indirect Taxes	9.8	8.9	8.6	8.7		
Non Tax Revenue	*4.3*	*3.1*	*3.6*	*3.7*		
Net Revenues*	12.0	10.3	11.3	11.7		

During 1996-97 the yield from taxes is expected to be 8.1 percent higher than in 1995-96. Sans measures for 1997-98 this is expected to be 11.9 percent higher next year. This is substantially lower than the combined impact of an expected real growth of 6 percent in the economy and 8.5 percent increase in prices. Thus the expected increase of Rs. 35 billion is not unachievable. Non-Tax revenues are expected to be 31.7 percent higher next year, largely as a result of an expected increase in State Bank Profits and Interest Income aggregating to over Rs. 20 billion. The overall revenue targets, therefore, appear to be realistic.

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Tax and non-tax measures announced by the FM for 1997-98 are largely the result of changes in administration and widening of bases. The administrative measures announced in the speech will increase the yield from Direct taxes by Rs. 3.8 billion, the bulk as a result of a tighter audit system of the returns filed with the help of private sector audit firms. As a result of exemptions granted, the total revenues from Sales Tax and Central Excise are expected to result in a relief to consumers in the order of Rs. 1.1 billion and Rs. 0.5 billion respectively. The anti-smuggling measures proposed will bring into the customs duty net a large part of the untaxed imports. This is expected to yield Rs. 3 billion. Another Rs. 1 billion is expected from the removal of some exemptions and anomalies. The net impact of measures announced by the FM is expected to be only Rs. 6.2 billion, less than one-sixth that of Benazir's impositions worth Rs. 41 billion last year.

Non-tax revenues measures are expected to be an increase of Rs. 3.6 billion in the profits from Pak Telecom. This is expected to be result of a 20 percent reduction in inter-city call charge rates combined to a 15 percent reduction in Excise Duty. Is this realistic? One feels that this alone will not yield the expected profits. However, if one recalls the FM's own words (see Box1) then the target appears to be manageable.

It is proposed to reduce the rate of excise duty from 40 to 25 percent of charges on all types of telephone services. This will also allow PTCL to adjust charges per call so that the present rates will remain unchanged.

As a result of a tightening of controls, current expenditures (see Table 2) increased by only 10 percent this year. In real terms, this suggests a shrinkage of about 1.4 percent. Next year, the Federal Government expenditures are expected to increase by 15.7 percent. This is largely due to an increase in debt servicing by nearly 25 percent and a nominal increase of 5.2 percent in expenditure on defence. In real terms this means a decline of nearly 3.3 percent in the expenditure on defence.

TABLE 2

	1995-96	1996-97	1997-98 Without measures	1997-98 With measures	1995-96 to 1996-97	1996-97 to 1997-98
	Rupees in Billion				Growth Rates (%)	
Total Expenditure	**400.4**	**430.4**	**489.5**	**489.5**	**7.5**	**13.7**
Current*	***313.2***	***345.2***	***399.4***	***399.4***	***10.2***	***15.7***
Debt Servicing	164.6	198.5	247.9	247.9	20.6	24.9
Defence	115.3	127.4	134	134	10.5	5.2
General Administration	19.4	21.1	20.5	20.5	8.8	-2.8
Development	***87.2***	***85.2***	***90.1***	***90.1***	***-2.3***	***5.8***

In keeping with its philosophy of downsizing the government, expenditure on General Administration is to be reduced by 2.8 percent in nominal terms (11.3 percent in real terms). To spur economic activity somewhat the expenditure on development is expected to increase nominally by about 6 percent (to Rs. 90 billion) next year.

The net impact of the budget is expected to result in a deficit of Rs. 144.8 billion (5 percent of the GDP - in 1996-97 this is expected to be 5.5 percent). How will this deficit be financed. The Government proposes to meet this by borrowing about 21 percent from donors and foreign banks, 38 percent from the domestic banking sector and 41 percent through sale of savings and other non-bank instruments. The traditional pattern of borrowings has been about 45 percent from abroad, and the reaminder equally from bank and non-bank sectors locally.

In conclusion one can only join the Nawaz government in praying for compliance by our traders and industrialists and with the people to hope that vested interests do not force the government to overshoopt their projected expenditure levels.

IMPACT ANALYSIS

Impact of 1997-98 Budget on Poverty
by
Muhammad Rashid Ahmed and Ajaz Rasheed[*]

South Asia is fast emerging as the poorest, most illiterate, most malnourished, least gender-sensitive, indeed the most deprived region in the world. According to a recent World Bank Report on Poverty Reduction *more than 1.3 billion people in the developing world still struggle to survive on less than a dollar a day, and this number is on the rise*. Poverty is also the concern of the present government. In his budget speech the finance minister Sartaj Aziz announced that *"Pakistan had successfully reduced its poverty level from 40% in 1970 to 17% in 1988, due to increased remittances and high growth in the agricultural sector. Unfortunately, however, we did not maintain the trend, and poverty is again increasing to 22%."* Moreover, according to the Human Development Report 1997 Pakistan ranks 64th of 78 Developing Countries, with 46.5% of its people living below the poverty line. Table 1 compares Pakistan's poverty profile with other countries/regions.

Increases or decreases in poverty are directly affected by the government's fiscal policy. As seen in Table 1, both Bangladesh and China have successfully reduced their poverty line by implementing effective fiscal policies. In Pakistan however, after 1990 the policies adopted have not been successful in reducing poverty. The number of people living below the poverty line in Pakistan has risen from 25.5% in 1990 to 34% in 1994. As a result, the poor are now looking to the new government, which has been given a historical mandate, to provide relief and improve provisions of basic amenities. Realizing this fact, the present government has announced several relief packages since taking oath. It has introduced food stamps, community participation, district support organizations, village support organizations and poverty alleviation funds. To appraise the impact of these policies on poverty and inequality, one has to see how some of the important determinants of poverty and inequality will be affected by these budgetary proposals.

TABLE 1
HUMAN POVERTY PROFILE

Country Group	People below the poverty line	
	% 1990	% 1994
East and South Asia and Pacific	-	26
South Asia	45	43
Pakistan	25.5	34
India	43.5	53
Bangladesh	53.5	48
China	12	11
Sub-Saharan Africa	38	39

Source: Human Development Report 1997 and 1995

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Food Stamps and Poverty

The poor spend a large part of their income on food and can be highly vulnerable to any setbacks in their ability to obtain it. Prevailing economic conditions have had a negative impact on their ability to obtain food items. Recognizing this, the government announced its food stamps program in the 1997-98 budget. This is aimed at redistributing income from higher income groups to lower income groups (the poor). Although the food stamp program can greatly benefit the poor, the level of leakage to the non-poor may far exceed actual benefits to the poor. The food stamp program implemented through utility stores is likely to facilitate the poor only in terms of consumption. It will not directly affect their overall social status. Studies show that the success of the food stamp program is strongly linked to self-targeting, by distributing stamps through, for example, an education program (i.e. if a household has one primary school-age child in school then that household is entitled to 15 kg of wheat per month, and so on). In 1993, Bangladesh adopted this strategy to distribute food stamps through schools and health centres. Not only has the number of people living below the poverty line reduced as a result of this program (see Table 1), preliminary results indicate that there has been a significant increase in attendance (from 63% to 77.6%). Yearly dropout rates declined from 18.5% to 10.9% in 1994. All beneficiaries of the program were among the poor. For the success of the food stamp policy, the government should consider wether it would be more beneficial to implement it through utility stores or through similar education programs.

Agriculture Package and Poverty

Poverty is largely a rural phenomenon and many of the poor depend, directly or indirectly, on the farm sector for their incomes. Policies that raise agricultural productivity and the return to farm labor ought to be particularly effective in reducing poverty. In this respect the present government has adopted a very optimistic package for agriculture. In its agricultural package the government aims at attaining self-sufficiency in food production primarily by improving the prices paid to farmers for their crops. The assumption is that giving the right prices will motivate farmers significantly enough to increase productivity and attain self sufficiency. The positive aspect of this policy is that it will increase the efficiency and productivity of farmers and reduce poverty in this sector. Paradoxically, however, this policy may actually increase poverty and inequality. Increasing output prices and lowering the cost of inputs may serve to redistribute output in favor of the wealthy farmers with large land holdings. The wealthy farmer is thus likely to become even more powerful and continue to create formidable barriers in the way of meaningful land reforms and agricultural income tax, which may be vital for agricultural and economic development.

The agricultural package also encompasses the distribution of land to poor farmers. Providing land to the farmer can also increase productivity. Studies have shown, as in the case of Malaysia, that distribution of land to poor farmers has contributed to rapid growth with some improvements in a fairly unequal distribution of income and a decrease in poverty of 23 percentage points between 1973 and 1987. During this period the income of the farmer also increased almost 75%.

The present government's agriculture policy, which includes mechanization, writing off loans and increased credit, has been opted for to increase the productivity of farmers, and to curb poverty in the sector. Credit can help the poor to accumulate assets and to cushion their consumption in hard times. Extending credit to the poor is however, costly to the lender.

Transaction costs are high, and the risk may be great owing to lack of collateral. Moreover, other borrowers, such as large-scale farmers, may have preferential access, because of their political clouts.

Social Services and Poverty

TABLE 2 REGIONAL COMPARISON OF THE SOCIAL INDICATORS						
Country	*Life Expectancy at Birth(Years)*		*Adult Literacy Rate (%)*		*Population Access to Safe water (%)*	
	1992	*1994*	*1992*	*1994*	*1988-93*	*1990-96*
Pakistan	*61.5*	*62.3*	*36*	*37.1*	*68*	*74*
India	*44*	*61.3*	*50*	*51.2*	*-*	*81*
Bangladesh	*39.6*	*56.4*	*36*	*37.3*	*-*	*97*
Source: Human Development Report 1997 and 1995.						

Table 2 compares Pakistan's social indicators with other countries in the region. Pakistan's performance in social services does not compare overall with India and Bangladesh. Pakistan's adult literacy rate is lower than both countries. Also, a smaller percentage of people in Pakistan have access to safe water (as shown in Table 2). Efforts to reduce poverty are unlikely to succeed in the long run unless these indicators improve. Improvements in education, health and nutrition directly address the worst consequences of being poor. There is ample evidence that investing in human capital, especially in education, also attacks some of the most important causes of poverty, and plays a vital role in its long term reduction. Unfortunately, in this budget the government has reduced total expenditure on education. The government is providing funds for basic education, health and other social services through SAP II. However, simply expanding the education system is not enough. The curriculum needs to be improved, the schools need modern text books, and the teachers need better training.

Community Participation and Poverty

Community participation and strengthening of district support organizations are the main components of the poverty reduction program in the recent budget. Evidence supports the view that involving the poor in the design, implementation, and evaluation of projects in the social sectors is likely to ensure efficient usage of government resources. However, the district support organization program may negatively affect the poor if any particular dominant group is able to misuse it for self serving purposes. The introduction of the poverty fund is a good step to combat poverty. If, however, this fund is financed by cutting spending on other social programs, the net effect on the poor will then depend on the balance between the benefits lost and gained.

Growth and Poverty

TABLE-3 EXPENDITURE AND GROWTH PROFILE IN SOCIAL SECTOR				
Year	1994-95	1995-96	1996-97	1996-97
Expenditure on Education (% of GNP)	2.36	2.44	2.59	2.59
Expenditure on Health (% of GNP)	0.64	0.76	0.74	0.74
Growth in Expenditure on Social Services (%)	5.75	3.47 R	3.07 P	3.07 P
Per Capita Income Growth(%)	2.8	0.6	-0.4	-0.4
Per Capita Consumption Growth (%)	3.23	3.28	6.06	

Source: Economic Survey 1996-97.
R = Revised, P = Provincial

Economic growth plays a vital role in eradicating poverty. Current studies on the impact of growth on poverty and inequality show that economic growth reduces poverty. Positive growth is associated with a falling incidence of poverty, while economic contraction is associated with a rising incidence of it. Economic growth can raise employment, productivity and incomes, expanding opportunities and choices in a variety of ways. Expenditure on the social sectors and per capita income is directly related to economic growth as shown in Table 3. High growth during the eighties caused a rise in real wages and productivity, which in turn caused a reduction in poverty. Poverty and population growth reinforce each other in a number of ways. Low and inadequate education, and high infant mortality - all linked to poverty - contribute to high fertility rates and thus rapid population growth. The most striking features of this budget are the incentives provided to the manufacturing and agricultural sector. This will make for greater investment in these sectors, which will increase employment and real wages. As a result, the income of the society will increase due to increases in productivity, and poverty will be eradicated.

Debt and Poverty

Debt servicing eats up the largest portion of public resources. Its share in expenditure has increased rapidly, from 37% in 1994-95 to over 45% in 1996-97. If present trends continue, its share may exceed 50% by the end of this century. During the eighties a major portion of the budget was spent on the Annual Development Plan (ADP). Now almost 70% of our budget is spent on debt servicing and defense. This excessive debt servicing eventually cuts public spending in economic and social services, which hurts the poor directly. Debt servicing is financed by cutting down on development expenditure, which plunges the country into further poverty. The National Debt Retirement program, although welcomed by ordinary citizens of the country, has not contributed significantly enough to allow the country to resolve its debt problem. The government is still seeking financial help from multilateral agencies and foreign governments. It is imperative that new borrowing be made at the minimum possible interest rates and that these funds be used for development purposes.

Inflation and Poverty

This year inflation is again in two digits. The CPI (Consumer Price Index), WPI (Wholesale Price Index), and SPI (Sensitive Price Index) rose by 11.62%, 13.03% and 12.09% respectively between 1995-96 and 1996-97. The increase in food prices has been the most significant contributor to the increase in the CPI. The highest percentage change within the WPI has been in the Fuel, Lighting & Lubricant sub group. The poor spend a large part of their income on food items. The government has been unsuccessful in its endeavour to control prices of major food items.

The government has taken several measures to curb inflation and the target for this year has been set at 8.5%. One of the decisions is to exempt essential items like wheat, fertilizer and life saving drugs from the minimum tariff rate of 10%. The government has also ensured that prices of fuel and energy will not increase further. These measures notwithstanding, no incentive has been given through salary indexation. Therefore, high inflation will decrease the real wage rate substantially, thus reducing purchasing power. As a result, people will have less income left over as savings.

The impact of inflation is asymmetrical. Some people benefit from inflation, while some are made worse off. Because inflation alters the distribution of income, a major concern is the degree of equity or fairness in the distribution of income. Under fixed nominal interest rates, fixed income earners and persons holding assets in the form of money are badly affected by inflation, as it reduces real income. Inflation not only redistributes incomes from the poor to the rich, it also reduces the national savings rate, which, at 14% of GDP, is already low.

Safety Nets

The provision of safety nets for vulnerable groups is an important element in the strategy to reduce poverty. The major scheme with transfer or "safety net" features in Pakistan is the *Bait-ul-mal* system which is financed through *Zakat and Ushr* and various rural employment schemes. In its 1997-98 budget, the government has decided to target the poor directly by transferring the responsibility of the *Zakat and Usher* fund to the provincial governments. The government will provide Rs. 300 per month for food security to about 258,000 families. For a given budgetary outlay, schemes that target benefits to the poor are likely to have a greater impact on poverty than universal ones. With its rural employment program the government aims to improve credit access and the quality of lending for those among the poor with the motivation, skills and experience to become self-employed.

NFC Award and Poverty

Social sector development is the priority of the provincial governments. The major portion of financing in this sector comes through the National Finance Commission Award. In the 1996 NFC Award the provincial governments lost an aggregate Rs. 18 billion. The reduction in this award may improve the provinces' ability to generate more revenue through their own resources. A failure to do this will directly impact expenditure on the social sectors (for example health, education and public health). The subsequent reduction in social sector investment will directly affect the lower income group.

Employment and Poverty

The basic problem of our economy is that it utilizes it resources inefficiently. Most public sector industries are facing huge losses due to bad management and problems related to over staffing. In this budget the government has decided to improve these sick industries by giving incentives and addressing the issue of over employment. Adoption of these policies will lead to increased efficiency at the displacement cost of employed labor.

In this budget the government is targeting a 7% growth of the industrial sector for 1997-98. Last year was a bad year for industry, when growth in large-scale manufacturing was negative (-1.4%). The government announced a grand package for the revival of this sector, and due to this pre-budget package, is expecting a growth of 6.24% in large-scale manufacturing. The growth of this sector will obviously increase employment and lead to a favorable impact on poverty reduction. If however, the country continues to remain in a recession, and industry does not respond, then lowering public sector spending will lead to a reduction in employment, which in turn will cause real wages to fall. In Pakistan 46.5% of the population is already living below the poverty line. Decreasing wages will cause further increases in poverty.

Fiscal Measure and Poverty

Previously, the government relied on indirect taxes for their resources. This is the first year in Pakistan's history that this reliance has shifted to direct taxes. It is well known that a good tax policy is one in which the incidence of tax is not shifted on to others. A tax shifted forward falls on the consumer in the form of higher prices. The government has decreased the income and corporate tax rate, and enhanced its tax base (increased the number of tax payers). However, agricultural income tax, which is heavily demanded by the industrialists, is still out of the tax net. The federal government has transferred the responsibility of levying this tax to the provincial governments. So far it seems that the fiscal policies implemented by the new government have had a positive impact on the eradication of poverty. Decreasing the sales tax rate from 18% and higher, to 12.5%, and reducing excise duty will surely decrease the prices of various items and help reduce poverty. The reduction of excise duty on Gas Consumption to 10%, and transfer of the General sales tax to the wholesale/retail level will also have a positive affect on poverty. However, reductions in the size of the government and cutting expenditure on development, specially on social services, will lead to increased poverty.

The overall impact of the budget 1996-97 on poverty alleviation seems to be positive as shown in Table 4. If the government is committed to implementing its policies efficiently, honestly and effectively, a reduction in poverty may be imminent.

Table-4 Incidence on Poverty due to some budgetary measures	
Policy	**Impact on Poverty**
Food Security Program	
Reliance on direct taxes instead of indirect taxes	
Privatization	
Reduction in Government Current Expenditure (Civil Administration) decreases employment in public sector	
Increased Debt and debt servicing burden	
High Inflation specially in food items	
Decrease in real development expenditure (deteriorate long-run prospects).	
Reduction of Divisible pool transfer to provinces, provinces are basically responsible for providing social sector services	
Increase support prices of wheat etc. increases the income of farmer	
Emphasis on community participation	
Small loans from Poverty Alleviation Fund to common man	
Imposing GST at Retail Stage	
Decreasing Excise Duty	
Transfer the responsibility of Distribution of Zakat/Ushr fund to provincial government	

Allocation of Budget to Priority Expenditures
by
Nazia Bano[*]

The Caretaker government, during its limited tenure, took some important and effective measures, including the formulation of the National Finance Commission (NFC) award. According to Article 160 of the 1973 Constitution, the President is expected to constitute the NFC every five years, making recommendations on the distribution of revenues between the federation and the provinces. The previous government had been unable to agree on the formation of a new revenue sharing arrangement and approval of the NFC had been pending since June 1996. NFC 1996, approved by the president under the Caretaker regime, was announced in the current budget.

Fiscal imbalances have been addressed by a downward adjustment of expenditures, particularly development expenditure, instead of resource mobilization through an improved taxation system. The share of development and current expenditures as a percentage of GDP have decreased from 5.2% and 15.9% in 1993 to 3.4% and 13.8% in 1997 respectively. The reduction in expenditures has taken place at the cost of some important areas like the social sectors. The importance of social sector expenditure for human capital development is obvious and needs no elaboration. The main objective of this article is to look into the budget 1997-98 through priority and non-priority expenditures. Previously, the concept of priority and non-priority expenditures was non-existent. It has been introduced by the newly formulated 1996 NFC. Under the new NFC award, the government has decided to reduce the budget deficit by improving the share of federal government in the divisible pool, and most importantly by reducing expenditures. Before deciding upon inter-governmental revenue sharing it has decided to distinguish between **priority and non priority expenditures.**

Total priority expenditures comprise total development expenditures and three major sectors of current expenditures. Expenditure on defence, domestic and external interest on the country's debt, social sector expenditures (including expenditure on SAP) are included in current priority expenditures. Other current expenditures, such as general administration, law and order, community services, economic services, subsidies and grants to local bodies, are included in non-priority expenditures.

Traditionally, the growth pattern of sectors which come under the priority head, has been slow as compared to those in the non-priority sector. The share of priority expenditure in total expenditure has been reduced by 4 percentage points between 1992-93 and 1996-97, while that of non-priority expenditure has grown at 5% per annum in the same period (see table 1). In the current budget the government has planned to curtail the growth of the share of both **priority and non-priority expenditures in total expenditures.**

If we look at past trends in these expenditures, it is interesting to note that the growth in non-priority expenditure was faster as compared to priority expenditure (see table 2). This budget has

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tried to balance this difference somewhat, particularly by reducing the growth of non-priority expenditure and accelerating the growth of priority expenditure.

TABLE 1
TREND IN PERCENTAGE SHARE OF PRIORITY AND NON-PRIORITY SECTORS

(in Percent)

	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
			Share in Total Expenditures			
Priority Expenditure	80.1	79.2	77.1	76.2	75.94	75.87
Non-Priority Expenditure	19.9	20.8	22.9	23.8	24.06	24.13
Total Expenditure	**100**	**100**	**100**	**100**	**100**	**100**
			Share in Priority Expenditures			
Current Expenditure	71.38	72.99	71.78	74.03	76.79	78.49
Development Expenditure	28.62	27.01	28.22	25.97	23.21	21.51
Total Priority Expenditure	**100**	**100**	**100**	**100**	**100**	**100**

Source: *Federal Budget in Brief, Finance Division GOP.*

TABLE 2
TREND IN SECTOR-WISE ALLOCATIONS OF PRIORITY EXPENDITURES

(Rs. In Million)

		1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98 [B]	ACGR % 1992-1997	ACGR % 1996-97 to 1997-98
A.	**Priority Expenditures**									
i)	Social Sector (including SAP)	5983	7358	7454	8889	8683	8913	9300	8.3	4.3
ii)	Defence	75769	87439	93781	100221	115254	127441	134020	11.0	5.2
iii)	Debt Servicing	61045	79557	98961	99195	124610	145559	185402	19.0	27.4
	Interest on Domestic Debt	*46902*	*63081*	*78416*	*76378*	*97814*	*115788*	*153898*	*19.8*	*32.9*
	Interest on Foreign Debt	*14143*	*16476*	*20546*	*22818*	*26796*	*29771*	*31504*	*16.1*	*5.8*
iv)	Development Expenditure	79100	69900	74100	81900	87200	85200	90100	1.5	5.8
	Total Priority Expenditure	**221898**	**244254**	**274296**	**290205**	**335747**	**367113**	**418822**	**10.6**	**14.1**
B.	**Non-Priority Expenditure**									
	Total Non-Priority Expenditure	**56094**	**60813**	**71961**	**86293**	**104682**	**116296**	**133185**	**15.7**	**14.5**
C.	**Total Expenditure**	**277992**	**305067**	**346257**	**376497**	**440429**	**483409**	**552006**	**11.7**	**14.2**

Note: *ACGR% = Annual Compound Growth Rate*
Source: *Federal Budget in Brief, Finance Division, GOP*

However, the increased growth in priority expenditure is because of increases in development expenditure and debt servicing on interest payment of domestic and foreign debt. Development expenditure is expected to grow at the rate of 5.8% over the revised estimate of 1996-97. This incremental increase in development expenditure is attributed in particular to general administration and some major sectors of economic services (rural development, fuel and power, transport and communication).

Debt servicing on interest payment for 1997-98 has been estimated at Rs. 185 billion, indicating a 27% increase over the revised estimate of Rs. 146 billion for 1996-97. Domestic debt servicing has increased by 32.9% and foreign debt servicing by 5.8%. Previously, growth in domestic and foreign debt was 19.8% and 16.1% respectively. Sectoral growth of social services and defence are noticeably declining at the rate of 4.3% and 5.2% respectively.

One of the reasons for reducing expenditure is to further narrow the deficit. The recent budget witnesses a clear-cut reduction in expenditure, particularly social sector on both the current and development side, on the presumption that the provision of social services is the prime responsibility of the provincial government. The reason behind the apex increase in expenditure on domestic debt is domestic bank borrowing from the State Bank of Pakistan. Bank borrowing for the year 1996-97 was budgeted at Rs. 20 billion, with revised estimates placing it at Rs. 88.6 billion. This massive increase is one of the basic reasons for reducing expenditures on other priority sectors. On the other hand, reduced allocation of expenditure can be attributed to the targets marked at the time of formulating the 1996 NFC award.

Conclusion

The above analysis clearly brings out the fact that increases in priority expenditures are due to increases in debt servicing, and not due to increases in social services. A better classification would have been discretionary and non-discretionary expenditure. Apparantly the government at this stage has little control over the automatic rise in debt servicing and is using her discretionary powers to axe the non-discretionary component of expenditures.

Federal PSDP Social Sector Allocations: What's New?
by
Nadeem Ahmed & Aisha Bano*

Given the existing economic crisis in the country, the 1997-98 budget arrived amidst much speculation. Although certain steps have been taken in this budget to improve the economy, some areas have received less priority. The PSDP ranks foremost among these. The overall budget allocation for PSDP in nominal terms for the year 1997-98 has declined by 14%, and now stands at 86% of the budget allocation of 1996-97. Looking back at trends over the recent past, we see that PSDP has never been in the high priority domain. Whenever a squeeze in financial resources is witnessed, PSDP is used as the scapegoat. Drastic cuts are made in it to cope with financial crunches. For instance, the original 1996-97 budget allocation for PSDP was Rs. 104 billion. This was revised to Rs. 85 billion just four months after the announcement of the budget. This translates into a major reduction of 18%.

No doubt, for several years now, our governments have been compelled to allocate a large quantum of resources to debt servicing and inevitable defense expenditure. However, this must not be at the expense of allocations to social sector development. The increasing cost of debt servicing has negatively permeated the entire budget making exercise and thus affected the PSDP. Since recurrent expenditures have always exceeded development expenditures, with many of these liabilities self-serving, there is a need for strict financial discipline both at the federal and provincial level. Gross financial mismanagement in recurring expenditures has always shrunk PSDP outlays and hence, progress in both the economic and social sectors has been retarded. The effects of these ill policies are already becoming evident: Pakistan's GDP growth has dropped from an average of 5.5% in the 1980s to an average of 2.99% in the last five years.

Whenever there is an overall decline in PSDP, the social sectors suffer more than the economic sectors. There is no arguing the critical role social sectors play in sustainable economic growth.

TABLE 1
PSDP BUDGET ALLOCATIONS AND PERCENTAGE CHANGE

	Budget Allocation 1997	% Change	Budget Allocation 1998	% Change
Education & Training	1625	0.68	914	-43.75
Health & Nutrition	3219	42.18	2779	-13.67
Population & Welfare	2000	39.57	2073	3.65
Culture, Sports & Tourism	93	-65.93	97	4.30
Manpower & Employment	456	-14.77	205	-55.04
Women Development	100	-20.00	50	-50.00
Social Welfare	131	-7.09	82	-37.40
Environment	523	44.88	261	-50.10
SAP	10500	0.00	4017	-61.74
PSDP	104751	8.55	90106	-13.98

Source: Federal Budget in Brief 1997-98

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Consequently, prudent government spending in this regard can have positive implications for the future growth of a country. In Pakistan, unfortunately, the social sectors have always been neglected and their share in public expenditure has always been negligible.

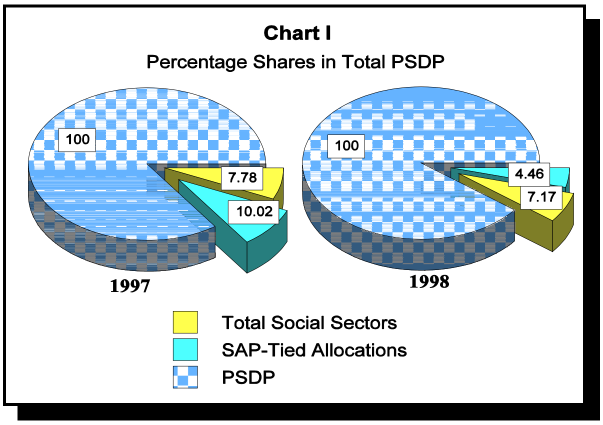
The federal budget for the current fiscal year (1997-98) does not indicate any notable change in the government's policy attitude towards social sector development. There is a significant decline in allocations to the social sectors, despite claims made by the government to remove social disparities by taking appropriate steps. It is quite obvious that Pakistan is lagging behind in the development of all social sectors. However, the two crucial areas of education and health present the most bleak scenario. The low literacy rates and pathetic health facilities rightly demand greater government spending. Yet, despite the alarming situation, PSDP allocations for 1997-98 show a drop in expenditures on these two sectors. Education shows a 44% plunge, whereas allocation to health has decreased by 14%. A glance at Table 1 shows the decline in allocations between 1996-97 and 1997-98.

TABLE 2		
Percentage Share of Social Sectors in PSDP Budget Allocations		
	1997	**1998**
Education & Training	1.55	1.01
Health & Nutrition	3.07	3.08
Population & Welfare	1.91	2.30
Culture, Sports & Tourism	0.09	0.11
Manpower & Employment	0.44	0.23
Women Development	0.10	0.06
Social Welfare	0.13	0.09
Environment	0.50	0.29
SAP	10.02	4.46
PSDP	100.00	100.00
Source: Federal Budget in Brief 1997-98		

The proportion of PSDP allocated to the social sectors is significantly small. A look at Table 2 reveals the percentage distribution of the social sectors in PSDP. It is seen that the share of each social sector is quite nominal, below 1% for many of the social sectors including women development, social welfare and environment. Education's share in PSDP has dropped from 1.55% in the 1996-97 budget to 1.01% in the 1997-98 budget. However, the share of population welfare in PSDP has increased from 1.91% in 1996-97 to 2.30% in 1997-98. The share of health has also increased, albeit marginally, from 3.07% in 1996-97 to 3.08% in 1997-98.

Social sector development has always been viewed as the primary responsibility of the provincial governments, with the role of the federal government fairly limited. Due to persistent resource constraints faced by the provincial governments, the provinces were unable to cater to the growing demands for improved social sectors, specially health and education. Recognizing this impediment, the government initiated the Social Action Program (SAP) in 1992-93, with a view to foster social sector development in the provinces. SAP is a part of PSDP which shows massive allocations in previous years for the social sector development of the provinces.

Sadly, this year's federal budget has shown a notable decline of 62% in SAP-Tied allocations compared to the previous year. This will eventually down size the pool of provincial governments' resources for social sector delivery. This budget shows a two-way cut in social sector development outlays. One directly, through a decline in PSDP allocations, and the other indirectly, through SAP-Tied allocations.



It can be seen from Chart 1 that the percentage share of SAP-Tied allocations in PSDP has declined from 10.02% in 1996-97 to 4.46% in 1997-98.

With provincial governments receiving lesser funds through the new NFC Award of 1996 because of the resource crunch at the federal level and decreases in SAP-Tied allocations, the question now arises 'how are the provinces expected to meet their expenditure requirements in the social sectors?'. The federal government has left the provincial governments no option but to increase existing tax rates and/or burden the people by imposing new taxes. If the provincial governments also opt for the policy of "No New Taxes" adopted by the federal government, then, once again, the axe falls on social sector development outlays. From a political perspective, the provincial governments may feel reluctant to levy new taxes. If they continue with this policy of the federal government, they will be unable to meet the requirements of the social sectors.

The country is paying a high cost of negligence, with human development in Pakistan in a state of perpetual decline. According to the latest Human Development Report 1997, Pakistan ranks 139th in the Human Development Index ranking among 174 countries, even below Sri Lanka, India and Maldives. Last year Pakistan ranked 134th, sadly it has further declined. It is now evident that we need to take some tangible steps or face a disastrous situation which may lead to a point of no return. It is suggested that the present government not follow the footsteps of its predecessor in the allocation of PSDP outlays, specially with regard to the social sectors. Mere rhetoric cannot bring forth any change, therefore the social sectors must get their due share in PSDP.

Budget 97-98: Implications For Infrastructure Development by *Ajaz Rasheed and Abu Nasar* [i]

Infrastructure services including power, transport, telecommunications, provision of water and sanitation, solid waste management, public works (dams, canal works for irrigation and roads) and rural development are central to the activities of households and to economic production. Improving infrastructure services enhances welfare and fosters economic growth. Infrastructure covers a complex set of distinct sectors that represent a large share of the economy. Taken together, the services associated with the use of infrastructure (measured in terms of value added) account for 14% of Gross Domestic Product (GDP). In the South Asia region, infrastructure investment usually lies in the range of 25-30% of total investment and 60-70% of total public investment. Many studies attempting to link infrastructure spending to GDP growth show very high rates of return in time-series analysis. Studies conducted by the World Bank suggest that the immediate impact of infrastructure investment on economic growth represents startlingly high rates of return (up to 60%). Efficient infrastructure lowers production costs and stimulates activity, but it requires expansion commensurate with the growth rate. The price linkages between infrastructure and development are still open to debate. Economic output is associated with infrastructure capacity growth. According to the World Bank Annual Report, increases in GDP are highly correlated with increases in the stock of infrastructure, across certain countries in South Asia.

As countries develop infrastructure, and the share of transport, communication and power in the total stock of infrastructure increases relative to that of such basic services as water and irrigation, they also adapt to support changing patterns of demand. The importance of infrastructure facilities can also be seen in the fact that they help to reduce poverty. Most of the poor are in rural areas and are involved in farm productivity, which requires infrastructure provision. The success of China's economic development has been a minimum package of infrastructure facilities at the village level. Rural enterprises now employ more than 100 million people (18% of the labor force) and produce more than one third of national output. In the Indian Budget 1996-97 an Infrastructure Development Finance Company has been established, with an initial paid-up capital of $ 1.4 Billion. In addition, infrastructure firms have been allowed to issue 20 year redeemable shares free of tax.

All infrastructure services have been dominated by public sector enterprises and government ministries. The Federal government finances nearly all infrastructure changes, primarily because it has been assumed that the production characteristics and the level of public interest involved required a monopoly, and hence government supervision. As a result the records of success and failure in infrastructure is largely a story of government performance. A comparative picture of Public Sector Development Program (PSDP) in terms of financial allocations to major sectors of Physical Infrastructure from 1989-90 to 1997-98 is given in Table-1. The allocations for 1996-

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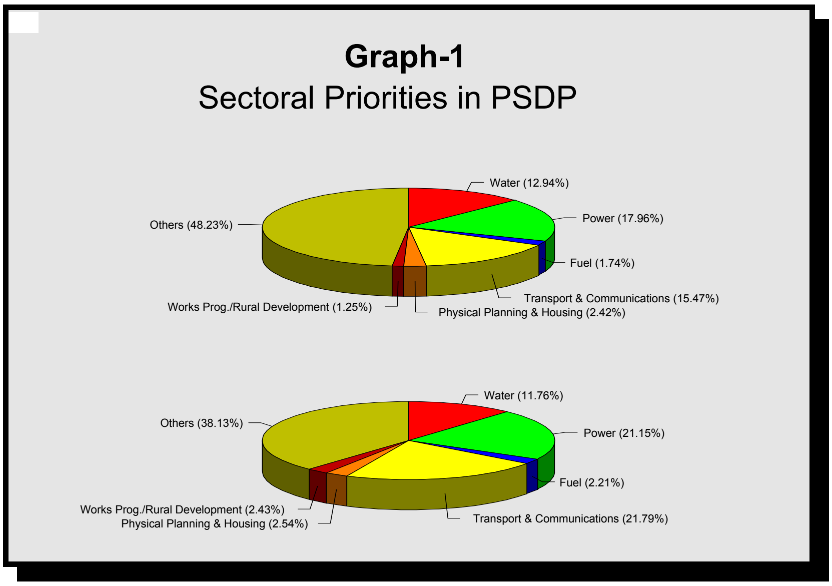
TABLE 1 SECTORAL ALLOCATION IN ANNUAL DEVELOPMENT PROGRAM (Rs. millions)								
Year	Water	Power	Fuel	Transport & Communication	Physical & Housing	Works Program/Rural Development	Others	Total Development Expenditure
1989-90	3,154	16,325	2,493	6,646	790	527	26,066	56,000
1990-91	5,386	16,587	3,212	8,204	773	647	28,192	63,000
1991-92	3,517	25,026	3,079	13,264	707	594	26,474	72,661
1992-93	6,682	12,689	2,376	13,456	562	558	31,277	67,600
1993-94	8,369	12,067	1,622	17,063	1,016	568	34,054	74,758
1994-95	11,294	16,418	2,236	15,210	2,013	646	42,184	90,000
1995-96	13,781	16,974	1,799	15,845	3,006	1,137	43,958	96,500
1996-97	11,020	15,291	1,479	13,170	2,063	1,062	41,068	85,153
1997-98	10,595	19,055	1,989	19,635	2,287	2,188	34,358	90,106

97 are revised figures, while the remaining years are budgeted. The revised size of PSDP was Rs. 85.15 billion in 1996-97. It has been raised to Rs. 90.1 billion in 1997-98 showing an increase of Rs. 4.95 billion i.e 5.8% over last year's revised allocation. The allocations for transport & communication and power have shown sufficient increases from 15 to 22% and 18 to 21% of development expenditure respectively. However, allocation for fuel in percentage terms has remained at the same level, rural development and physical planning & housing have increased by 1%, while water has shown a 1% decrease in development expenditure as compared to the year 1996-97. The allocation figures for water, physical planning & housing, and rural development are more or less the same or have increased marginally by 1 to 2% percent each year. Graph-1 Sectoral priorities in Public Sector Development Program (PSDP) shows the current budget as compared to the previous PDF government.



Insufficient budget allocations to development expenditure, result from large sums being pledged to defense and debt servicing. This, combined with inefficient operations and maintenance capacity, has generated large unmet demand for power, telecommunication, transport and water. According to a study, capacity shortages in the power and telecommunication sectors are estimated to be around 20%. Power supply shortages alone are estimated to cost industry about 9% of its value added. Due to this the allocation of money to this sector as a percentage of development expenditure was highest across sectors. In 1991-92 allocation to the power sector was 34% of development expenditure, whereas between 1992-93 and 1996-97 this figure fluctuated between the 16% to 18% range. Efforts will be made to exploit existing energy resources to build a strong native exploration and production base. The demand for electricity is rapidly increasing but generation capacity is lagging behind, causing power shortages and load-shedding. In the public & private sector power generation was 13,184 MW and 1,292 MW respectively for 1996-97. The power generation capacity in the country reached 14,476 MW in March 1997 which is 1,227 MW more than it was in June 1996. Fortunately, this year the government recognizing the need for and importance of power, has targeted a power generation capacity figure of 7500 MW. The cabinet approved a comprehensive hydel policy in 1995. A Private Power and Infrastructure Board (PPIB) was also setup as an autonomous organization. Its aim was to facilitate foreign investors to develop, operate and manage on a Build Operate and Transfer (BOT) or a Build Operate and Own (BOO) basis. In 1995 the PPIB signed 16 Memoranda of Understanding (MOU) and agreements worth US$ 13,085 million in collaboration with foreign investors. The Hub river power project is the first private project in the country.

The government is also working to obtain the technology of solar energy. The technology is important in that it is the most economical source of energy discovered so far and needs our attention in view of our increased energy requirements. The government should take this opportunity to appeal to its country men to support solar energy. The government wants to promote and facilitate the use of solar energy in the country. During the current fiscal year it has already proposed a tax holiday for five years to manufacturers of solar energy equipment who set up their industrial under taking between July 1997 and June 2000.

Similarly another important sector of physical infrastructure is transport & communication. Allocation to this sector was the highest in 1993-94, i.e. 23% of development expenditure. However, this was reduced over the years to reach 15% in the year 1996-97. Special priority has now been given to this sector. Allocations to it have now been raised to Rs. 19,634.5 million in 1997-98 or 22% of the development expenditure budget. As a result the Lahore __Islamabad Sector of the Motorway will be completed this year and work on the Islamabad __ Peshawar section will start soon. In order to enhance the communication system a network of roads is being developed in the country which will not only open new avenues of progress, but will also promote trade with Iran, Afghanistan, and Central Asian countries. Owing to the shortage of funds the government of Pakistan must encourage investors on a BOT and BOO basis so that the process of development keeps on moving.

In the communication sector the Government has granted certain relaxations, for example it has been proposed that the withholding tax on mobile phones should be fixed at Rs. 1500 per annum (Rs. 125 per month) instead of being charged at a rate of 10% of the monthly bill. It is expected that this measure will considerably reduce the tax burden of the subscribers to mobile phones and act as an incentive for further foreign investments in the high-tech communication sector. It is further proposed that the rate of excise be reduced from 40 to 25% on all types of telephone services.

It has also been proposed that excise duty be increased from 10 to 12.5% on courier services, AC/parlor trains fare and cargo by air. The increase in excise duty especially on Air Cargo Services is an attempt to promote the use of train cargo services which is the most cheap mode of goods transportation. This step has been taken to increase the additional revenue of Pakistan Railway.

In irrigation infrastructure, where Pakistan has one of the largest systems in the world, investment and maintenance expenditures have been low over the past decade and services have markedly deteriorated. Moreover, complementary investment in drainage has been neglected. These trends have been responsible for declining agricultural growth. If these trends continue the overall growth of the economy will be significantly reduced, as Pakistan's economy is still basically dominated by agriculture. In the recent budget speech the government has announced the launch of a National Drainage Program (NDP) at an estimated cost of Rs. 31 billion, over the next six years. According to Federal Finance Minister Sartaj Aziz after the Indus Basin works this will be the largest program in the country and will bring about a revolution in the agricultural field, allowing us to achieve 5% growth in agriculture sector.

Access to a given minimum of infrastructure facilities is one of the essential criteria for defining welfare. According to the Pakistan Integrated Household Survey (PIHS) 1995-96, the majority of population in Pakistan's rural areas lack access to an adequate supply of safe drinking water and sanitation system. The main source of drinking water in Pakistan is the handpump. Almost 46% of households got their water from this source in 1995-96 as compared to 48% in 1991. In the past due attention was not paid to the development of physical infrastructure - like water, physical planning & housing and rural development - in rural areas. As a result the rural population migrated towered urban areas which is now emerging as a bottleneck in economic development. To make up for this deficiency more funds will have to be provided to these sectors.

Investment in infrastructure is not sufficient on its own to generate sustainable and long run increases in economic growth. The demand for infrastructure services itself is sensitive to economic growth. The economic impact of infrastructure investment varies not only across sectors but also by its design, location, and timeliness. Evidence confirms that investment in infrastructure alone does not guarantee economic growth. Increasing social infrastructure is, in fact, complementary to long-run growth.

Federal Budget 1997-98:
Will it stimulate Private Investment?
by
Dr. Sajjad Akhtar & Rao Asif Iqbal[i]

After consumption expenditures, investment demand is the second largest component determining the overall growth in GDP. However it differs from consumption in two respects. While consumption absorbs current production, current investment not only absorbs current output, it also helps to increase output in the future. Secondly, consumption expenditures are mostly stable and predictable, while investment activity and particularly private investment behavior is sensitive to a host of economic and non-economic factors and therefore difficult to predict. PM economic package of March'97 and the current budget aims at reviving the investment climate more than the stimulation of consumption demand. Will these policy announcements give a boost to private investment? What role does the public investment have in stimulating or dampening private investment activity? What type of investment will be promoted? Residential, speculative or productive? Before assessing the likely impacts it will be useful to document the recent trends in investment activity in the country.

As Table 1 reveals investment for 1997-98 is projected at Rs 541 billion, 18.8 percent higher than the current year expected investment of Rs 455.5 billion. The growth in total investment at current prices, markedly decelerated in 1996-97 at 12.7 percent as compared to 16.7 percent in the preceding year. This slower growth can be largely attributed to public sector investment which rose only by 9.8 percent. Private investment also recorded a depressed growth declining from 18.5 percent in 1995-96 to 15.7 percent in 1996-97. In real terms, total investment in the outgoing fiscal year fell by 3.4 percent with private and public investment contributing by a fall of 0.5 percent and 6.7 percent respectively.

TABLE 1
GROWTH IN INVESTMENT (%)

	Nominal Growth		Real Growth	
	1995-96	1996-97	1995-96	1996-97
Total Investment	**16.7**	**12.7**	**5.6**	**-3.4**
Private	18.7	15.7	8.2	-0.5
Public	13.1	9.8	1.8	-6.7

Sources:
- *Economic Survey, Government of Pakistan, 1996-97.*
- *Annual Plan 1997-98, Government of Pakistan.*

Table 2 gives the share of investment in total GNP. It declined from 18.7 percent in 1995-96 to 18.4 percent in 1996-97. Private investment's share in GNP remained stagnant at 9.0 percent while that of public investment decreased from 8.1 percent in 1995-96 to 7.8 percent in 1996-97.

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Target of total investment for the forthcoming fiscal year, i.e., Rs. 541 billion, depends largely upon private sector investment of Rs 281 billion while public investment is projected at Rs 216 billion. In terms of percentage share in GNP, private investment is targeted to rise from 9.0 percent in 1996-97 to 9.9 percent of GNP in 1997-98 and public investment to decline from 7.8 percent to 7.6 percent in the same period.

TABLE 2
INVESTMENT AS % OF GNP

	1994-95	1995-96	1996-97	1997-98 (Target)
Total Investment*	**18.3**	**18.7**	**18.4**	**19.0**
Private	8.6	9.0	9.0	9.9
Public	8.2	8.1	7.8	7.6

*Total of private and public investment may not tally due to exclusion of changes in stock.
Sources:
- *Economic Survey, Government of Pakistan, 1996-97.*
- *Annual Plan 1997-98, Government of Pakistan.*

Direct budgetary impact on public investment comes through the Annual Public Sector Development Programme (PSDP) of the Federal government and private sector investment is influenced indirectly by fiscal incentives and directly by monetary policy. The latter impacts through the instruments of interest rate changes and credit availability. However due to a large debt overhang, monetary policy in Pakistan is almost ineffective and interest rates are being largely determined by the fiscal policy. While discussing the impact of budgetary measures on public and private investment, let us be clear that any one year's budget has marginal impact on long-term decisions to invest and works with a time lag. It is equally possible that measures introduced in the present budget may lead to significant increase in investment in 1998-99, and only a marginal increase in 1997-98.

Public Investment:

The size of annual PSDP is Rs 90.1 billion, compared to revised allocation of Rs 85.2 billion in the preceding year. Based on revised figures, current year allocation gives a modest increase of 5.8 percent in nominal and a negative growth of about -3.0 percent in real terms. Sectorally there appears a clear shift towards infrastructure and rural development in the current PSDP. In the budget of 97-98 transport sector receives the highest priority and despite all the resource crunch its allocation increased by Rs.6.6 billion, recording a jump of 135 percent over the last year. Moreover allocations to the National Highway Authority have been increased by 28 percent as compared to the preceding year. The share of transport sector (comprising Ministry of Transport & Communication and National

TABLE 3
CHANGES IN THE PERCENTAGE SHARE OF SOME MAJOR SECTORS IN TOTAL PSDP

	1996-97	1997-98
Agriculture	0.7	0.5
Industry	0.4	0.6
Minerals	0.7	0.5
Water	12.9	11.1
Power	4.7	5.3
Transport	3.1	6.6
Rural Development	1.2	2.3
PP&H	2.4	2.4
Social Services	9.1	7.3
WAPDA	13.2	14.7
NHA	12.4	14.2

Source: *Annual Plan, Government of Pakistan.*

Highway Authority) in PSDP rose significantly from 15.5 percent in 1996-97 to 20.8 percent in 1997-98 as shown in Table 3. Next in importance are allocations to Rural Development, Industry and WAPDA recording a growth of 106 percent, 50 percent and 24 percent respectively. Increase in the share of industry in total PSDP from 0.4 percent to 0.6 percent though small in absolute terms indicate some revival of public sector involvement in production activities. In terms of development allocations major losers are Agriculture, Water and Social Sectors. Nominal allocations have declined by 15 percent in Agriculture, 4 percent in Water and 11 percent in Social Sectors over the previous year. Share of Federal ministries responsible for Social Sectors has decreased from 9.1 percent in 1996-97 to 7.3 percent in the current PSDP. The size of Tameer-e-Sindh Programme has also been cut down to Rs 1.0 billion, compared to 2.2 billion in 1996-97. What are the investment implications of the current PSDP? To the extent that overall public investment acts as a multiplier for the private investment activity, its decline in real terms will dampen private investment demand and thus overall investment target. Excluding telecommunications, spin-offs in terms of greater production may not be visible in the next one year from long-gestation investments by the National Highway Authority and Transport Ministry. However a World Bank study documents a positive impact of government infrastructure investment on private investment. Impact on private investment in the long-run will turn out to be higher than the short-term negative impact of smaller real PSDP. Smaller allocations to Agriculture, Water, and Social Sectors signal shifting of greater responsibility to the private sector and provincial governments. As per estimates, the provinces are likely to receive Rs.18 billion less under the 1996 NFC Award than what they would have received under the previous Award. Interestingly, allocations to SAP one of the components of priority expenditure have been reduced. In other words block transfer to provinces under this head may also be affected. Ruling out a herculean short-run effort by the provinces to maintain the real expenditure on social sectors, the gains made in the last few years in these sectors may slowly reverse themselves with consequences on the long-term growth.

Private Investment:

Although as a share of GNP, private investment is expected to go up by 1 percentage point, in absolute nominal terms, the policy makers expect it to increase by 25 percent, as compared to 15 percent recorded in the last year. Many would regard it as fairly ambitious single year target and figure of 20 percent is more realistic. In 1996-97, private investment in productive sector grew at relatively lower rate (13.7%), than in the non-productive sectors (19.5%). In addition to the government investment, the above mentioned study identifies two other determinants of private investment, i.e., credit extended to the private sector and GDP growth. It is interesting and somewhat surprising to observe that in the long-run interest rates do not show up in the study as a significant determinant of private investment behaviour.

Let us briefly dissect the composition and growth of credit plan targets for the coming year (Table 4). The monetary and credit aggregates for 1997-98 have been estimated assuming real GDP growth of 6 percent and inflation rate of 9 percent. Total monetary expansion during the year 1997-98 has been targeted at Rs 150 billion assuming no impact of foreign assets (net) on the banking system. Domestic credit of Rs 150 billion is over 9 percent higher than the preceding year's revised estimates. Allocation of credit for private and public commercial enterprises is Rs 82 billion, significantly higher than the previous year. Major part of this credit (about 96%) would be provided by the commercial banks. Enhanced availability of credit for private sector may lead to significant increase in private investment provided there is pent-up demand for this enhanced credit?

This brings us to the controversial question of interest rate elasticity of investment. Indirectly it also assesses the effectiveness of monetary policy in normal circumstances in promoting investment demand.. One can question the findings of the above study and attribute them to the selection of time frame when interest rates were usually low in nominal terms. Till early nineties the real interest cost was in the range of 4-5%. In the last year it climbed to 8-10 percent based on nominal interest rate of 22 percent and inflation rate of 13 percent. However credit expansion of Rs.63.8 billion to the private and public commercial enterprises against the targeted Rs.60 billion in the outgoing year apparently belies the notion that high interest rates in the last year acted as a deterrent to private investment. By exaggerating the responsiveness of productive investments to interest rates the business community wants to extract one more concession out of the government. No doubt lower interest rates reduce the probability of default by preventing interest costs piling up on previous borrowings but due to the fungibility of money low real rates encourage speculative and poor investments in the country. As a historical note, considerable hue and cry was raised about the interest rates in 1993. After recommendations of the interest rate committee in 1994, interest rates were lowered by one percentage point. As Table 2 indicates the growth rate in private investment only inched up from 8.6 in 1994-95 to 9.0 percent in 1995-96. Will the abolition of CED on loans lower the borrowing costs enough to spur demand for loans for long-term productive investments. The impact on average rates will be marginal. Consequently increase in demand for credit for long-term productive investment will be insignificant. Without first reducing the governments appetite for borrowing and lowering inflation, trying to lower interest rates for investment purposes through political directives will further distort the capital market and lead to outflow of capital thereby further exacerbating the Balance of Payments problem.

TABLE 4
ANNUAL CREDIT PLAN

	1996-97 (Target)	1996-97 (Revised)	1997-98 (Target)
Total Monetary Expansion	**116.0**	**123.1**	**150.0**
Domestic Credit	102.0	137.1	150.0
Public	42.0	60.7	66.0
Private & Public commercial enterprises	60.0	63.8	82.0
Others	0.0	12.6	2.0
Foreign Assets	14.0	-14.0	0.0

Sources: *Annual Plan 1997-98, Government of Pakistan.*

Tax holidays for food processing industry and manufacturers of solar energy related equipments might have some impact on private investment in the long-run. Lowering rates of custom duties on imported machinery for export oriented industry will stimulate investment in the manufacturing sector. Other concessions announced in the budget will have an indirect impact on productive investments. There primary impact is on encouraging speculative and portfolio investments by strengthening capital market. Income tax exemptions to non-resident's income from shares and wealth tax exemption to investment on stocks and shares are likely to have positive impact on portfolio investments. Tax exemption on bonus shares will increase relative profitability of the corporate sector eventually improving portfolio investments. With strengthening of the capital market, new companies will find it attractive to and easier to raise low cost capital through flotations of shares rather borrow at high cost from institutional lenders and increase their debt liabilities. Incentives to boost speculative investment may also been aimed to push the stock market to new heights in order to facilitate the privatization of public enterprises (PTCL, HBL, and UBL) at reasonable prices.

Lastly one needs to comment on the accelerator type behavior of private investment. The interdependence between investment spending and GDP growth presents an interesting dilemma. Investment is positively related to GDP growth, but being a part of GDP it has to grow first for GDP growth rate to pick up. The present government is banking on the latter linkage which assumes rational expectations on the part of our investors particularly those interested in productive investment, while by tradition our long-term investors have adaptive expectations. Only next year's growth rate will reveal which approach came out the winner.

Budget 1997-98: Implications to the Stock Market
by
Amjad Nazir and M. Ajaz Rasheed [i]

The performance of stock market is increasingly seen as a barometer of economic strength and stability. Ideally, all the economic and political zigzags should be mirrored in the trend of market index. In Pakistan, the Karachi Stock Exchange (KSE) is the main equity market. Following the economic liberalization in 1990, the stock market soared and registered a remarkable gain of 160% in 1991. Ranking third among the emerging markets tracked by the IFC, reaches a peak in 1993, and then steadily declined to a post 1990 lowest level in 1996. An efficient, smooth and transparent, stock market leads to successful mobilization of vast private savings for productive investments and is regarded as an indicator of the confidence placed by the investors.

Market capitalization during the month of June 1997 was Rs. 465,745 million, in which four major scrips i.e. PTC, Hubco, Dewan and ICI contribute around 40.3 % of the total. Average daily volume of the market is 60 million shares and 70 to 85 percent of the turnover also originate from trading in the four above mentioned scrips. Up to the month of June the weight of Hubco was the largest in Index. From July 1997, Hubco's weight in the KSE index will be replaced by PTC's weight. However, PTC and Hubco are still the trend setters in the market as one rupee change in these shares (which is a normal practices of these scrips) normally change the index by almost 10 points. Therefore any positive or negative change in these scrips have a psychological impact on the demand and supply of other scrips in the market. Table-1 shows the contribution of the above four scrips. From July when PTC's weight in total index will increase, therefore, the role of PTC and Hubco will increase at further, larger extent Along with PTC and Dewan Salman, there are significant number of other scrips whose performance are not according to the standard and,

TABLE 1

	1995	1996	1997
KSE Index	1497	1339	1583
Total Valume Traded (millions)	2701	4530	3953
Market Capitalization (Rs. Million)		471665	465745
Average Market Prices			
PTC	30-35	30-37	26-29
Hubco	13-25	30-33	38-39
Dewan Salman	70-126	27-51	35-40
ICI	-	17-19	23-25
Volume Traded (millions)			
PTC	945.8	1634.03	1099.83
Hubco	354.87	1428.03	863.37
Dewan Salman	90.93	258.86	375.25
ICI	16.35	109.91	967.38
Profit Distribution			
PTC	-	6%	7.5%(i)
Hubco	-	-	-
Dewan Salman	20%(b)+ 20%	10%	-
ICI	50%+ 220%(r)	17.5%(i)+ 325%(r)	-

(i): Interim; (b): Bonus; (r): Right
1997 Figures are for June 1997; and for 1995 and 1996 figures are for 31st December

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which fail to resist decline in their market value and trade even below their face value due to recession, political uncertainty and unstable policy changes.

Given the importance of the role of stock market in the country's future economic development, the finance minister Sartaj Aziz, in his budget speech proposed a few fiscal measures for boosting the capital market through improving investors confidence.

"Income of non-residents (subject to certain exceptions) from foreign investment in government and corporate fixed income securities is proposed to be exempted from tax"

This tax exemption will be welcomed by the foreign investor, but they also consider other two important factors before investing in the securities i.e., Devaluation, and Interest rate offered by other financial institutions. Rumors of imminent devaluation shakes, the foreign investors confidence or if the rate of interest is higher in other financial institutions they might not see any attraction. Any marginal increase in investment by the foreign investors in the fixed income securities may not reflect in KSE 100 index, as they do not have any weight in the index.

"the bonus share have been completely exempted from withholding tax" It p is another positive proposal to increase the confidence of the investor. Previously, government charged 10% withholding tax on bonus shares. For example, if a company declared Rs.100 million profit for bonus shares, government received Rs.10 million as withholding tax and remaining Rs. 90 million was distributed among recipients of bonus shares. Withdrawal of withholding tax will increase the income in the hands of the share holder. And they will tend to invest in those companies who normally announce their dividend in the form of bonus shares like PSO etc.

"Mutual funds which distribute at least 90% profits amongst shareholders may be exempted from tax".

At present there are 39 mutual funds listed in the KSE. Among these 26 funds namely ICP Mutual Funds are managed by the government. while others are private in nature. The performance of ICP mutual fund is more or less satisfactory because many of them offered attractive profits to their share holders. However, performance of Private Funds is not very ideal. For instance, during 1995/97 only a few funds declared profits t for distribution to the share holders and 95% of them failed to earn any profit.

The conditions of 90 percent distributions of profit is not new because according to the rules every mutual fund is liable to distribute 90 percent of its declared audited profit to its holders. Therefore any Mutual fund which earn profits will definitely distribute this much amount among the shareholders. We think this is the first right decision that has been taken to cure the basic weakness of the industry. After this incentive this industry will become very attractive for investors. At present, these funds pay on average 35 percent tax on their audited profits and the exemption of these taxes will definitely increase the profit margin of shareholders.

"Exemption from tax on capital gains from sale of shares is proposed to be extended for another three years"

It is a fiscal distortion to helps the market as long as interest rates remain at their punitive high level. In a situation when the market is trading in a recessionary period this type of incentive can help to attract some investment but it can not be regarded as permanent and ultimate solution for the development of the market. A long-term bullish market will definitely attract fresh investments even in the presence of some percentage of capital gain tax. On the other hand if the fundamentals of the market are not favorable, then this type of incentive will not help the market for sustained revival of the market.

"Investment in shares will be valued at half for wealth tax purposes".

The purpose of these proposals is to attract investors and capital holders to invest in capital market. Apparently this proposal provides motive to substitute other form of wealth for stocks or may be even add stocks in these existing portfolio. However, it needs to be emphasized that the decision to invest in capital market will depend on market's own performance not on these types of fiscal crutches. Investing in bearish market the investor may succeed to save half of its wealth from tax but capital gain/loss will remain a decisive factor.

"It is proposed to reduce the rate of excise duty from 40% to 25% of charges on all types of telephone services."

The finance minister announces a rate cut of 15% in the excise duty. However PTCL will have to cut its tariff rate on NWD calls only. PTCL will benefit from the cut in excise duty as the reduction will add directly PTCL's revenues, due to increase in retention tariffs of nearly 12% of domestic revenues.

One point that is clear, is that stock market is not a sector by itself it is an image of various real sectors of the economy. If sectors perform well with the passage of time or receive a fill up from announced monetary and fiscal policies the performance of the sector will improve and consequently will the stock market. On the other hand if our policy makers try to boost capital market by providing some marginal injections then they might succeed in achieving their goal for a very limited period of time but the objective of long-term stability will remain elusive. From above discussion it is clear that incentives which are directly related with an industry succeed towards attracting investment while proposals providing direct incentive for investment in stock market prove to be a short-lined bubble and increase speculations. These short-term measures aimed at boosting speculative investments, are no substitute for long-term credible and stable fiscal, monetary and exchange rate policies for attracting a sustained increase in industrial activity and overall macro-economic performance.

The Budget 1997-98: A Boon To Industry
by
Rafia Ghaus[*]
Abdul Rauf Khan

One contributing factor to the economic crisis in the country is the recent three year slum in industrial production. To induce growth in the industrial sector an industry friendly budget has been formulated, even though an Economic Revival Programme (ERP) was announced on March 28, 1997. The main objectives of the ERP was to expand exports through increased industrial production. ERP reduced custom duty rates by 20 percent and introduced the concept of cascading the structure of tariffs. This is expected to utilized the full potential of industrial capacity and to attract new investments. The budget 1997-98 provides further relief by announcing a reduction in loan mark-up rates and excise duties, enhancement in exemptions, simplification of tax structure, etc.

Table 1 shows the concessions given to boost output. The withdrawal of federal excise duty along with reduction in custom duty will reduce input costs and thereby accelerate the growth in industrial sector. However, domestic production is protected from competition through exemption in sales tax. The financial incentive given through withdrawal of excise duty on bank loans and advances, lease financing and musharkas, would result in reduction of the mark-up by 1.7 percent. This will consequently reduce the cost of both investment and working capital which by lowering costs will stimulate production. To promote cottage industry the exemption ceiling has been increased from Rs. 100,000 to Rs. 300,000. Tax holiday to manufacturers of solar energy equipments is also a part of the budget measures to induce investment. Prices of gas and energy have not been increased. This is contrary to all expectations, particularly by industry.

The reforms announced will not only influence the future process of industrialization of the country in the desired direction, make it simpler and transparent but also help in tackling the problem of smuggling. The common perception is that it will reduce corruption and increase efficiency. Is this possible keeping the previous track record of response to stimulus for industrial revival?. The reforms have in effect replaced that 'dunda' of the excise inspector by the fear of sales tax audit. Successful implementation of these reforms is dependent to a very large extent on voluntary compliance by industry. In the event that this hope does not materialize, the Government has sanction to ensure compliance through coercive measures in the amended sales tax regulations. Will the boon to industry translate itself into higher output, thereby reducing prices which in turn will induce further demand? Or, will this translate into fatter profits for the bloated industrialists?. Will the common man profit?. We live in hope.

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TABLE 1
INCENTIVES GIVEN IN 1997-98 FEDERAL BUDGET FOR THE DEVELOPMENT OF INDUSTRIAL SECTOR

Budgetary Proposals	Tax Incentives	Revised Rate
Income Tax		
Export of Computer Software	Tax Holiday	
Manufacturing of Soft & Stuffed Toys	Tax Holiday	
Processing of Fruits	Tax Holiday	
Solar Energy	Tax Holiday	
Excise Duty		
Cement Industry	Sale Tax (withdrawal)	35% to 40%
Bank Loans & Advances	Withdrawal	
Telephone Services	Reduced	40% to 25% + Increase in Call Charges
Beverages	Reduced	17.5% to 15% of retail price
Beverages Concentrate	Reduced	100% to 50% ad val
Locally Manufactured Television	Withdrawal	
Locally Manufactured Air Conditioners	Withdrawal	
Audio Video Cassette	Withdrawal	
Slag Wool	Withdrawal	
Bodies of Motor Vehicle	Withdrawal	
Cottage Industries	Withdrawal	Exemption limit Rs. 1 lac to Rs. 3 lac
Sales Tax		
Poultry Industry	Exempted	
Pharmaceutical		
- Raw Material	Exempted	
- Packing Material	Exempted	
Import & Manuf. of Computer Hardware	Exempted	
Import of Life Saving Drugs	Exempted	
Custom Duty		
Import Duty on Newsprint	Reduced	25% to 10%
Import Duty on Machinery For All Sort of Export-Oriented Industries	Withdrawal	

BUDGETARY TARGETS AND TRADE PERFORMANCE
by

Naveed Hanif and Naeem Ahmed[*]

The people of Pakistan are witnessing the arrival of the federal budget 1997-98 at a time when the country is completing 50 years of its independence. Since 1947, socio-economic statistics have been showing signs of improvement. A short-term analysis shows that the country is presently going through a period of crises; especially in terms of the economic situation. Economic growth, the backbone for social sector development, has slowed down substantially during the 1990s, reflecting the weak structure and policies which are preventing Pakistan from sustained economic development.

TABLE 1

Years	Export Growth Targets	Export Growth actual	Import Growth Targets	Import Growth actual	Trade Deficit % of GNP	Devaluation
1990-91	11.53	19.81	0.13	12.14	-5.73	2.1984 (10 %)
1991-92	20.0	14.57	2.5	7.31	-4.54	0.72 (3 %)
1992-93	22.02	0.3	3.25	11.68	-6.27	1.8354 (7.4 %)
1993-94	19.76	-1.43	-5.61	-3.57	-3.83	4.20 (16.2 %)
1994-95	17.13	16.07	7.01	18.55	-4.13	0.6879 (2.3 %)
1995-96	18.65	7.11	6.24	16.7	-5.75	2.72 (8.8 %)
1996-97 July - March	20.0	-2.04	-3.24	0.33		(11.6 %)
1997-98		15.0				
1990-96 ACGR %*	10.88	9.11	8.07	8.39		11.26 (53.1 %)

* ACGR % = Annual Compound Growth Rate in percentage.

In 1995-96, the real GDP growth rate was 4.6%. This has decreased to 3.1% in 1996-97; a very low rate compared to the original target of 6.3%. Similarly, the export growth target for the year 1996-97 was 14.4%. However, a comparison of export figures for the 9 month period July- March 1997 with the corresponding figure last year, shows a decline of 2.04%. The import target of 5.3% also declined 3.28% for the corresponding period. Pakistan has been consistently unable to meet its export/import targets since 1992. Only 14.57% of the 20% projected rate of export growth for 1992 was realized; the target set for 1993 was 22.02%, while the actual value was 0.3%. In 1994, the target was 19.76% and the actual figure was -1.43%. Last year`s projected figure for export

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growth was 18.65% (see table 1), of which only 7.11% was achieved. As far as the average annual growth rate is concerned, however, between 1990 and 1995-96 our actual exports grew 9.1% annually; not far behind our projected figure of 10.88%. On the import side, actual imports are seen to have surpassed their projected values. For 1992, the projected growth of imports was 2.5%; whereas actual growth was 7.31%. The target for 1993 was 3.25%, while the actual was 11.68%. In 1995, the target was set for 7.01% and realized at 18.55%. Last year`s projected figure for import growth was 6.24%, whereas the actual figure has gone up to 16.7%. Like the case of accumulative export growth, the actual average annual growth of our imports, 8.39%, is quite close to our average annual growth of 8.03%. It is quite clear from the figures that yearly fluctuations and differences between the actual and projected figures in both the import and export sector are quite high as compared to the average annual growth rates. Based on this analysis, we can see that a 15% target for our exports is reachable in 1997-98 if factors such as climactic conditions, timely rainfall, unexpected floods and plant diseases etc. remain favorable. Prior experience has shown the high influence of these factors on export.

An analysis of the import/export structure shows that more than 50% of our export earnings are from manufactured goods. This is followed by semi-goods and a minimum share of primary goods. In 1991, the share of manufactured goods in total exports was 56.89%, while that of semi-manufactured and primary commodities was 24.44% and 18.67% respectively. By 1996, the share of manufactured goods in total exports reached 62.12% (up 5.23% compared to 1991), semi-manufactured goods 21.65% (down 2.79%), and primary commodities 16.24% (down 2.43%). In 1996, in absolute terms, the growth of primary goods was the highest, reaching 70.21%, followed by manufactured goods with 14.12% and semi-manufactured with 1.88%. The positive change in the share of manufactured goods in total exports is evidence of the country's move towards industrialization. Therefore, every possible incentive must be given to export oriented industries in order to boost export earnings.

In connection to this, the government announced an economic revival package on 28th March 1997, thereby substantially cutting down the tariff from a maximum of 65% to 45%. This package aims at reductions in tariff on industrial raw materials to boost industrial production. The rate of tariffs on plant and machinery for the export sector was reduced to a minimum of 10%, whereas raw materials required mainly for exportable item production were zero-rated. The domestic engineering company was also protected by subjecting competing imports to a tariff rate of 35%. It is expected that these measures will help improve our position within the balance of trade. The new government has proposed a 15% export target for 1997-98. It is achievable based on the factors relating to natural and agricultural conditions explained earlier. However, the policy implications of subsidising exports and devaluing the currency and other measures proposed will not be seen in a short period. The main reason for this is our low export-elasticity, estimated at only 0.344 as compared to our high import elasticity of 0.944. High export elasticity can only be achieved if exports are diversified. Although this is a long term measure, it should be implemented as soon as possible. This is especially important as the effects of natural calamities on our crop production directly affects our mostly agriculturally-based exports.

The trade deficit of US$ -3704 million is 46% higher than that of last year. The situation of the current year (1996-97) is even worse; by March 97 the trade deficit had touched US$ -2517 million compared to US$ -2681 million during the same period last year. The changes in government from 1990-97 greatly affect the economic uncertainty.

The adverse balance of trade situation is also affected by currency devaluation. Devaluation is usually under taken in order to keep the price of our exports cheaper in the world market and to capture demand. Between 1990 and 1995-96, the Pakistani rupee has been devalued approximately 53%. It is not prudent to use devaluation for stabilizing exports as it contributes to national inflation, through industrial imported raw material used in the production of consumer goods, which account for about 40% to 45% of total imports. In the year 1995-96, the Government of Pakistan devalued the Pakistani rupee twice, once on September 10th by 3.7% and then on October 22 by 7.9% with minor devaluation continuing as a regular phenomenon.

As far as our import structure is concerned, the share of industrial raw material for consumer goods is higher and has been exhibiting an increase from 1991 to 1995-96. In 1995-96, it was almost 46% of total imports. The share of finished capital goods is also very high at about 35.32% in 1995-96. The share of industrial raw material for capital goods is very low and has been showing a decreasing trend. Since 1991, the heavy burden on our imports has been the import of capital goods and industrial raw material for consumer goods. The increased import of machinery indicates greater economic activity and is likely to push up the production of manufactured goods in the country. It is necessary to import industrial raw material for capital goods in order to raise the level of industrial production. Pakistan's industries primarily engage in the production of consumer goods and the machinery used in these industries is imported instead of being produced in the country. As far as their growth rates are concerned, except for industrial raw material for consumer goods, all other import categories show a very high growth rate in 1996 when compared to 1991. Our policies in this respect should only be in favor of imports for developing export oriented industrialization, thereby increasing the efficiency and competitiveness of our industries.

As far as the supply side effect of imports is concerned, the cost of smuggling is 35% and the reduction in the mark up of smuggling with the new tariff of 45% is 10%. This will shift the market from illegal to legal. Although our trade deficit will rise, the supply side effect on export and domestic industry will not be significant as nothing new will be entering the country.

Thus, the overall rising trend of our imports and decline in exports resulting in the trade deficit has given rise to a huge current account deficit of US $ -4575 million in 1995-96 as against US$ -2171 million in 1991. The highest point was in 1996. The current account deficit has not shown any remarkable changes, even in the past 9 months from July - March 96 to July - March 97. It was about US$ -3522 million in 1995-96 and US$ -3308 million in 1996-97. Although remittances play their role in improving the country's deficit position, their effect is nominal. Moreover, the growth of remittances which was -4.84% in 1991 is now -21.7% in 1996.

Pakistan depends heavily on external loans and credits in order to meet the deficit situation and the rising import bill. Our position regarding the outstanding external debt has slightly improved from 1991-92 when it had a growth rate of 12.2%. In 1995-96 it was about 0.7%. Total national debt comprising external debt of Rs 1164.7 billion was about US$29 billion up to the end of March-97. During July - March 97, the external debt rose by $ 390 million (1.4% of US$29 billion) and debt servicing during this period was US$ 3.9 billion, as compared to US$ 3.5 billion during the same period last year. Therefore, debt-servicing increased about US$ 422 million, a 12% increase as compared to last year. The situation of net capital inflow is far from satisfactory and stands at a growth rate of -47.7% in 1996. This is because a large portion of whatever we get in the form of total loans and contracted credit is utilized in debt servicing. In this respect, past data reveals the continual positive growth of our debt-servicing, whereas the growth of loans and credit is running negative especially in 1996 with a figure of -8.1%. The year 1996 shows a minimum growth of debt servicing i.e. 44.7% since 1990-91. All these factors cumulatively give rise to the serious problem of an adverse balance of payments. The improved inflow of remittances along with foreign aid can reduce pressures on our balance of payment. The fact remains, however, that without widening the base and diversification of exports, the country cannot overcome the problem of the actual trade deficit, which has no doubt affected the economic situation of the country.