

Executive Summary

Overview of Economy

The economy of Pakistan has grown on an average of 7.5 percent over the last four years 2003-07, whereas during the current year 2006-07 a growth rate of 7 percent has been achieved. The size of GDP increased three times from Rs 2,938 billion in 1998-99 to Rs 8,716 billion in 2006-07, while per capita income increased more than two times from \$ 438 to \$ 926, investment by five times from Rs 409 billion to Rs 2,004 billion and national savings 4.6 times from Rs 344 billion to Rs 1,572 billion in the same period. On the basis of rapid and sustained growth achieved in the recent past, Pakistan has joined the fastest growing economies of the Asian region. Impressive growth of Pakistan's economy is attributed to the continuity and consistency of policies initiated by the present regime within the overall framework of deregulation, privatization and liberalization.

Efficient management and structural reforms introduced in the recent past have brought about healthy changes in almost all sectors of the economy. A major breakthrough has been achieved in managing the domestic and external debt. Total debt (domestic and external), which was 100.3 percent of the GDP in 1998-99, has been reduced by half to 51.1 percent in 2006-07. The ability of the country to borrow from international and regional capital markets at relatively low rates and long maturities has improved substantially. The recent floatation of Euro-Bond in the international market was subscribed by seven times to over \$ 3.5 billion. The steep decline, both in the stock of debt and debt-servicing as a ratio to GDP has provided ample fiscal space to pursue expansionary economic policies.

Total investment has increased substantially and reached an all time record of Rs 2,004 billion (23.0 percent of GDP) in 2006-07. The public sector development expenditure (PSDP) excluding allocations for earthquake has witnessed a sharp increase, from 2.2 percent of GDP in 2002-03 to 4.1 percent in 2006-07. In the last seven years, Pakistan has spent over Rs 1,450 billion on poverty related and social sector programs.

The confidence of foreign investors in Pakistan economy has improved as non-debt creating capital inflows are expected to touch around \$ 7.5 to 8.0 billion during 2006-07. The foreign direct investment has risen from \$ 485 million in 2001-02 to \$ 6.0 billion in 2006-07. The economy has also witnessed a sharp rise in the workers' remittances, which increased to \$ 5.5 billion during 2006-07, showing a five times increase from a level of \$ 1.1 billion in 1998-99.

As a consequence of tight monetary policy, inflation is expected to marginally decline from 8.0 percent in 2005-06 to 7.7 percent in 2006-07. The food inflation, however, still remains high. The government has maintained an expansionary fiscal stance to ensure higher investment for growth and increase in pro-poor expenditures. It is expected that the CBR tax collection would meet the target and the fiscal deficit would be close to the projected level of 4.2 percent of GDP.

High economic growth, targeted poverty reduction, social protection programs and increase in pro-poor spending has created gainful employment opportunities and lifted millions of people out of poverty in the rural and urban areas. The unemployment rate has declined from 8.3 percent in 2001-02 to 6.2 percent in 2005-06. The poverty measured on head count basis, decreased from 34.4 percent

in 2000-01 to 23.9 percent in 2004-05. The trend of poverty reduction is more pronounced in the rural areas.

GDP Growth: The 7 percent real GDP growth in 2006-07 has been supported by the robust growth in agriculture and services sectors. The agriculture sector is estimated to record a growth rate of 5.0 percent. However, the growth of large-scale manufacturing (LSM) is likely to be around 8.8 percent.

Agriculture: The record output of wheat at 23.5 million tonnes and sugarcane 54.7 million tonnes would be significantly higher than the output in 2005-06 and would exceed the targets for the current year. The cotton crop at 13.0 million bales is close to the production level of 2005-06, while the rice output is slightly lower than the previous year level. The strong livestock production has significantly contributed to the increased growth in the agriculture sector.

Manufacturing: A large number of industrial items show significantly higher growth. The production of sugar, paints and varnishes, cement, steel products, cotton yarn, caustic soda, electric motors, refrigerators, bicycles all posted double-digit growth. The cement industry's high growth (18.4 percent) is mainly attributable to enhanced installed capacity during the last five years and the rise in local as well as external demand. Similarly, the growth in sugar production at around 46.3 percent is partly due to about 23 percent increase in the sugarcane production during the *kharif* of 2006-07.

Services: Based on the growth in value-added in agriculture and manufacturing sectors and increase in imports, the services sector is estimated to grow by 8.0 percent, well above the target of 7.1 percent. The growth is likely to be much higher in services sub-sector such as Transport, Storage and Communications (5.8 percent), Finance and Insurance (18.2 percent), Ownership of Dwellings (3.5 percent), Public Administration and Defence (7.0 percent) and Social, Community and Personal Services (8.5 percent).

Investment and Savings: The total investment in 2006-07 is expected to increase by 21.4 percent (23 percent of GDP) and fixed investment by 21.9 percent to Rs 1864 billion (21.4 percent of GDP).

Balance of Payments: Exports at \$ 17.2 billion in 2006-07 are 5 percent higher than exports in 2005-06. The imports at \$ 27.1 billion are 10 percent higher than imports of \$ 24.6 billion in 2005-06. The trade deficit for the year is estimated at \$ 9.9 billion against the deficit of \$ 8.3 billion during 2005-06. The invisibles balance is anticipated to register a surplus of \$ 2.8 billion. On this basis, the current account deficit is likely to be around \$ 7.1 billion (5.0 percent of GDP) for the year 2006-07.

Fiscal Developments: The Budget 2006-07 estimated an overall fiscal deficit of Rs 373.5 billion (4.2 percent of GDP). Tax revenues collected by the Central Board of Revenue (CBR), during July-April 2006-07 increased more than 18 percent to touch the level of Rs 646.9 billion as against collection of Rs 547.0 billion for the corresponding period of 2005-06. It constitutes 77.5 percent of the full year target of Rs 835.0 billion. The direct taxes at Rs 2993.3 billion recorded the highest growth of 48.8 percent, followed by federal excise (17.8 percent) and sales tax (6.2 percent).

Monetary Developments: In view of high inflation, the State Bank of Pakistan has tightened the monetary policy, by raising simultaneously the discount rate, the cash

requirement on demand deposits, and the statutory liquidity requirement of demand and time deposits. The monetary expansion upto May 12, 2007 stood at Rs 477.9 billion (13.99 percent). The current trends indicate that monetary expansion for the full year would be around 14.2 percent.

Inflation: The underlying inflationary pressures in the economy continued to ease in 2006-07, with Consumer Price Index (CPI) inflation during July-April 2007 declining below 8 percent. The non-food inflation witnessed an increase of 6.2 percent as compared to 8.8 percent increase in the corresponding period in 2005-06. However, the annualized increase in food prices accelerated to 10.2 percent from 7.0 percent in the same period of 2005-06.

PSDP: During the fiscal year 2006-07, Federal PSDP is expected to achieve an expenditure level of 98 percent which is Rs 246 billion of net PSDP size of Rs 250 billion. This significant improvement in utilization of PSDP is due to timely disbursement of the funds allocated for the purpose.

Prospects for 2007-08: The real GDP growth of 7.2 has been envisaged for the year 2005-06 on the basis of growth of commodity sectors by 7.4 percent and services sector by 7.1 percent. In order to achieve these targets, total investment is targeted to increase by 19 percent to Rs 2.4 trillion which will be financed through national savings and foreign savings by 79 percent and 21 percent respectively.

The federal **PSDP** in 2007-08 envisages an investment of Rs 335 billion, up by 24 percent as compared to the last year level of 27 percent. The provinces would spend Rs 150 billion during the year out of the increased revenue transfers under the NFC award which is 30 percent higher over the transfer of Rs 115 billion in 2005-06. An additional amount of Rs 35 billion has been allocated for the reconstruction and rehabilitation of earthquake hit areas. Moreover, the public sector organizations like WAPDA, NHA, OGDC, SSGC, SNGPL, PIA, CDA will invest an amount of Rs 204 billion during the year. In all, a sum of Rs 724 billion would be the overall development program which is a record investment outlay.

Exports are projected to grow by 10 percent to \$ 18.9 billion. Implementing various measures suggested under Pakistan Export Plan 2007-13 is likely to accelerate this process. **Imports** for 2007-08 are projected to increase by 9 percent to \$ 29.6 billion. The trade account is projected to be in deficit by \$ 10.6 billion. The workers remittances are projected at \$ 5.8 billion against the expected level of \$ 5.5 billion for 2006-07. Allowing for other invisible receipts and payments, the surplus on the invisible account is anticipated at \$ 2.5 billion against a surplus of \$ 2.8 billion estimated for 2006-07. With a deficit of \$ 10.6 billion on the trade account and a surplus of \$ 2.5 billion on the invisible account, the **current account deficit** is estimated to be close to \$ 8.1 billion in 2007-08 against a deficit of \$ 7.1 billion in 2006-07.

Taking into consideration the transactions of the banking system and a build up of \$ 2.8 billion in foreign exchange reserves, the gross **reserves** are expected to reach the level of \$ 17.7 billion in 2007-08, compared to a level of \$ 14.5 billion in 2006-07.

The main thrust of **fiscal policy** during the year 2007-08 would be on strengthening the reforms in the tax system which would further broaden the tax base at the federal, provincial and district level, improve the tax compliance and minimize tax evasion. The main objective of policy would be to allocate adequate resources for development activities particularly for pro-poor expenditure in conformity with the

Fiscal Responsibility and Debt Limitation Act, 2005 to achieve projected economic growth of above 7.0 percent and further reduce the unemployment and poverty levels and improve social indicators.

The State Bank of Pakistan would continue to follow tight **monetary policy** to curb the inflationary pressures. The monetary expansion for the year 2007-08 will be around 14.4 percent. The CPI **inflation** during 2007-08 is targeted at 6.5 percent.

Poverty Reduction and Human Development: The Medium Term Development Framework and Vision 2030 attach high priority to reduce poverty by articulating holistic policies and development synergies across sectors. Despite a sharp reduction in poverty by 10.6 percentage points in recent years, it is still pervasive and almost one out of four persons in Pakistan remains below the poverty line. The pro-poor expenditure as percentage of GDP has been continuously rising in the last seven years reaching a benchmark of 6 percent of GDP in 2005-06.

Social Indicators: Pakistan's ranking in the Human Development Index has moved up by 10 places from 144 in 2001 to 134 in 2004. The social indicators depict a visible improvement as the gross enrolment ratio increased from 83 percent in 2001-02 to 94 percent in 2005-06, literacy rate from 45 to 54 percent, infant mortality rate (per 1000 live births) was reduced from 82 in 2001-02 to 70 in 2005-06 and the share of water supply and sanitation increased significantly.

Sectoral Development Programs

Agriculture Development: Introduction of high yielding varieties of crops, increased use of chemical fertilizers and pesticides, farm mechanization, development of irrigation facilities, implementation of price mechanism, credit and other policies and support for agricultural education, research and extension are core areas of development in the agriculture sector. Agriculture presently accounts for nearly 22 percent of GDP, employs 45 percent of labour force and is a source of livelihood for about two-thirds of the population. To meet the growing food needs of population, to increase our export earnings and to overcome the social deficit, agriculture development is crucial. Government has significantly enhanced allocations to this sector reflecting a 13 times increase over a period of 5 years.

The balanced application of fertilizer has played an important role in boosting crop production. Conservation of irrigation water, development of culturable waste land, integrated pest management, agriculture sector loans, use of quality seeds, compliance WTO regulations, higher spending on research and development especially in bio-technology are some of the major programs of agriculture sector.

Livestock: Livestock is an important sub-sector of the economy contributing 49 percent of the agriculture value addition and 11 percent of the GDP. Consequently, the development of livestock has strong linkages with other sectors including rural development, environment and poverty alleviation. The potential of livestock sector is yet to be explored through provision of adequate nutritious feed, improved coverage against diseases, artificial insemination and adoption of modern animal husbandry practices. Similarly, the production of fisheries can also be enhanced through exploitation of marine resources and aquaculture development programs. The milk and meat production has registered growth of 6.2 percent and 6.6 percent respectively during 2006-07. The fish production was 3.3 percent higher than production in 2005-06.

A new project 'Improving Reproductive Efficiency of Cattle and Buffaloes in Small Holders Production System' is being launched in collaboration with public sector organizations. Quality semen will be provided to the farmers at subsidized rate and facilities of embryo transfer will be extended to private sector on the same lines. The semen production and processing facilities will be strengthened both in the public and private sectors to improve local non-descript breeds of cattle.

Water Resources Development: The broad objective of water resources development is to uplift the agro-based economy at the national level by maximizing crop production through progressively increasing surface water supplies and conserving them by means of latest available technologies and protecting land and infrastructure from water-logging and salinity, floods and soil erosion in an integrated manner. The goals also include catering to the increasing demand for drinking water and for industrial and commercial activities in a cost effective manner.

The year 2006-07 focused on the irrigation, drainage and flood control sub - sectors. The maximum resources were allocated to complete the on-going projects and high priority storage and canal projects in an effort to overcome the scarcity of water. For 2007-08, water sector has been given the highest priority in the budgetary allocations which are 24 percent higher than the allocations of 2006-07. The main strategy is to increase the water storage capacity and canal lining for the irrigation sector.

Energy: Energy is the lifeline of economic development. It is planned to optimize utilization of country's indigenous resources to reduce dependence on imported fuel. The total investment required for the energy sector during the next 25 years has been estimated at \$ 150 billion (\$ 50 billion in the public sector and \$ 100 billion in the private sector). This works out to an annual average investment of \$ 6 billion and calls for doubling of the current investment level.

On the oil sector, it is planned that the number of exploratory and development wells would increase from at least 100 wells per year during the MTDf period (2005-10) to 330 wells per year during 2025-30. Plans have also been made to accelerate the exploration of indigenous coal while the import of coal in the short run for the power sector will be encouraged. An allocation of Rs 60 billion including foreign aid of Rs 30 billion has been made for the power sector for 2007-08.

Manufacturing: The manufacturing sector as a whole grew by 8.4 percent during 2006-07 with Large Scale Manufacturing (LSM) growing at 8.8 percent and the small scale manufacturing at 8.1 percent. The industries contributing to the LSM growth are textiles, sugar, cement and basic metals. Since the manufacturing sector still revolves around the traditional low value added industries and its share in world trade is continuously declining, therefore the major challenge facing Pakistan is to diversify its manufacturing sector, develop SMEs and enhance productivity.

Mineral: Despite its vast potential, the mineral sector has not been developed and efforts will be required to create awareness about the potential of the mineral sector of Pakistan through holding of events, exhibitions, production and dissemination of promotional material both for the foreign and local investors.

Transport and Communication: The development in this sector aims at facilitating competitive economy while ensuring safety and effective connectivity using the existing capacity. The sector currently contributes around 11 percent in GDP and provides employment to around 2.3 million people. The sector is faced with numerous constraints. For example, about 60 percent of maintenance funds are

spent on national roads, which leaves little room for provincial and district roads. Roads, ports and railway provide the necessary links to the exporters to reach their targeted markets. Nearly 95 percent of country's exports are handled through the national ports. Growth in telecommunication sector has been remarkable. Teledensity has risen to 42 showing visible expansion in the telecommunication services.

Physical Planning and Housing: During the year 2006-07, an amount of Rs 10 billion was provided for undertaking PP&H activities at the Federal level, including a provision of Rs 4 billion by the provincial programs. The allocations for the sector for 2007-08 stand at Rs 12 billion, including an amount of Rs 6 billion for the 'Clean Drinking Water for All' Program, reflected in the Environment Sector. The overall strategy pertaining to Physical Planning and Housing (PP&H) sector aims at the development of urban areas and cities, housing, drinking water supply and sanitation. The strategic thrust of urban policy will be related to ensuring the integrated fast track urban development including enhancing the rural-urban complementarities and linkages to improve productivity and sustainable development.

Mass Media: Total allocations for the mass media amounted to Rs 869.4 million in 2006-07. Two studios each at five stations were digitalized. The allocations for mass media for the 2007-08 stand at Rs 2,100 million. The Master Control Rooms in all five stations will be modernized and 27 new FM radio stations will be established across the country. The focus of the policy for mass media is on modernization of the country's premier news agency 'Associated Press of Pakistan' and strengthen the technological base of public sector electronic media through replacement of the existing electronic equipment by the state of the art equipment.

Culture, Sports, Tourism and Youth Affairs: To promote Culture, Sports, Tourism and Youth Affairs, an amount of Rs 1,100 million has been proposed which will be spent both on the ongoing as well as on the new projects. The strategy would be to provide appropriate incentives for greater private sector investment in tourist facilities. The main emphasis will be to involve Pakistan Embassies/Missions abroad to promote tourism. The focus of the culture policy is to promote education in arts and culture, development of arts institutions and galleries and provision of financial assistance to arts organizations.

Education: The scale and quality of education in general and the scale and quality of scientific/technical education in Pakistan in particular are areas of serious concern. During the past few years the country is recovering from the previous investment shortfalls with heavy public sector development expenditure in this vital sector touching close to 2.5 percent of the GDP. Though this is still less than the desired level however, government is striving hard through the promotion of primary education and higher education.

During the year 2006-07, an amount of Rs 6,598.6 million was provided for basic and college education. The major achievements in this sector include enrolment of children aged 5-7 years which increased from 54 percent to 80 percent in 48 districts of Pakistan. The National Institute of Science and Technical Education (NISTE) trained 429 Science and 330 Technical Teachers. For 2007-08, an allocation of Rs 7,077.9 million has been made for this sector. The targets for 2007-08 include establishment of 13 new cadet colleges and training of science teachers and technical teachers at the national level.

Higher Education: The Government policy for promoting higher education is driven by the objective of transforming the development of indigenous universities into the world-class centers of education, research and development so as to develop Pakistan as a knowledge-based economy. In the 2006-07, a total amount of Rs 14.3 billion was allocated for Higher Education Commission (HEC). In 2007-08, 2861 scholarships would be awarded for completing Ph.D. degrees. A pool of 224 highly qualified foreign professors was placed on long-term assignment with universities, 122 researchers have been sent abroad to pursue their Post-Doctoral research. An amount of Rs 18 billion for 2007-08 has been allocated for the HEC. The targets include establishment of 4 new engineering universities, 1000 indigenous Ph.D. scholarships and hiring of 75 faculty members under foreign hiring program.

Science and Technology: For 2006-07, a total amount of Rs 5,499 million was allocated for Science and Technology sector. A total of 25,514 water samples were collected and diagnostic tests completed by PCRWR; 18 new monitoring laboratories in 24 districts were developed; water supply assessment survey and installation of 24 pilot demonstration water conditioning and treatment plants were completed. For 2007-08, an amount of Rs 4,829 million has been allocated for this sector. The major targets for 2007-08 include construction of 18 water labs, 24 Water Filtration Plants and Monitoring of 1000 water supply schemes.

Information and Communication Technology: Information Technology remained a priority area of Government in line with MTFD 2005-10's focus of moving towards a competitive and technologically driven knowledge economy. The initiatives focused on mainly three areas i.e. human resource development, strengthening of IT industry and e-enablement of Government/public sector organization. For 2006-07, an allocation of Rs 5,963 million was made to the Information and Communication Technology Sector. Major schemes included; Provision of Computer Science Teachers and Computer labs in 1098 secondary/higher secondary and inter colleges all over the country which were equipped with 17,500 PCs. The target of IT export was US \$ 108 million which is expected to be achieved. On the telecommunication side, there has been phenomenal growth especially in the mobile phone sector increasing the teledensity to above 38%. The trend is expected to continue in future. Major projects on telecom side included; establishment of optical fiber based transmission link for establishing coastal communication link and expansion and improvement of telecommunication facilities in Northern Areas.

For 2007-08, an allocation of Rs 7,231 million is allocated to ICT sector to further promote the human resource development, IT industry development, e-government and infrastructure development. In this connection, 124 projects will be executed and major ones include the Federal Government Data Centre & Intranet, Replication of E-Office Applications at all Divisions of the Federal Government and purchase of land for IT Parks in Karachi, Lahore and Islamabad. On telecom side, the major initiatives include; Northern Areas Terrestrial MW Link, Rural Telecommunications and E-Services and High Performance Secure Network Architecture at Islamabad.

Health: Health interventions are an important area and attract attention as it is a major contributor to human development and poverty reduction. Strengthening the health system is a prime strategy so as to better serve the majority of population. A balanced approach between preventative, promotive and curative interventions is being followed in view of the needs of population with focus on Women and Children. Attention will also be paid to the epidemiological transition and the emergent double disease burden. Another area of focus is improving surveillance and health information system which would help in better planning and monitoring. At the same time, the policy is to focus on improving the health infrastructure particularly in rural

areas as well as in the tertiary sector. Commensurate with the spirit of devolution, it is planned to integrate health initiatives with community approaches.

Population: The population growth rate has been brought down to about 1.8 percent per annum and the total fertility rate has been lowered to 3.13 per women. In 2007-08, 2803 family welfare centres (FWCs) and 297 Reproductive Health Centres will be established.

Employment: A sizeable reduction in the unemployment rate has been achieved from 8.3 per cent in 2001-02 to 6.2 percent in 2005-06. The labour absorption is faster for the rural areas and the female workers. The participation rate for female workers increased from 11.2 per cent in 2003-04 to 13.3 per cent in 2005-06, thus reducing the female unemployment rate from 12.8 per cent to 9.3 per cent during this period. The Annual Plan for 2007-08 envisages creation of additional jobs for 780,000 unemployed workers during the year. The major initiatives to attain the targets include President's *Rozgar* Scheme, National Internship Program, and expansion of technical and vocational training facilities.

Women Empowerment and Social Welfare: The government is committed to social, political and economic empowerment of women which is not only a cross-cutting issue in the MTFD but specific interventions programs have been designed to bring women in the mainstream of development activity. Specific targets include enhanced availability of microfinance services, especially to the rural poor women, establishment of Women Crisis Centers for destitute women and District Resource Centers for the female elected representatives of local governments. The social welfare services for the vulnerable and special population will be strengthened through public-private partnership during the year 2007-08.

Rural Development: The rural development is being achieved by adopting a holistic policy that encompasses development of agriculture, augmenting social and physical infrastructure in the rural areas, strengthening local government institutions, involvement of community in development activities and poverty reduction through a set of coherent policies including social mobilization of the poor and their access to microfinance. Rural livelihood through development of non-farm and livestock sectors is the key area of interaction during the fiscal year. To achieve the targets set in the Annual Plan 2007-08, the Rural Development Sector has been allocated Rs 6.2 billion as compared with the allocations of Rs 3.7 billion for 2006-07. Specific initiatives for drought-hit areas have been proposed for implementation in 2007-08 to mitigate the effects of drought through implementation of water and infrastructure projects the rebuy increasing opportunities of livelihood and poverty reduction.

Environment: There is an increasing awareness that pursuit of growth and development place heavy burden on environmental resources. One of the principal objectives of the MTFD relates to establishing an environment friendly and just and sustainable economic system. The focus of the environmental policy is on integration of social and environmental considerations into the development process in all the sectors of the economy. The policy aims at an equitable sharing of environmental benefits, increasing management of national resources and integrating environmental issues into socio-economic planning so as to achieve sustainable development.

Good Governance: Good governance is one of the core issues in the agenda of economic reforms. These include strengthening of decentralization process, capacity building and strengthening of public sector institutions, access to justice program, corporate governance, public-private partnership and undertaking reforms in the

public sector including the financial administration. Progress has been made in reforming the judicial system through Access to Justice Program which includes amendment/ enactment of several laws/rules. Tax Administration Reforms Project (TARP) is one of the key initiative which focuses on promoting voluntary tax compliance through facilitation of taxpayers and provision of incentive packages to the employees of CBR. This policy has yielded good results in terms of better tax collection while mitigating the difficulties of the taxpayers. The Annual Plan 2007–08 envisages strengthening of monitoring and evaluation of development projects to achieve better impact of funds spent through public sector development program.

The monitoring and evaluation system has been revamped. In 2006-07, monitoring of 500 development projects which consist of 92 percent of PSDP was conducted during 2006–07. This review helped in solving the critical issues that were constraining the implementation of projects. Similar number of projects would be reviewed during 2007–08.