

Chapter

3

Balance of Payments

Pakistan's external sector till FY 2002, suffered from stagnation in export growth, level of workers' remittances and foreign exchange reserves. However, the sector started experiencing a significant transformation since FY 2003 as a result of structural reforms and sustained economic growth. The exports showed an impressive average annual growth of around 15 percent during the period from FY 2003 to FY 2006. Workers' remittances touched a level of \$ 4.6 billion in 2005-06 and by the end of current fiscal year these are estimated to be \$ 5.50 billion. Similarly, foreign exchange reserves by June, 2007 are expected to be around \$ 14.5 billion by the end June, 2007. The prospects for sustained high economic growth during FY 2006-07 and over the medium term mainly depend on macroeconomic stability, market reforms, the privatization program, trade liberalization and export promotion and improvement in the country's physical and human infrastructure providing the right environment to encourage further investment and increase in productivity. At the same time, a strong pick-up in domestic and foreign direct investment is an important factor for reducing the current account deficit of the economy.

The biggest challenge to sustaining the growth momentum of Pakistan economy during the past few years is from an unprecedented rise in international oil prices and declining export competitiveness. Fortunately, the oil shock receded somewhat during the later half of FY07, even though the export growth and competitiveness remained an area of concern during the year. Nevertheless, substantial capital inflows, especially in the form of FDI and workers' remittances provided the much needed cushion to the rising current account gap (Box 3.1).

Box 3.1

Balance of Payments

Balance of payments is a statistical statement that systematically summarizes, for a specific time period, the economic transactions of an economy with the rest of the world. While the balance of payments depicts country's macro economic fundamentals, a coherent structure for classifying balance of payments transactions also facilitates the process of analyzing recent trends and making projections. Major components of the "balance sheet" are the current account and the capital and financial accounts. The current account comprises goods and services, income and current transfers, while capital and financial account includes capital transfers and financial account's major functional categories such as foreign direct, portfolio and other investments, reserves build ups, exceptional financing, etc.

Review of Annual Plan 2006-07

The Annual Plan 2006-07 visualized an increase in the trade deficit mainly on account of higher growth in imports than in exports. The exports (fob) were projected at \$ 19,797 million up by 20.8 percent from \$ 16,388 million (actual) in 2005-06. The growth in exports were anticipated on the basis of sustained increase in agriculture and manufacturing sector output, improvement in the overall competitiveness and

increased market access for Pakistan's value added exports. Imports (fob) were anticipated at \$ 27,410 million, up by 11.2 percent from \$ 24,647 million (actual) in 2005-06. The trade deficit during 2006-07 was thus projected to be \$ 7,613 million against a deficit of \$ 8,259 million during 2005-06. The balance on invisible account was projected to be in surplus to the tune of \$ 1,325 million as against a surplus of \$ 2,610 million in 2005-06. The current account deficit was thus projected to increase to \$ 6,288 million (4.3 percent of GDP) in 2006-07 from a deficit of \$ 5,649 million (4.5 percent of GDP) during 2005-06.

Exports: According to the latest data released by the Federal Bureau of Statistics, exports during July-April, 2006-07 stood at \$ 13,909 million, up by 3.4 percent from \$ 13,457 million during corresponding period of last year. The slight improvement is due to increase in export receipts of textile group (6.2 percent), engineering goods (6.7 percent), cement (26 percent), gem and jewelry (98 percent), tobacco (47 percent), basmati rice (18 percent), vegetables (67 percent), cutlery (14 percent), onyx manufactured (6 percent), and guar and guar products (6.2%), while almost all other important/traditional items have shown a deceleration during the period under review. About 82 percent of the total export items, for which data on both volume and price are available, show a growth of 1.0 percent. The decomposition of this growth into volume and price effect reveals a decrease of 3 percent in volume and an increase of 4 percent in price. Exports (fob) for the full year 2006-07 are estimated to be around \$ 17,205 million as against the target (Annual Plan) of \$ 19,797 million. Details are in Annex 3.1.

Box 3.2

Competitiveness

According to the Global Competitiveness Report 2006-07, Pakistan's ranking is 91 out of 125 countries surveyed for the purpose. India is at 43 and China at 54. Denmark, Singapore, USA, Japan, Germany, the Netherlands and UK compete for the top ten position. Some of the Muslim States have moved up their ranks such as Indonesia 19, Turkey 12, Kazakhstan 8, Qatar 8, Tunisia 7, Morocco 6, Algeria 6, Kuwait 5 and Pakistan 3 ranks as compared to the 2005 ranking.

A recent World Bank study identifies macro-economic instability, infrastructure bottlenecks (power, water and transport/trade logistics), inadequate supply of quality education/skilled manpower, weak governance, pockets of high protection, and poor quality and safety standards as major constraints to growth and international competitiveness in Pakistan.

It is agreed by all that Pakistan's economic performance in the past remained well below its potentials and that broader and deeper investment climate, reforms and a strengthened macroeconomic framework could propel the economic revival of past few years to produce a higher and sustained growth. Macro-economic stability is strategic for country's enhanced growth and competitive prospects. The basic micro-economic fundamentals of competitiveness are:

- Total factor productivity
- Quality investment environment (policy, regulatory and institutional frameworks)
- Efficiencies and competitiveness at firm level.

Public and private sectors need to strive hard for growth and export competitiveness by over-coming constraints and bottlenecks identified above.

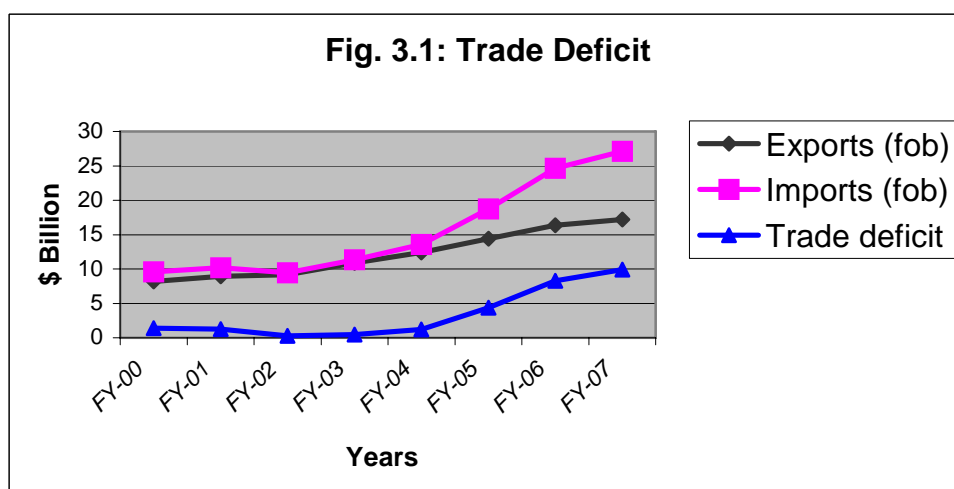
The exports of textile and clothing sector performed below expectations due to following reasons:

- increased competition in the international market for textile products, high cost of business in the country, inflation and increasing interest rates in the wake of tight monetary policy;
- flooding of domestic market with smuggled and under-invoiced imports from China, Thailand and other countries thus discouraging local industry to reap economies of scale;
- imposition of anti-dumping duty and abolition of GSP concession in Europe and an imbalanced custom duty in USA facilitating the substitution of Pakistani products in the export markets of USA and Europe by China, India and Bangladesh (the latter due to special preferences having the status of a least developed country).
- As over 60 percent of total exports of Pakistan originate from textile and clothing sector, concerted efforts are needed to become a reliable exporter for value added textile products. Garment industry, especially women's garments should concentrate on fashion design for keeping pace with rapidly changing fashion in the international market. The challenges being posed by regional countries like China, India and Bangladesh need to be adequately met by Pakistan's textile sector, through overcoming constraints of high cost of doing business, low level of value addition and dynamic marketing strategies for export of textile goods to USA , EU and other markets (Box 3.2).

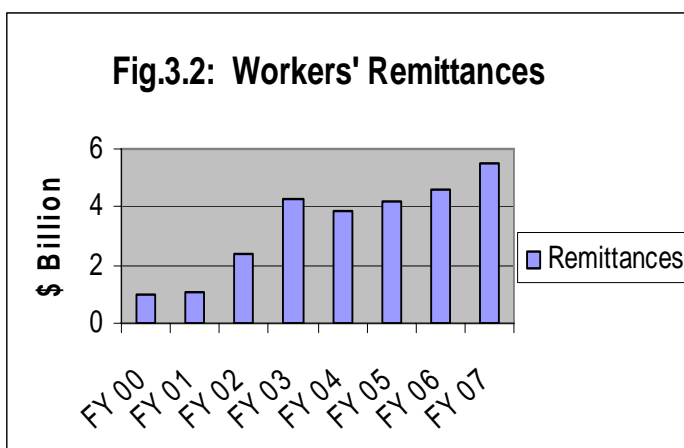
Imports: According to the Federal Bureau of Statistics, imports during July-April period of 2006-07 have increased by 8.9 percent to \$ 24,993 million over the corresponding period of last year (\$ 22,946 million). They remain well within the target of 11.2 percent increase set for FY 06-07. The trend increase in imports of food group (milk cream and milk food for infants, dry fruits, soyabean and palm oil and pulses), machinery group (power generating machinery, electrical machinery and apparatus, telecom machinery and equipments, agriculture machinery), transport group (aircrafts, ships and boats, and motor cycles, buses and trucks), petroleum group, raw cotton, paper and paper board contributed to this projected increase. The important items of import which have shown decline during this period include wheat unmilled (68 percent), textile machinery (35 percent), CUB trucks and buses (23 percent), CKD motor cars (31 percent), fertilizers (49 percent), insecticides (17 percent), gold (58 percent), iron and steel scrap (9 percent) and iron and steel (12 percent). Import items for which data on both volume and prices are available (48 percent of total import item) show a growth of 5.5 percent. Decomposition of this growth into volume and price effect reveals an increase of 2.8 percent in volume and 2.7 percent in price. Imports (fob) for FY 2007 are estimated at \$ 27,112 million. Details are at Annex 3.2. The details of the trade balance for the last eight years may be seen in Table 3.1. The Trade deficit is also depicted at *Fig. 3.1*.

Table 3.1: Trade Balance

Fiscal Year	(\$ Billion)		
	Exports (fob)	Imports (fob)	Trade Deficit
1999-00	8.191	9.602	1.411
2000-01	8.934	10.202	1.269
2001-02	9.140	9.434	0.294
2002-03	10.889	11.333	0.444
2003-04	12.396	13.604	1.208
2004-05	14.401	18.753	4.352
2005-06	16.388	24.647	8.259
2006-07	17.205	27.112	9.907

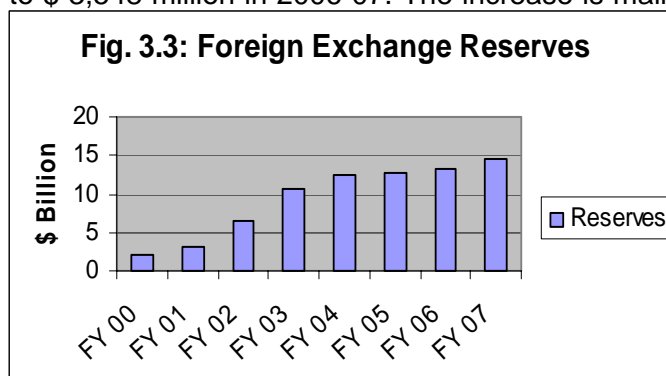


Invisible Account: During 2005-06, the workers' remittances stood at \$ 4,600 million, which were 10.3 percent higher than \$ 4,169 million in 2004-05. The inflow of workers' remittances show a rising trend during the period July-April of fiscal year 2007 touching \$ 4,450 million as against \$ 3,630 million in the corresponding period of the last fiscal year, registering an increase of \$ 820 million or 22.6 percent. The monthly average remittances for the July- April period of FY 2007 stood at \$ 445 million as compared to \$ 363 million during the same period of the last fiscal year (Fig: 3.2). Remittances for full year 2006-07 are estimated at \$ 5,500 million. After allowing for other invisibles receipts and payments, the invisible, balance is estimated to register a surplus of about \$ 2,787 million in 2006-07 as against a surplus of \$ 2,610 million of last year.



Current Account Balance: Though the current account deficit will exceed the budget estimates (4.3 percent of GDP), however, there is an explicit increase in non-debt creating inflows like foreign direct investment (FDI), home remittances, which will contain the drain on foreign exchange reserves. With the trade deficit at \$ 9,907 million and invisible surplus of \$ 2,787 million, the current account deficit for the FY 2007 is estimated to increase to \$ 7,120 million (5.0 percent of GDP) from last year deficit of \$ 5,649 million (4.5 percent of GDP). Details are at Annex 3.3

Capital Account: Gross aid disbursements are estimated to register an increase from \$ 2,253 million in 2005-06 to \$ 3,548 million in 2006-07. The increase is mainly shared by increase in project aid from \$ 1,230 million in 2005-06 to \$ 1,316 million in 2006-07 and in program/commodity aid from \$ 1,021 million in 2005-06 to \$ 2,216 million during 2006-07. Allowing for other capital inflows, the surplus in overall balance is estimated at \$ 3,021 million in 2006-07 from \$ 1,200 million in 2005-06. The incorporation of the transactions of the banking system will allow a build-up of \$ 2,694 million in gross foreign exchange reserves reaching the level of \$ 14,535 million, equivalent to almost 28 weeks of imports (Fig:3.3).



Projections for 2007-08

Trade Account: During 2007-08, exports (fob)* are expected to grow by 10 percent to \$ 18,921 million against \$ 17,205 million estimated for 2006-07. Projections of exports are based on the following assumptions: (i) an increase in exportable surplus through increase in agricultural production and manufacturing output, (ii) improvements in the productivity of industrial workforce from technical education and on the job training, (iii) greater market access through bilateral arrangements, preferential and free trade agreements with regional and other countries and (iv) improvement in the overall competitiveness of the external sector by enhancing value addition in the manufacturing sectors. This process will be accelerated by implementing various measures suggested under the Pakistan Export Plan 2007-13 (Box 3.3).

Imports during 2007-08 are anticipated to increase moderately by 9 percent due to higher volume of import of food items, POL, edible oil and fertilizer (Annex 3.2). As a result, the trade account is projected to be in deficit by \$ 10,631 million in 2007-08 against a deficit of \$ 9,907 million estimated for 2006-07. Details are given at Annex-3.3.

Invisible Account: Prospects for the invisible balance will continue to be governed mainly by the behavior of the workers remittances. For 2007-08, remittances are projected at \$ 5,800 million against \$ 5,500 million estimated for 2006-07. Allowing for other invisible receipts and payments, the surplus on invisible account is anticipated at \$ 2,521 million against a surplus of \$ 2,787 estimated for 2006-07.

* final figure would be announced by Ministry of Commerce in Trade Policy.

Box 3.3
Export Plan of Pakistan 2007-13

Although during the past eight years Pakistan's exports have more than doubled from \$ 7.2 billion in FY 1999 to \$ 16.4 billion in FY 2006, however, presently country's exports are 13 percent of GDP whereas Indian and Chinese exports were 16 percent and 40 percent respectively. Indian exports are expected to reach \$ 128 billion during 2006-07. In 2006 Chinese exports reached to \$ 969 billion.

The Prime Minister of Pakistan, while chairing the Federal Export Promotion Board's meeting on July 08, 2006, assigned the task to Deputy Chairman, Planning Commission to prepare the Export Plan outlining detailed strategy to enhance exports from present 13 percent to 15 percent of GDP in next six to seven years. In pursuance of this decision, the Planning Commission prepared the Export Plan in consultation with the stakeholders from both public and private sectors. The Deputy Chairman, Planning Commission presented the detailed Export Plan for Pakistan in a high powered meeting chaired by the Prime Minister on March 06, 2007. He made a detailed review of all major exports, highlighted constraints impeding exports and presented a strategic framework to achieve a quantum leap in exports from \$ 16.4 billion in FY 2006 to \$ 40-45 billion by FY 2013. The strategic thrust to achieve the exports target is focused on:

- **Enabling policy environment:** The need is of consistency, stability and continuity of the economic policies. Higher investment in high value added export oriented manufacturing and agriculture activities is required. Investment to be encouraged through tax and investment incentives. State of the art infrastructure and technology support centers are to be established. Besides, simplification of laws, to ease doing business and building strong confidence between public and private sectors would also be needed.
- **Human resource development:** Raise the skill base and competitiveness by establishing more technical and vocational training institutes. Capacity of the existing public sector training institutions to be enhanced. Institutional measures are also needed to strengthen industry / academia linkages.
- **Physical, scientific and technological infrastructure:** Revamp the existing industrial estates. The need is to establish and operate new industrial estates / export cities / industrial parks. Common Facilitation Centers (CFCs) and dedicated utility services are to be provided. Effluent treatment plants also need to be established. Reconstruction Opportunity Zones (ROZs) are to be launched at the earliest to take advantage of exports from less developed areas to the US on preferential terms.
- **Logistics chain:** Trade and transport logistics chain is to be improved to reduce the cost of doing business and increase competitiveness.
- **Trade facilitation:** Trade handling issues along key export corridors in relation to streamlining procedures and improving services are to be addressed to maximize efficiency gains.
- **Production of quality products:** Production of quality products to be encouraged. National quality standards to be conformed to the International standards. Accredited labs are to be established and strengthened for quality certification.
- **Marketing:** Aggressive regional and country specific marketing strategy. Focus should be on key fast growing markets and export diversification. Effective trade diplomacy (FTAs / PTAs etc) is required for market access with particular emphasis on China, USA, EU, Latin America and CARs
- **Trade and social compliances:** To ensure WTO and bilateral compliances, sectoral task forces to be constituted. They may create awareness and formulate time bound implementation plan to address the issues of trade and social compliances.

Sectoral growth strategies and targets provided in the Export Plan to promote core and development categories of country's exports were approved by the Prime Minister to be implemented by the concerned agencies. The key areas requiring investment of \$ 65 billion in the manufacturing sector include: textile & garments \$ 20-23 billion, (Spinning \$ 4 Bln, Weaving \$ 7 Bln, Finishing \$ 5 Bln and Downstream industry \$ 5 Bln), steel & engineering goods \$ 13-16 billion, chemical & pharmaceuticals \$ 5-8 billion, leather & leather products \$ 3-6 billion, sports & surgical Instruments \$ 3-5 billion, gems & Jewelry \$ 2.5-4 billion, marble & granite \$ 2-3 billion, rice \$ 2-3 billion, fish & fish products \$ 1-2.5 billion. Keeping in view the policy recommendations, concerted efforts are needed on the part of both public and private sectors to achieve the desired objectives and goals of the Pakistan Export Plan 2007-13.

Source: Export Plan –Pakistan Inc 2007-13: March 6, 2007, Planning Commission Islamabad

Current Account Balance: With a deficit of \$ 10,631 million on the trade account and a surplus of \$ 2,521 million on the invisible account, the current account deficit is estimated to close at around \$ 8,110 million in 2007-08 against a deficit of \$ 7,120 million in 2006-07.

Capital Account: Gross disbursements are expected to be \$ 3,245 million in 2007-08 compared to \$ 3,548 million in 2006-07 largely due to decline in disbursements of commodity aid. After allowing for other capital movements, surplus of \$ 3,146 million is likely to occur in the overall balance in 2007-08 as compared to a surplus of \$ 3,021 million during 2006-07. However, taking into consideration transactions of the banking system and a build up of \$ 2,770 million in foreign exchange reserves, the gross reserves are likely to reach the level of \$ 17,705 million in 2007-08, compared to a level of \$ 14,535 million in 2006-07. Annex 3.3 depicts the detailed balance of payments position of the country.