4 Pakistan

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I. Introduction

Pakistan is situated in Southern Asia. The area of Pakistan is 796,095 square kilometers, slightly less than twice the size of California. It is bordered by India on the east, Iran and Afghanistan on the west, China in the north and Arabian Sea in the south. The name Pakistan is derived from the Persian words *Pak* (meaning pure) and *stan* (meaning territory). Pakistan consists of four provinces including Punjab, Sindh, Khyber Pakhtunkhawa and Balochistan, Federally Administered Tribal Areas (FATA), and Islamabad Capital Territory. The Punjab province has the largest population and the Balochistan province has the largest area.

Geography and Climate

Pakistan lies between latitude 24 degree and 37 degree North and longitude 62 degree and 75 degree East. Total land and water of Pakistan are 770, 875 square kilometers and 25,220 square kilometers, respectively. Total land boundary of Pakistan is 6,774 kilometers, with Afghanistan 2,430 kilometers, China 523 kilometers, India 2,912 kilometers and Iran 909 kilometers, respectively. The coastline is 1,046 kilometers.

Pakistan is a land of great diversity. It ranges from northward coastal beaches, lagoons and mangrove swamps in the south to sandy deserts, desolate plateaus, fertile plains, and upland in the middle and high mountains with beautiful valleys, snow-covered peaks and eternal glaciers in the north. Pakistan is divided into six major regions including, the North High Mountainous Region, the Western Low Mountainous Region, the Balochistan Plateau, the Potohar Upland, the Punjab, and the Sindh Plains.
Stretching to the north, from east to west is a series of high mountain ranges including the Himalayas, the Karakoram and the Hindu Kush, which separate Pakistan from China, Russia and Afghanistan. This region, which is congregation of 35 giant peaks over 24,000 feet (7,315 meters) high, is highly popular among world mountain climbers. Many peaks are higher than 6,000 feet. The height of the world's second highest peak K2 (the "K" stands for the initial letter of the name of mountain Karakoram) is at 28,250 feet.
Pakistan has four seasons including spring, summer, autumn, winters, and spring. Spring starts from March and ends in May. The weather remains pleasant during this short duration period. After spring, summer season starts from June and ends in September. This period is characterized as hot, dry and rainy season. Autumn comes during October and September, which is characterized by falling leaves with floors of grounds covered with leaves. Winter starts from December to February, which is characterized by cool and dry weather.

Pakistan has continental type of climate characterized by hot, dry desert, temperate and arctic with extreme variations of temperatures. The areas close to the snow-covered mountains are cold. Temperatures on the Balochistan Plateau are comparatively high. Along the coastal strip, the climate is modified by sea breezes. In the rest of the country, temperature rises steeply in the summer and hot winds called "loo" blow across the plains during the day. The temperature soars to 40 degree centigrade and beyond. The highest recorded temperature at Jacobabad is 53 degree centigrade. Winters are cold with average minimum and maximum temperature 4 degree and 18 degree centigrade respectively. Pakistan experiences a general deficiency of rainfall. In the plains the annual average ranges from 13 cm, in the northern parts of the lower Indus Plains to 89 cm in the Himalayan Region. Rains are of monsoon origin and fall late in summer.

Pakistan has a wide variety of natural resources. These include land, extensive gas reserves, limited petroleum, poor quality coal, iron ore, copper, salt, limestone, etc. The country is exposed to earthquakes, occasionally severe especially in north and west; and floods along the Indus after heavy rains during July and August. Water pollution from raw sewage, industrial wastes, and agricultural runoff is an important current environment problem in the country. The other issues include limited natural freshwater resources, limited access of most of the population to potable water, deforestation, soil erosion and desertification.

People and Culture

Population growth rate in Pakistan is quite high as compared to other countries since its creation. When measured by population size it has moved from the thirteenth largest country in 1950 to the sixth largest country in 2011. According to World Bank projection it will become the fifth largest country by 2050. By 1st July 2012, Pakistan's population is around 180.71 million (Economic Survey of Pakistan 2011-12). Some of the selected demographic indicators for the period 2006-07 to 2011-12 are posted in Table-1.

Table-1: Selected Demographic Indicators

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Total Population (Million)	162.91	166.41	169.94	173.5	177.1	180.71
Urban Population (Million)	56.82	58.74	60.87	63.05	65.3	67.55
Rural Population (Million)	106.09	107.67	109.07	110.46	111.8	113.16
Total Fertility Rate (TFR)	3.9	3.8	3.7	3.6	3.5	3.4
Crude Birth Rate (Per thousand)	29.1	28.7	28.4	28.4	27.5	27.2
Crude Death Rate (Per thousand)	7.9	7.7	7.6	7.6	7.3	7.2
Population Growth Rate (Percent)	2.12	2.1	2.08	2.1	2.05	2.03
Life Expectancy (Year)						
Females	62.7	63	63.3	65.4	65.8	66.1
Male	64.1	64.5	65	63.6	63.9	64.3

Source: P&D Division, National Institute of Population Studies

In absolute numbers, Pakistan's population has increased from about 163 million in 2006-07 to about 181 million in 2011-12, an increase of about 6.8 percent during the period. Though population growth rate has declined from 2.12 percent to 2.03 percent during 2006-07 to 2011-12, but it is still one of the highest amongst nine most populous countries of the world. Average life expectancy has improved during the period 2006-07 to 2011-12.

The people of Pakistan speak many languages and dialects, reflecting the country's ethnic diversity. Main ethnic groups include Punjabi 44.68%, Pashtun (Pathan) 15.42%, Sindhi 14.1%, Sariaki 8.38%, Muhajirs 7.57%, Balochi 3.57%, others 6.28%, respectively. The main regional languages are Punjabi, Sindhi, Saraiki, Pashtu, Balochi, Hindko, Brahui, etc. Urdu is a national language and its use is encouraged to foster unity. Main official language is English and is used in government offices and as medium of education.

Dress code varies from province to province and region to region within provinces. Common dress used in both rural and urban areas is *shalwar-qameez*. Usually it is made of cotton. It differs for men and women. Men wear solid, plain colors and add a vest or coat for a formal occasion. The women, however, wear bright patterned colors, with more tailoring. Women also wear a *dupatta* (long scarf). The joint family system is quite common. In a joint family system father, mother, children and their families live together in the same household. The presiding male of the family has significant influence over the lives of all family members. The elder members of the family grandfather and grandmother etc. are highly respected. Arranged marriages are still a standard tradition. *Chapati* or *roti* unleavened bread similar to pita bread) is a staple food in Pakistan although rice is also a part of most meals and deserts. The food is generally spicy and oily.

Pakistan has been the cradle of a civilization that dates back more than five millennium. Over the centuries, through successive waves of migrations from the north-west, as well as by internal migrations across the subcontinent, Aryans, Persians, Greeks, Arabs, and Mughals came and settled in this region. However, it was Islam and Islamic traditions that finally took roots and formed the mainspring of Pakistan's cultural heritage. Muslims from the earliest days, built cities, forts, palaces, mosques, tombs and mausoleums which are marked by simplicity and grandeur, with open spaces and abundance of light. Pakistan therefore, inherits immense treasure of culture.

History and Political Structure

Pakistan came into being after the Indian sub-continent was divided into two parts namely Pakistan and India on August 14, 1947. But it has its roots into the remote past. The Indian sub-continent was occupied by the British government in middle of the 19^{th} century. The British ruled over sub-continent continued for almost one century. During the British era, the Muslim started struggle for independence under the leadership of Muhammad Ali Jinnah. The struggle strengthened in 1940s and culminated in separation of Indian sub-continent. Initially, Pakistan consisted of two wings: the East wing and the West wing. The East wing separated in 1971 and became Bangladesh. The present Pakistan is the West wing and has been administratively divided into four provinces, Federally Administered Tribal Areas (FATA) and Islamabad Capital Territory. The four provinces are Punjab in the East, Sindh in the South-East, Balochistan in the South-West and Pakhtunkhawa (formerly known as North-West Frontier Province) in the North-West.

According to the constitution of the Islamic Republic of Pakistan 1973, there shall be federal parliamentary system of government in the country, with President as Head of the State and Prime Minister as Head of Government and the country's Chief Executive. The Parliament of Pakistan consists of the President and two Houses known as the National Assembly and the Senate. The National Assembly is elected for a five year term on the basis of adult franchise.

In a country with 97 per cent Muslim population, and minimum chance of Non-Muslim securing a general seat, 10 seats have been reserved for Non-Muslims in a House of 342 seats. Out of total seats of the lower house, 60 seats are reserved for women. The Senate of Pakistan is the Upper House of the Parliament. The Senate derives equal representation from all the four federating units namely Punjab, Sindh, Balochistan, Pakhtunkhawa, and Federally Administered Tribal Areas (FATA), and Islamabad Capital Territory. Total membership of senate is 99. The Provincial Assemblies of the four Provinces elect 22 members each from their respective provinces. The Federally Administered Tribal Areas (FATA) is represented by 8 members, whereas the Federal Capital has 3 seats in the Upper House of Parliament.

To administer the subjects falling within the jurisdiction of the Federation, there are Ministries, Divisions, attached departments, subordinate offices, autonomous and semi- autonomous bodies. A ministry may comprise one or more divisions. There are other statuary bodies having an important role in the affairs of the Federation, such as the Attorney General, the Auditor General, the Election Commission, the Federal Public Service Commission, the Council of Islamic Ideology, and Federal Ombudsman. Judiciary is headed by the Chief Justice of the Supreme Court and enjoys independence in dealing with judicial matters.

II. Overview of Macroeconomic Activity and Fiscal Position

The economy of Pakistan performed well in the early decades of its history. The average growth rate was 6.8 percent in the 1960s, 4.8 percent in the 1970s, and 6.5 percent in the 1980s, respectively. But average annual growth declined to 4.6 percent in the 1990s. The economic situation during the 1st decade of the 21st century was further declined because of numerous domestic and external shocks. The sharp rise in international oil and food prices, the internal security hazards brought on by the campaign against extremism and the repeated natural disasters in the form of successive floods have rocked the macroeconomic strategy. At domestic level, two huge floods, the difficult security situation and the energy crisis have combined to significantly impact economic growth. The campaign against extremism with its associated destruction of physical infrastructure, the displacement of thousands of people from the affected areas and the associated rise in expenditure to support the moved people have also contributed towards deterioration of economic situation. The growth in the export markets slowed down compared to last year. Gross Domestic Product (GDP) growth, which was 6.8 percent during 2006-07 was declined to 3 percent during 2010-11 and projected at 3.7 percent during 2011-12 based on nine month data. It was at half the level of Pakistan's long-term trend potential of about 6.5 percent per annum and is lower than what would be required for sustained increases in employment and income and a reduction in poverty. The selected macro-economic indicators for the period 2006-07 to 2011-12 are posted in Table-2.

Table-2: Selected Macro-Economic Indicators

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12 (P)
Gross rates (percent)						
Real GDP (at factor cost)	6.8	3.7	1.7	3.1	3	3.7
Agriculture	4.1	1	4	0.6	2.4	3.1
Manufacturing	8.3	4.8	-3.6	5.5	3.1	3.6
Commodity producing sector	6.6	1.3	1.8	3.6	1.5	3.3
Services sector	7	6	1.7	2.6	4.5	4
Consumer Price Index (growth %)	7.8	12	20.8	11.7	13.9	10.8
Monetary Assets (M2)	19.3	15.3	9.6	12.5	15.9	8.1
Domestic Assets	14.2	33.6	15.4	12.7	13.1	13.7
Exports (fob)	4.5	18	-6.4	2.9	28.9	2.4
Imports (fob)	8	31.6	-10.3	-1.7	14.9	14
As % of GDP						
Total Investment	22.5	22.1	18.2	15.4	13.1	12.5
National Savings	17.4	13.6	12.5	13.1	13.2	10.7
Total Revenue	14.9	14.6	14.5	14	12.5	8.5
Tax Revenue	10.2	10.6	9.5	10.1	9.5	6.7
Total Expenditure	19.1	22.2	19.9	20.3	19.2	12.8
Overall Deficit	4.3	7.6	5.3	6.3	5.9	4.3

P: Provisional
Source: Economic Survey of Pakistan 2011-12

The performance of macroeconomic indicators during 2006-07 to 2011-12 has been given in Table 2. Agriculture accounts for more than 1/5th of output and 2/5th of employment. The growth of agriculture sector was not impressive during the period as it recorded a modest growth of 3.13 percent during 2011-12 based on nine month data which is better than 2.4 percent last year. The floods and heavy rains of 2010 and 2011 destroyed the crop standing crops. Other factors that are contributing to low agricultural growth include poor soil management, inefficient methods of fertilizers application, poor crop management practices, water shortage and lopsided marketing system for agriculture produce.

There was a significant declined in the growth of manufacturing sector from 8.3 percent in 2006-07 to 3.6 percent in 2011-12 but better than 3.1 percent of last year. The Large Scale Manufacturing sector grew by 1.78 percent as compared to the target of 2.0 percent and against the growth of 1.15 percent in the last year. Important factors hindering growth of manufacturing include acute shortage of electricity, skyrocketing oil prices, law and order situation and global contraction. The Services sector recorded steady growth of 4.02 percent as compared to 4.45 percent in 2010-11. Macroeconomic data is indicative of the fact that the economy has started showing signs of modest recovery because the commodity producing sectors, the agriculture sector, the Large Scale Manufacturing (LSM) sector and the service sector have started showing better performance. Pakistan has the potential to grow at 6 to 7 percent in the next couple of years.

Some of Pakistan's economic problems are structural in nature. The objectives of sustaining high growth, low inflation, and external payment viability cannot be achieved without removing certain structural barriers. The major reforms programs of the government include reforms in tax legislation, trade reforms, further privatization of State Owned Enterprises (SOEs), financial sector reforms, human resource development and social protection.

The EU approval of duty waiver on textile items of Pakistan as pursued aggressively, would help in improving the exports and providing support to the business environment. In recent times, Pakistan has also undergone political and constitutional changes. Civil societies and other organizations are now playing a more active and independent role and this coupled with government reforms are helping economic growth.

II. A. International Environment

Under Bretons-Woods System, the member countries were required to maintain fixed exchange rate and stable fixed accounts. There were strict controls over capital flows. The demand for and supply of foreign exchange arises because of exports and imports. But after collapse of Bretons-Woods System in 1971, the capital began to flow rapidly across countries. The demand for and supply of foreign exchange not only arises on CA side due to exports and imports but also on S-I side due to investment in financial and real assets across the countries. Countries in the world become more and more integrated with rapid flows of capital, labour and goods across borders. As the economic theories enumerated the benefits of openness of economies more than the closed economies, there started a struggle among countries to increase trade volume. The measure of trade (Exports + Imports) to GDP ratio gives an idea about openness of an economy. Pakistan's trade to GDP ratio has increased from 25.8% of GDP from 1999-2000 to 36% of GDP in 2007-08, which indicates its greater integration with the world economy.

However, the unfavorable global environment has slowed down the world output and trade volume during 2011. The world output which grew by 5.3 percent in 2010 decelerated to 3.9 percent in 2011. The global economic contraction caused a sharp decline in the growth of world trade. Against the strong pick up of nearly 13.0 percent in 2010 the growth of world trade dropped to 5.8 percent in 2011. The global economic slowdown and consequential decline in the growth of world trade has also depressed the international commodity prices. The prices of non-fuel commodities witnessed a deceleration from 26.3 percent in 2010 to 17.8 percent in 2011 and projected negatively for 2012. These developments can be attributed to the ongoing European Sovereign Debt Crisis, the turmoil in the Arab Countries and the natural disasters that hit Thailand and Japan which caused disruptions in the supply chain. The growth in world output and trade volume is projected to decelerate further during 2012 due to the downside risks of deepening of the sovereign debt crisis and worsening financial stress, increase in oil prices, and geo-political risks. It is projected that world output will grow by 3.5 percent and trade volume will increase by 4.0 percent during the period.

As the external shocks are also translated in the integrated economies, amid the difficult global economic environment, the slowing down of the world trade, the drop in international commodity prices, and the energy shortages domestically, the exports from Pakistan remained higher by US$ 14.0 million during July-April 2011-12 over the same period last year and stood at $ 20,474 million. During the period July-April 2011-12, the growth of imports at 14.5 percent remained more or less the same as the corresponding period's growth in the previous period. Les exports and more imports led to huge trade deficit mainly because of global economic recession.

III. A.1 Balance of Payment Account

Balance of payment is the credit and debit record of all transactions arising due to international trade as well as international finance during the financial year. The current account (CA) is the credit and debit record of transactions arising because of international trade mainly exports and imports. Capital Account (KA) is the credit and debit record of transactions arising because of international finance such as borrowing and lending, financial investment and loans. The surplus (deficit) in CA must be equal to deficit (surplus) in KA and discrepancy between the two account is removed through foreign exchange reserves. The financial account posted a surplus of $1,200 million during July-April 2011-12 against a surplus of $690 million in the corresponding period last year. The balance of payment account from 2006-07 to 2011-12 is given in Table-3.

Table-3: Summary Balance of Payments

(US$ Million)

Items	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12* P
Current Account Balance	-6878	-13,874	-9,252	-3,946	214	-3,394
Trade balance	-9711	-14,970	-12,627	-11,536	-10,516	-12,683
Goods: Exports	17278	20,427	19,121	19,673	25,356	20,474
Goods: Imports	26989	35,397	31,747	31,209	35,872	33,157
Services Balance	-4170	-6,457	-3,381	-1,690	-1,940	-2,347
Services: Credit	4140	3,589	4,106	5,229	5,768	4,101
Services: Debit	8310	10,046	7,487	6,919	7,708	6,448
Income Account Balance	-3582	-3,923	-4,407	-3,282	-3,017	-2,655
Income: Credit	940	1,613	874	561	716	668
Income: Debit	4522	5,536	5,281	3843	3733	3323
Current Transfers Net	10585	11,476	11,163	12,562	15,687	14,291
of which:						
Workers' remittances	5494	6,451	7,811	8,906	11,201	10,877
Capital & Financial Account	10276	8,252	6,058	5,272	2,262	1,367
Capital Account	304	121	474	175	161	167
Financial Account	9972	8,131	5,584	5,097	2,101	1,200
Direct Investment	5140	5,410	3,720	2,151	1,635	668
Portfolio Investment (Net)	3283	32	-1,073	-65	338	-126
Other Investment	1663	2,764	2,962	3,087	172	721
Net Errors and Omissions	159	257	138	-60	16	-515
Overall Balance	3557	-5,365	-3,056	1,266	2,492	-2,542

P: Provisional, * July-April

Source: Economic Survey of Pakistan 2007-08 and 2011-12

II. A.2 Current Account

The current account deficit of Pakistan stood at $ 3,394 million during July-April 2011-12, largely caused by the widening of trade and services account deficit. However, continued support from current transfers in the form of workers' remittances helped in containing further increase in the current account deficit during the said period. The trade deficit expanded mainly due to the 14.5 percent growth in imports and the 0.1 percent increase in exports and therefore, leading to widening the trade deficit by 49.2 percent during the period. The major factor behind the widening of the trade deficit was the sharp rise in the import bill during July-April 2011-12 which increased due to the higher international prices of crude oil.

Commodity-Wise Performance of Exports

The total market value of exports depends upon nature of exported commodities that is primary products, secondary or tertiary products and secondly on quantity exported during the fiscal year. Group-wise analysis of exports growth suggests that the exports of the "other manufacturers" witnessed an impressive growth of 19.9 percent during July-April 2011-12 over the same period last year. Its share in overall exports also increased by 3.9 percentage points and stood at 20.0 percent during current fiscal year 2011-12. Jewelry, chemicals and pharmaceutical products, surgical goods & medical instruments, guar and guar products and engineering goods remained the prominent categories among the positive contributors to the overall increase in “other manufactures” group. Cement exports also increased by 3.5 percent during July-April 2011-12 against the fall of 9.9 percent during July-April 2010-11. This increase in cement export receipts is mainly the outcome of higher unit values, which increased by 12.9 percent during the period. However, the overall increase in “other manufactures” group was offset to some extent by the negative growth of carpets (5.9 percent), leather garments (15.6 percent) and cutlery (6.3 percent) during July-April 2011-12. The export category of carpets, rugs and mats declined due to increased competition from the neighboring countries of Pakistan.

The value of exports from the food group stood at $ 3509.7 million during July-April 2011-12 compared to $ 3597.6 million in the corresponding period last year, thereby showing a negative growth of 2.4 percent. In absolute terms this represents a fall of $ 87.9 million during the period. Further details reveal that the lower quantity of exports of most of the food items remains the major reason behind the overall decline. The unit values of different food items remained largely positive during the period. The major factors behind the overall fall in food exports remain wheat, rice and vegetables. In absolute terms these three items fell by $ 442.3 million during the first ten months of the current fiscal year 2011-12. Rice exports followed last year’s trend and declined by 3.2 percent during July-April 2011-12 because higher availability of rice internationally and higher proportion of non-basmati rice in the overall export quantum of rice.

Wheat exports declined due to the internationally lower demand and prices as quantity and unit value of wheat both witnessed a negative growth of 70.6 percent and 8.3 percent, respectively. On the other hand, fruits exports witnessed a major increase during 2011-12. In contrast to the 32.1 percent growth in July-April 2010-1, textile exports declined by 9.6 percent during July-April 2011-12 because of the energy crisis hitting the textile sector and the fall in international demand. Owing to this, the share of the textile sector in overall exports declined from 55.8 percent in July-April 2010-11 to 52.4 percent during July-April 2011-12. The negative effects of the energy shortages domestically and the slowdown of global demand are especially visible in the decline in the quantity of exports despite the increase in the unit values of the majority of items during the period July-April 2011-12. As a result, the quantum exports of high value added items such as knitwear, bed wear, towels and readymade garments have shown negative growth during the period.

The petroleum group export receipts declined by 29.0 percent during the first ten months of the current fiscal year compared to the same period last year owing to high international prices. This decline in the petroleum group is due to the decline in quantum export as petroleum products and naptha fell by 68.4 percent and 13.9 percent respectively causing a decline of $ 331.0 million in net absolute terms in export receipts from petroleum group over the corresponding period last year due to the circular debt problem in the country. The structure of exports during 2010-11 and 2011-12 is given in Table-4.

Table-4: Structure of Exports

(US$ Million)

Particulars	2010-11*	2011-12* P	% Change	Absolute Change
A. Food Group				
Rice	1792.2	1735.2	-3.2	-57
Fish & Fish Preparation	234.4	259.3	10.6	24.9
Fruits	252	322.4	28	70.5
Vegetables	211.7	131.9	-37.7	-79.8
Wheat	418.2	112.7	-73	-305.5
Spices	38.7	38.6	-0.3	-0.1
Oil Seeds, Nuts & Kernels	14.5	23.4	60.6	8.8
Meat & Meat Preparation	122	141.6	16	19.6
B. Textile Manufactures				
Raw Cotton	327.3	433.1	32.3	105.8
Cotton Yarn	1880	1451.7	-22.8	-428.3
Cotton Cloth	2081.2	1969.8	-5.4	-111.4
Knitwear	1870.1	1624.5	-13.1	-245.6
Bed Wear	1686	1453.1	-13.8	-232.6
Towels	607.8	556.5	-8.4	-51.3
Readymade Garments	1396.5	1326.6	-5	-69.9
Made-up Articles	509	472.7	-7.1	-36.3
C. Petroleum Group				
Petroleum Products	752.9	291.9	-61.2	-461
Petroleum Top Naptha	388.5	518.4	33.4	129.9
D. Other Manufactures				
Carpets. Rugs & mats	110.9	104.3	-5.9	-6.6
Sports Goods	262.9	269.2	2.4	6.2
Leather Tanned	370.8	358.7	-3.3	-12.2
Leather Manufactures	450.3	435.3	-3.3	-14.9
Surgical Goods & Medical.Inst	212.6	249.6	17.4	37
Chemicals & Pharma. Pro.	725.5	909	25.3	183.5
Engineering Goods	196.4	230.1	17.2	33.7
Jewellery	314.1	649.7	106.9	335.6
Cement	374.2	387.3	3.5	13.1

P*: Provisional, * July-April
Source: PBS

Major Exports

Pakistan is moving gradually towards higher value addition in exports of textile manufacturers. The shares of bed wear, knitwear and towels (value added exports) have increased while those of cotton yarn and synthetic textiles have declined. The shares of other components of textile manufactures either remained constant or fluctuated during the last decade.

The process of decrease in concentration of exports items continued in the current fiscal year (July-April 2011-12) as the share of other items in overall exports increased to 39.0 percent against the 28.5 percent during 2006-07, a 10.5 percentage points increase during the period. Moreover, the share of the other items category witnessed a 6.2 percentage points increase during July-April 2011-12 compared to the same period last year. In spite of this structural change in exports of the country, the major share of Pakistan's export is still concentrated in a few items with only three items (cotton manufactures, leather and rice) making up 61.0 percent of total exports during July-March 2011-12. Pakistan's major exports as percentage share are given in Table-5.

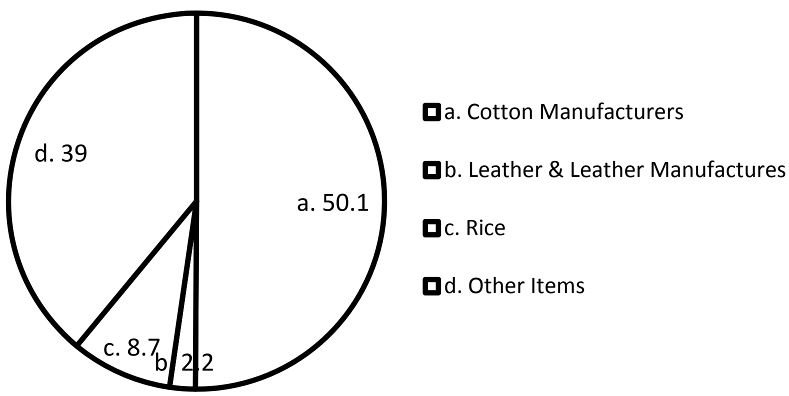
Table-5: Major Exports
(Percentage Share)

Commodities	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12* P
Cotton Manufacturers	59.7	51.9	52.6	50.6	52.9	50.1
Leather & Leather Manufactures	5.2	5.8	5.4	4.5	4.4	2.2
Rice	6.6	9.8	11.2	11.3	8.7	8.7
Sub-Total of three Items	71.5	67.5	69.2	66.4	66	61
Other Items	28.5	32.5	30.8	33.6	34	39
Total	100	100	100	100	100	100

*Provisional
Source: Pakistan Bureau of Statistics

Figure-1 presents decomposition of major exports of Pakistan during 2011-12. The share of cotton and cotton manufacturers was the highest about 50 percent in the total exports, whereas contribution of rice export was around 9 percent. The leather and leather manufacturers' exports were about 2 percent and the other exports were 39 percent.

Figure -1: Major Exports (%) 2011-12



* Provisional
Source: Economic Survey of Pakistan 2011-12

Country-Wise Exports Performance

The concentration of exports of a country may be one of the indicators of diversification. If the exports are concentrated into a few markets in the world, it is indicator that country's exports are comprised of some particular items. Whereas if exports are concentrated in many countries around the world, it indicates that exports are diversified in nature. Table-6 shows that Pakistan' s exports have been concentrated in a few markets in the world, which is indicative of the fact that Pakistan has not achieved high diversification in exports. But the trend of concentration in a few markets is declining meaning thereby that Pakistan is moving toward diversification in exports. The major markets of Pakistan's exports are USA, UK, Germany, Hong Kong, U.A.E etc. The share of these five markets in total exports of Pakistan was 46.4 percent in 2006-07, which has reduced to 35.2 percent in July-March 2011-12. As the share of these five market is on decline whereas the share of all other countries increased from 53.6 percent in 2006-07 to 64.8 percent in July-March 2011-12. This improvement in geographical diversification was mainly the result of the Strategic Trade Policy Framework (STPF-2009-12) introduced by the government and the resulting increase in exports to China, Afghanistan and Bangladesh.

Table.6: Major Exports Markets

(Percentage Share)

Commodities	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12* P
USA	24.6	19.5	18.9	17.4	16	14.7
UK	5.6	5.4	4.9	5.3	4.9	5.1
Germany	4.1	4.3	4.2	4.1	5.1	4.8
Honk Kong	3.9	2.7	2.1	2.2	2	1.6
U.A.E.	8.2	10.9	8.2	8.9	7.3	9
Sub-Total	46.4	42.8	38.3	37.9	35.3	35.2
Other Countries	53.6	57.2	61.7	62.1	64.7	64.8
Total	100	100	100	100	100	100

*Provisional
Source: Pakistan Bureau of Statistics

Commodity-Wise Imports

Imports result in outflow of capital and causes current account imbalances and, therefore, generally not popular among policy makers. Imports flow into the country either that country is not self-sufficient in production of these particular goods or the goods or cheaper in the international market compared to local market or both. Therefore, structure of imports a country is important.

Structure of imports of Pakistan indicates that food group imports accounted for 11.4 percent of total imports and showed a negative growth rate of 1.7 percent during July-April 2011-12 compared to last year due to decline in the quantity of imports of most of the food items despite the increase in the unit values of food group items. For instance, import bill of sugar declined by $ 665.0 million in absolute terms during July-April 2011-12 compared to the same period last year because of improved sugar production domestically due to higher crop production of sugarcane during the said fiscal year.

Moreover, the import bill of spices and pulses also witnessed a fall during the period. However, the import bill for edible oil increased by 16.5 percent and has added $ 273 million to this year's import bill due to higher international prices and higher domestic demand during the period, resulting in an increase in the palm oil import bill in absolute terms by $ 292 million. Palm oil imports surged in quantity, value and per unit value as it increased by 5.1 percent, 18.3 percent and 12.5 percent, respectively. In addition, the import bill for tea during 2011-12 also increased by 4.8 percent on the back of higher import prices during the period.

The Import of petroleum group products grew by 43.5 percent during July-April 2011-12 against the 8.4 percent growth in the corresponding period last year reflecting mainly the impact of higher international oil prices since per unit values of petroleum products and petroleum crude increased by 28.9 percent and 36.6 percent, respectively. Moreover, during July-April 2011-12, the petroleum group import bill increased by $ 3,815.3 million over the same period last year. Nearly 76.4 percent of this increase in the import bill is contributed by the price impact and 23.6 percent by the quantum impact. The increase in the petroleum import bill is also evident from the international monthly average prices of oil. These surged from $ 76.4 per barrel in July 2010 to $ 120.5 per barrel in April 2012. Moreover, the quantity of petroleum product imports increased by 31.7 percent while quantum imports of crude oil declined by 19.5 percent during July-April 2011-12. This phenomenon in quantum imports results from the effect of the circular debt problem in the country faced by refineries.

The import of consumer durables added $ 229.8 million to the overall import bill for July-April 2011-12. The contribution to the increase in consumer durables imports remained road motor vehicles. The import bill has been increased by $ 229.3 million. Moreover, the import of electric machinery and appliances also increased by 0.1 percent during the period. During July -April 2011-12, the increase in road motor vehicle imports was the outcome of higher import of complete build-up unit which increased by $ 234.3 million over the last year due to the import of cars and buses, trucks and other heavy vehicles categories increasing by 161.0 percent and 91.3 percent respectively during the current fiscal year period under review. Moreover, the complete knocked down-down (CKD)/semi-knocked-down (SKD) category of road motor vehicles also increased by 6.8 percent during July -April 2011-12. Within this category, motor cycles and buses, trucks and other heavy vehicles contributed positively during the period. Due to these developments, the import quantum and value of rubber tyres and tubes witnessed an increase of 25.4 percent and 14.4 percent respectively during July-April 2011-12.Increase in the overall import bill of consumer durables is generally the outcome of the fall in duties on automobiles, deep freezers, air conditioners and beverages along with the cut in taxes announced by government. Telecom imports grew by 22.9 percent during the first ten months of the current fiscal year. In absolute terms the import in the telecom sector witnessed an increase of $ 195.2 million. Out of the total increase in telecom imports, 65.4 percent has been contributed by mobile phone imports which grew by 29.0 percent and added $ 127.7 million to the import bill during July-April 2011-12 as compared to the corresponding period last year. This increase may be the result of increased availability of cheaper mobile phones in the country.

The machinery group imports decreased to $ 3148.4 million during the first ten months of the current fiscal year 2011-12 as against $ 3595.9 million in the corresponding period last year. Among the different items of the machinery group, textile machinery, air crafts, ships and boats and other machinery witnessed a decline during the period under review. The decline in textile machinery import may be attributed to the fall in external demand; decline in export prices; and, energy problems faced by textile sector.

On the other hand, the items which grew positively continued to be the power generating machinery, office machines, construction and mining machinery and agricultural machinery. Power generating machinery imports increased due to energy shortfalls in the country. As a result the import bill stood at $ 877.2 million during July-April 2011-12. The increase in import of construction and mining machinery reflects the increase in construction activities in the country. This improvement can be attributed to the start of public projects and is also the result of the increase in remittances which went primarily into the construction sector. The higher demand for agricultural machinery imports ($ 25.4 million) is mainly the outcome of remarkable improvement in the agriculture sector. The import of products in the raw material group surged by 7.4 percent and accounted for 22.4 percent of total imports during the period of July-April 2011-12. Within raw material imports, raw cotton declined in absolute terms by $ 483.4 million mainly due to increased availability of the crop domestically. The prominent increase witnessed in the imports of fertilizer is due to decline in domestic production owing to gas shortages. As a result the import bill of fertilizer increased by $ 582.1 million over the last year. Of this total increase around 87.6 percent was due to increase in quantity and the remaining 12.4 percent due to higher prices. The structure of imports is given in Table-7.

Table-7: Structure of Imports

(US$ Million)

	Particular	2010-11*	2011-12** P	% Change	Absolute Change
A. Food Group	Milk & milk food	129.5	134.3	3.7	4.9
	Wheat Un-milled	5.2	0	-100	-5.2
	Dry fruits	74.4	72.3	-2.8	-2.1
	Tea	288.3	302	4.8	13.7
	Spices	91.3	86.6	-5.2	-4.7
	Edible Oil (Soybean & Palm Oil)	1,660.30	1,933.60	16.5	273.3
	Sugar	679.9	14.4	-97.9	-665.5
	Pulses	344.6	320.3	-7.1	-24.3
B. Machinery Group	Power Gen. Machines	865.6	877.2	1.3	11.6
	Office Machines	195.6	239.8	22.6	44.2
	Textile Machinery	399.4	339	-15.1	-60.4
	Const. & Mining Mach.	98.6	111	12.6	12.4
	Aircraft Ships and Boats	713.5	305.8	-57.1	-407.7
	Agriculture Machinery	77.6	103	32.7	25.4
C. Petroleum Group	Petroleum Products	4,919.90	8,354.80	69.8	3,434.80
	Petroleum Crude	3,847.60	4,228.10	9.9	380.5
D. Consumer Durables	Electric Mach. & App.	674.8	675.3	0.1	0.5
	Road Motor Vehicles	1,082.80	1,312.10	21.2	229.3
E. Raw Materials	Raw Cotton	852.8	369.5	-56.7	-483.4
	Synthetic fibre	464.2	434.6	-6.4	-29.5
	Silk yarn (Synth & Arti)	444.7	503.9	13.3	59.2
	Fertilizer	499.6	1,081.70	116.5	582.1
	Insecticides	122.3	110.4	-9.8	-11.9
	Plastic material	1,263.80	1,287.50	1.9	23.7
	Iron & steel and Scrap	423.9	446.8	5.4	22.9
	Iron & steel	993.9	1,119.00	12.6	125.1
F. Telecom		854.3	1,049.50	22.9	195.2

* July-April, ** Provisional
Source: Pakistan Bureau of Statistics

Major Sources of Imports

Table-8 shows the major markets of Pakistan's imports which include the United Sates, the United Kingdom, Germany, Japan, Kuwait and Saudi Arabia. The table also indicates the fact that imports are concentrated in a few markets. It reveals an important fact that Pakistan's import sources are witnessing a change in direction since 2006-07. The combined share of Pakistan's major imports markets has been declining from the 36.3 percent in 2006-07 to 30.2 percent in July-March 2011-12, showing a 6.5 percentage points fall during the period. The imports from other countries have increased from 63.7 percent in 2006-07 to 69.8 percent in July-March 2011-12, an increase of 6.1 percent points during the period.

Table-8: Major Sources of Imports

(Percentage Share)

Country	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12* P
U.S.A.	5.8	6.1	5.4	4.6	4.5	3.3
U.K.	2.8	1.9	2.6	1.7	1.6	1.2
Germany	4.7	3.2	3.8	3.4	2.3	2.5
Japan	5.6	4.6	3.6	4.4	4.1	4.2
Kuwait	6.2	7.5	6.6	6.9	8.2	8.4
Saudi Arabia	11.2	13.4	12.3	9.7	11.3	10.6
Sub-Total	36.3	**36.7**	**34.3**	**30.7**	**32**	**30.2**
Other Countries	63.7	63.3	65.7	69.3	68	69.8

*Provisional
Source: Pakistan Bureau of Statistics

II. A. 3 Financial Account

The financial account posted a surplus of $ 1,200 million during July-April 2011-12 against a surplus of $ 690 million in the corresponding period last year. Foreign direct investment declined by $ 625 million and portfolio investment witnessed a fall of $ 126 million. Other investment stood at $ 721 million during July-April 2011-12. During the period July-April 2011-12, Foreign Direct Investment (FDI) declined by 48.3 percent. This decline was primarily due to lower investment in the telecommunication, financial business and power sector during the period. The fall in FDI in Pakistan appears to be the result of factors such as energy crises and circular debt. However, the Oil & Exploration remained the major attraction during current fiscal year as its share in overall FDI stood at 69.8 percent with 37.9 percentage points increase during the period. Foreign direct investment declined by $625 million and portfolio investment witnessed a fall of $126 million. Other investment stood at $721 million during July-April 2011-12. During the period July-April 2011-12, Foreign Direct Investment (FDI) declined by 48.3 percent. This decline was primarily due to lower investment in the telecommunication, financial business and power sector during the period. The fall in FDI in Pakistan appears to be the result of factors such as energy crises and circular debt. However, the Oil & Exploration remained the major attraction during current fiscal year as its share in overall FDI stood at 69.8 percent with 37.9 percentage points increase during the period.

Foreign Exchange Reserves

Foreign exchange reserves are used by the central bank for balance of payment purpose. So these reserves are very important. If the central bank is short of foreign exchange reserves or it can no more borrow, this may cause balance of payment crises. Table-9 reveals that main source of foreign exchange earnings and foreign exchange reserves are from exports and remittances from expatriates as well as Foreign Direct Investments. In current fiscal year 2011-12, Pakistan's foreign exchange reserves reached by $ 16.49 billion at the end-April 2012 compared to $ 17.05 billion in corresponding period last year. This was mainly due to current account deficit and repayment of $ 400 million to the IMF. On the other hand, the rising inflows of scheduled banks reserves on account of healthy rise in FE-25 deposits and trade NOSTROs helped increase reserves in scheduled banks by $ 1.10 billion. The position of foreign exchange reserves over the period of last seven years can be observed from Table-9.

Table-9: Foreign Exchange Reserves

(US$ Million)

End Period	Net Reserves with SBP	Net Reserves with other Banks	Total Liquid Reserves
2006-07	13345.4	2301.8	15647.2
2007-08	8577	2821.7	11398.7
2008-09	9117.9	3307.3	12425.2
2009-10	12958.2	3792.2	16750.4
2010-11	14783.6	3460.2	18243.8
2011-12	10799.3	4485.3	15284.6

Source: State Bank of Pakistan

Exchange Rate and Exchange System

The exchange rate systems include fixed exchange rate system and floating exchange rate system. However, there are versions of managed floating exchange rate as adopted by the countries. The choice of the exchange rate system between fixed and floating or managed floating depends upon decision makers. In fixed exchange rate system the central bank control fluctuations that is appreciation or depreciation of exchange rate against the fixed value (may be single value fixed by central bank or range of values) by purchasing or selling its foreign exchange reserves. Under floating exchange rate, there is a market clearing exchange rate that clears the foreign exchange market. There is no need of intervention. The exchange rate stays at a level where demand for and supply of foreign exchange becomes equal.

In Pakistan, the State Bank (The Central Bank) is responsible to keep the exchange rate of the rupee at an appropriate level and prevent it from wide fluctuations in order to maintain competitiveness of exports and maintain stability in the foreign exchange market. To achieve the objective, various exchange policies have been adopted from time to time keeping in view the given circumstances. Pak-rupee remained linked to Pound Sterling till September, 1971 and subsequently to U.S. Dollar. However, it was decided to adopt the managed floating exchange rate system in January 1982 under which the value of the rupee was determined on daily basis, with reference to a basket of currencies of Pakistan's major trading partners and competitors.

After nuclear detonation by Pakistan in 1998, a two-tier exchange rate system was introduced from July 1998, with a view to reduce the pressure on official reserves and prevent the economy to some extent from adverse implications of sanctions imposed on Pakistan. However, effective from May 1999, the exchange rate has been unified, with the introduction of market-based floating exchange rate system, under which the exchange rate is determined by the demand and supply positions in the foreign exchange market. The surrender requirement of foreign exchange receipts on account of exports and services, previously required to be made to State Bank through authorized dealers, has now been done away with and the commercial banks and other authorized dealers have been made free to hold and undertake transaction in foreign currencies. As the custodian of country's external reserves, the State Bank is also responsible for the management of the foreign exchange reserves. The task is being performed by an Investment Committee.

After witnessing the continuous decline in depreciation of average annual exchange rates during 2009-10 and 2010-11, the domestic currency remained under pressure through most of fiscal year 2011-12. This pressure is emerging from the deficit in the overall external account of the country during July-April 2011-12. As a result Pakistan's currency vis-à-vis the US dollar depreciated during July-April 2011-12 In absolute terms, the exchange rate averaged Rs. 85.50/US$ during July-April 2010-11, whereas it averaged at Rs. 88.55/US$ during July-April 2011-12. The Pak Rupee depreciated by 3.4 percent during July-April 2011-12 over the depreciation of 2.2 percent in July-April 2010-11 periods due to the widening current account deficit and speculations on account of the repayment of IMF loan during the period. Apart from the deficit in the current account balance during July-April 2011-12 other domestic factors as well as the speculative environment in the foreign exchange market added volatility to the exchange rate.

Given the weakness against the US dollar, the Pak Rupee depreciated by 8.8, 5.7 and 3.7 percent, against Yen, Euro and Great Britain Pound, respectively. However, despite the depreciation against the US dollar and other major currencies in nominal terms, the Pakistan currency appreciated by 0.51 percent in real terms during Jul-Dec 2011-12 against an appreciation of 0.16 percent during Jul-Dec 2010-11. The appreciation in real terms was due to the sharp and persistent rise in the relative price index (RPI).

Foreign Direct Investment

In the today's global economy, foreign direct investment (FDI) has emerged as one of the biggest sources of private external finance for developing countries. The developing countries like Pakistan are able to bridge their widening saving-investment gap through this important non-debt creating inflow. Pakistan by pursuing trade openness and liberalized FDI regime was able to attract gradually more and more FDI since 2001-02.

Pakistan has a very fertile market for foreign investors given its very large consumer base of 180 million people. People need food, energy and other amenities to live and thrive. There is a great potential in the power and infrastructure sector and in natural resources. There seems to be huge scope for investment in hydel and coal based power projects, alternative energy like wind power, and natural gas transmission from foreign lands. The country also needs infrastructure, world class education systems, exploration of its natural resources and mechanization of industries. Foreign investors can exploit all such opportunities.

Global foreign direct investment will be close to $ 800 billion during 2012 but less than the $ 1 trillion achieved in 2007. The Euro crisis has dampened enthusiasm. However, prospects from East Asia are looking good. The United States is focusing on economic revival and its stock markets are responding positively. China, India, Turkey, Brazil and Indonesia also appear to be moving in a positive direction. From Table-10, it can be seen that FDI in absolute values has been declining since 2006-07. It is the lowest during July-April 2011-12. grew on a steady pace from fiscal year 2002-03 onwards. The FDI stood at $ 670.4 million during July-April 2011-12 as against $ 1292.9 million last year. This is a decline of 48.1 percent.

Pakistan will certainly attract foreign direct investment with the resolution of the energy shortages and improvement in the law and order situation. The Board of Investment (BOI) under the Prime Minister's Secretariat is making efforts to provide an increasingly investment friendly environment to investors. Efforts are being made to facilitate foreign investors in Pakistan with improved infrastructure and a better working environment so that the favorable business climate may induce investors to initiate new investment projects. In particular, efforts are also going on to encourage the setting up of fruit processing industries and more export processing zones in the country, so that sustained high economic growth through exports may be achieved. Foreign Direct Investment and Portfolio Investment with total foreign investment in Pakistan during the period 2006-07 through 2011-12 is given in Table-10.

Table-10: Foreign Direct Investment

(US$ Million)

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
FDI	5139.6	5409.8	3719.9	2150.8	1739.4	741.5
Portfolio Investment	1820	19.3	-510.3	587.9	344.5	-71.1
Total	6959.6	5172.1	3209.6	2738.7	2083.9	670.4

Source: Board of Investment Pakistan

Table-11 shows sector wise distribution of the FDI. Transport, communication, financial business, oil exploration and power sectors are the dominant sectors where most of the FDI inflows are concentrated to a few sectors. FDI from Oil & Gas Exploration improved over the years and remained the major sector for foreign investors. The share of Oil and Gas Exploration in total FDI during July-April 2012 stood at US$ 612.8 million. Major decline in FDI has been recorded in the communication sector over the years and reached at (US$ 315.5million) in July-April 2011-12 from record US$ 1898.7 million in 2006-07, when FDI in this sector were highest compared to another sector.

Table-11: Foreign Direct Investment

(US$ Million)

Sector	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Oil and Gas	545.1	634.8	775	740.6	512.2	612.8
Financial Business	930.3	1864.9	707.4	163	246.9	56.4
Textiles	59.4	30.1	36.9	27.8	25	30.3
Trade	172.1	175.9	166.6	117	53	25.3
Construction	157.1	89	93.4	101.6	60.8	71.8
Power	193.4	70.3	130.6	-120.6	155.8	-84.9
Chemical	46.1	79.3	74.3	112.1	30.5	96.3
Transport	30.2	74.2	93.2	132	104.6	17.4
Communication	1898.7	1626.8	879.1	291	-34.1	-315.3
Others	1107.2	764.5	763.4	586.3	418.9	302.5

Source: Board of Investment Pakistan

From Table-12, it can be observed that the UAE, the US, the UK, Switzerland, and Norway are the major investors in terms of FDI in Pakistan. But FDI from these countries have been declined over the years and have reached lowest during 2010-11 and July-April 2011-12 partly because of the global recession and partly because of poor law or order situation which Pakistan has been facing since it has been playing its role of being key ally in the war against international terrorism.

Table-12: Country Wise FDI Inflows

(US$ Million)

Country	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
USA	913.1	1309.3	869.9	468.3	238.9	233
UK	860.1	460.2	263.4	294.6	208.1	142.8
UAE	661.5	589.2	178.1	242.7	284.2	36.6
Japan	64.4	131.2	74.3	26.8	3.2	22.8
Hong Kong	32.6	339.8	156.1	9.9	125.6	80.3
Switzerland	174.7	169.3	227.3	170.6	47.2	127.1
Saudi Arabia	103.5	46.2	-92.3	-133.8	6.5	-20.2
Germany	78.9	69.6	76.9	53	21.2	28.2
South Korea	1.5	1.2	2.3	2.3	7.7	25.4
Norway	25.1	274.9	101.1	0.4	-48	-275
China	712	13.7	-101.4	-3.6	47.4	120.9
Others	1512.2	2005.2	1964.2	,019.6	631.6	290.7

Source: Board of Investment Pakistan

Borrowing from Abroad

When a country requires borrowing from abroad? When deficit in the current account is large enough that could not be financed with surplus in the capital account, the discrepancy is financed with foreign exchange reserves held by the central bank but if foreign exchange reserves are neither sufficient, then the country resort to external borrowing. Deficit financing through external borrowing has been used in Pakistan as an instrument for achieving external balance in most of the years of its history.

Pakistan's total stock of external debt and foreign exchange liabilities grew at an average rate of 7.4 percent per annum during 1990 to 99, which rose from $ 20.5 billion in 1990 to $ 38.9 billion by end June 1999. Foreign exchange earnings on the other hand, either remained stagnant or increased at a snail's pace during the same period. Despite the accumulation of almost $ 18.4 billion debt in the 1990s, foreign exchange earnings rose by only $ 4.0 billion. Consequently the debt burden (external debt and foreign exchange liabilities as a percentage of foreign exchange earnings) rose from 256.6 percent in 1989-90 to 335.4 percent in 1998-99.

Following a credible strategy of debt reduction over the last decade, Pakistan has succeeded in reducing the country's debt burden. External debt and foreign exchange liabilities, instead of growing at the pace of the 1990s, were in fact reduced from U.S. $38.9 billion in 1998-99 to $ 35.8 billion by end of 2005 — a reduction of $3.1 billion in six years. Pakistan External Debt and Liabilities (EDL) stock was recorded at $60.3 billion as of March 2012. During July-March 2012, $179 million was added to the EDL stock. As a percentage of GDP in dollar terms, the EDL was down by 200 basis points in July-March, 2012 compared to fiscal year 2011 and approximated to 26.5 percent. Since fiscal year 2010, EDL has increased in absolute terms, but decreased in relation to GDP.

However, focusing on the absolute increase in the outstanding stock of EDL can be misleading for two main reasons. Firstly, the outstanding stock of debt must be analyzed in relation to the size of the economy and its repayment capacity (in terms of GDP and other macroeconomic indicators). Secondly, the absolute change in EDL neglects classification between an actual increase in stock and increases caused by fluctuations in international exchange rates.

Pakistan's external debt and liabilities (EDL) include all foreign currency debt contracted by the public and private sector, as well as foreign exchange liabilities of the State Bank. EDL has been dominated by Public and Publically Guaranteed Debt having share of 76 percent owing to current account deficit which is financed through loans from multilateral and bilateral donors. Debt obligations of the private sector are fairly limited and have been a minor proportion of EDL (6 percent). Borrowing from IMF contributed 13 percent in EDL Stock which was intended for Balance of Payment (BoP) support and is reflected in foreign currency reserves of the country.

The explicit concessional terms of loans (low cost and long tenors) contracted with international financial institutions or donor countries have concealed the inherent capital loss associated with foreign currency debt to some extent. However, the analysis of currency movement of last 20 years reveals that cost of foreign currency borrowing adjusted for exchange rates movement has been 1.5 percent lower than the average domestic interest rates. Table 13 presents the developments in the various components of EDL during fiscal year 2007 to the first nine months of the fiscal year 2012. Table-13 gives external debt and liabilities account of Pakistan.

At the end-March 2012, Public and publicly guaranteed debt accounted for the largest share of 76 percent in EDL. Public and publicly guaranteed debt is dominated by the loans from bilateral and multilateral donors. Multilateral debt, which is the largest component of Pakistan's EDL witnessed a decrease of $730 million. The project-based nature of loans contracted under this category hinges on Pakistan's ability to instill project efficiency. The composition and structure of Pakistan External Debt as on March 31, 2012 is depicted in the Table-13. Bilateral sources includes loan contracted with Paris Club countries and other countries outside the Paris Club. It is second largest component of Pakistan's EDL. It witnessed an increase of $137million during the said period. At the end-March 2012, debt owed to IMF aggregated up to $ 8.1 billion. Payment amounting to $79 3 million has been made in the 3rd and 4thquarter of fiscal year 2012. The share of private non-guaranteed debt in total EDL stood at 6 percent at end-March 2012. The stock of private non-guaranteed debt decreased by $147 million; from $3.48 billion in June 2011 to $3.34 billion by end-March 2012.

Table-13: Pakistan External Debt and Liabilities

Country	2007	2008	2009	2010	2011	2012
					(In billions of US dollars)	
1. Public and Publically Guaranteed debt	35.3	40.6	42.6	43.1	46.7	46.4
A. Medium and long term(>1 year)	35.3	39.5	41.1	42.3	46.1	45.8
B. Short Term (<1 year)	0	1.1	1.5	0.8	0.6	0.6
2. Private Non-guaranteed Debt (>1 yr)	2.3	2.9	3.3	3.4	3.5	3.3
3. IMF	1.4	1.3	5.1	8.1	8.9	8.1
Total External Debt (1 through 3)	39	44.9	51.1	54.6	59.1	57.8
4. Foreign Exchange Liabilities	1.5	1.3	1.3	1.3	1	2.5
Total External Debt & Liabilities (1 to 4)	40.5	46.2	52.3	55.9	60.1	60.3
(of which) Public Debt	36.5	40.9	46.3	49.5	54.6	53.1
					(In percent of GDP)	
Total External Debt (1 through 3)	27.3	27.4	31.5	30.9	28.1	25.4
1. Public and Publically Guaranteed debt	24.7	24.8	26.3	24.5	22.1	20.1
A. Medium and long term(>1 year)	24.7	24.1	25.4	24	21.8	19.8
B. Short Term (<1 year)	0	0.7	0.9	0.4	0.3	0.2
2. Private Non-guaranteed Debt (>1 yr)	0.02	0.02	0.02	0.02	0.02	0.01
3. IMF	1	0.8	3.2	4.6	4.2	3.5
4. Foreign Exchange Liabilities	1	0.8	0.8	0.6	0.5	1.1
Total External Debt & Liabilities (1 to 4)	28.3	28.2	32.3	31.5	28.5	26.5
Memo:						
GDP (in billion of Rs.)	8673	10243	12724	14804	18033	20,654
Exchange Rate (Rs./U.S. dollar, Period Avg.)	60.6	62.5	78.5	83.8	85.6	90.8
Exchange Rate (Rs./US$, EOP)	60.6	68.3	81.4	85.5	86	90.7
GDP (in billions of U.S. dollars)	143	163.8	162.1	176.5	210.8	227.8

Source: State Bank of Pakistan, EAD and Debt Policy Coordination Office

External Debt Servicing

Table -14 presents external debt and liabilities servicing account. During fiscal year 2011, total external debt servicing amounted to US$ 4,799 million that is 14.3 percent lower than the previous year. A segregation of this aggregate number shows a payment of US$ 2,348 million in respect of maturing EDL stock where interest payments were US$ 963 million. US$ 1,488 million was rolled-over. Servicing of external debt and liabilities during the first nine months of fiscal year 2012 amounted to US$ 3,567 million. Out of the total, US$1,692 million was paid against principal while interest payments were US$ 633 million. US$ 1,243 million was rolled-over. When compared to a stock of approximately US$ 60.1 billion at the end of fiscal year 2011, the relatively smaller amount of interest payments made during the first three quarters of fiscal year 2012 signal towards the concessional nature of most of the foreign loans contracted by Pakistan. Notwithstanding, with the IMF-SBA repayments over next two years, the servicing will increase.

Table-14: Pakistan's External Debt and Liabilities Servicing

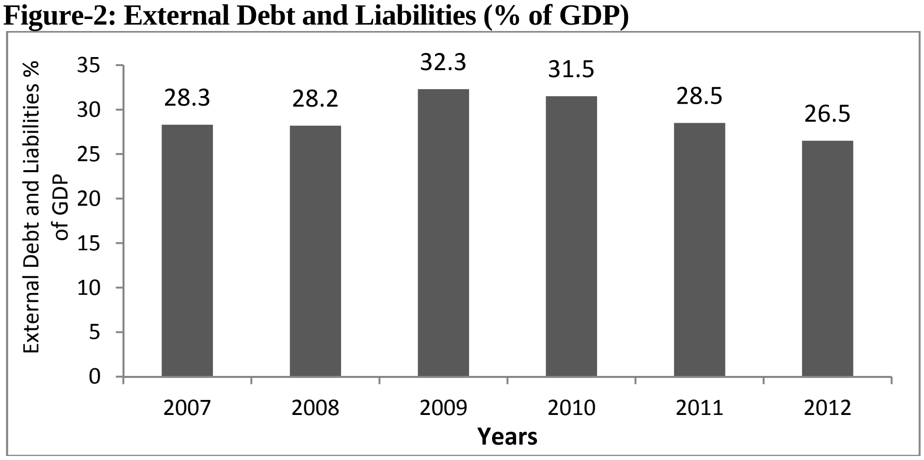
($ Million)

Years	Actual Amount Paid	Amount Rolled Over	Total
2007	2,326	1,300	3,626
2008	2,558	1,200	3,758
2009	3,986	1,600	5,586
2010	3,880	1,723	5,603
2011	3,311	1,488	4,799
2012*	2,325	1,243	3,567

*July-March 2012
Source: State Bank of Pakistan

Figure-2 presents external debt and liabilities as percent of GDP. External debt and liabilities stood at 28.3 percent of GDP in fiscal year 2007, which rose to 32.3 percent during fiscal year 2009. During July-March 2012, the external debt and liabilities as percent of GDP was 26.5 percent.

Figure-2: External Debt and Liabilities (% of GDP)



Source: Ministry of Finance Government of Pakistan

II.B Domestic Environment

II. B.1 Economic Growth Rate

Table-15 presents comparative real GDP growth rates of various countries during the period 2007 to April, 2012. It is clear that overall GDP has declined from 5.2 percent in 2007 to 3.5 percent in April, 2012. There was contraction of world economic growth during the period under review. In this scenario, China has remained a bright spot. Its growth rate, although down to a forecast of 8.2 percent for the year 2012 compared to 9.2 percent last year, has remained relatively high. Since China is largest populated country in the world, so if China can maintain its growth, it's good for the world. It can provide support for commodities markets and growth in other countries.

The International Monetary Fund (IMF) maintained its forecast of 2.1 percent growth for the US in the year 2012 and 2.4 percent for the year 2013. The improved economic growth in USA would have positive effect on the economies of rest of the world, particularly of developing countries. For Japan, the growth rate projected for 2012 is 2.0 percent and for 2013 it is 1.7 percent. Overall, economic activity in advanced economies is likely to expand by 1.7 percent on average in 2012 and 2013. Growth in emerging economies is projected at 5.7 percent in 2012. The IMF expects growth in oil exporting countries in the Middle East and North Africa to slow to 3.9 percent in 2012, from 4.9 percent in 2011. Net oil importers in the Middle East and North Africa region are expected to record 2.6 percent growth in 2012, after sluggish growth of 1.4 percent in 2011.

GDP growth across the Gulf Cooperation Council (GCC) countries is expected to be moderate at a rate of 4 percent in 2012. Unfortunately, Europe is now caught in a vicious cycle of high debt and low growth. Highly burdened by debt, most of the economies in the region may not attain respectable levels of growth to improve their fiscal position. This will imply potential debt servicing difficulties and limit their abilities to unshackle their growth potential. Almost 17 percent of total exports of Pakistan are to the Euro zone as are a reasonable portion of its total import from this region. Problems in this area can impact on Pakistan's trade and hence its overall growth. Asia on the other hand, continues to move ahead, with China and India leading the growth. There is some hope that perhaps Asia has created some distance from the OECD, and has therefore, not been dragged down so far? However, if the OECD continues its downward slide, the export-led Asian giants could see their growth prospects diminish.

Pakistan's economy is very closely linked to the rest of the world due to its high external sector exposure. Several countries of the euro zone are important trading partners of Pakistan. As such, any untoward development in these countries could have a substantial negative impact on the economy of Pakistan. A contraction or stagnation in economic activity in the global economy, can potentially affect the level of our exports, Foreign Direct Investment (FDI) and home remittances adversely. Similarly further increase in oil prices can create hurdles in the ongoing economic activities of the country. Table-15 presents the comparative real GDP growth rates during the period 2007 to 2012.

Table-15: Comparative Real GDP Growth Rates (%)

Region/Country	2007	2008	2009	2010	2011	2012
World GDP	5.2	3.2	-0.5	5.3	3.9	3.5
Euro Area	2.7	0.9	-4.1	1.9	1.4	-0.3
United States	2	1.1	-2.6	3	1.7	2.1
Japan	2.4	-0.6	-6.3	4.4	-0.7	2
Germany	2.5	1.3	-4.7	3.6	3.1	0.6
Canada	2.7	0.5	-2.5	3.2	2.5	2.1
Developing Countries	8.3	6.1	2.7	7.5	6.2	5.7
China	10.7	10.4	9.2	10.4	9.2	8.2
Hong Kong SAR	6.4	2.5	-2.7	6.8	5.4	2.6
Korea	5.1	2.2	0.2	6.1	4.5	3.5
Singapore	7.8	1.1	0.6	2.8	3.3	2.7
Vietnam	8.2	8.4	5.3	6.8	5.9	5.6
Asian						
Indonesia	6.3	6.1	4.6	6.2	6.5	6.1
Malaysia	6.3	4.6	-1.6	7.2	5.1	4.4
Thailand	4.9	2.6	-2.3	7.8	0.1	5.5
Philippines	7.2	4.6	1.1	7.6	3.7	4.2
South Asia						
India	9.3	7.3	6.6	10.6	7.2	6.9
Bangladesh	6.3	5.6	5.9	6.4	6.1	5.9
Sri Lanka	6.8	6	3.5	8	8.2	7.5
Pakistan	6.8	4.1	**1.7**	3.1	3	3.7
Middle East						
Saudi Arabia	3.5	4.6	0.1	4.6	6.8	6
Kuwait	2.5	6.3	-5.2	3.4	8.2	6.6
Iran	7.8	4.5	3.9	5.9	2	0.4
Egypt	7.1	7.2	4.7	5.1	1.8	1.5
Africa						
Algeria	3	3	2.4	3.3	2.5	3.1
Morocco	2.7	5.4	4.9	3.7	4.3	3.7
Tunisia	6.3	4.5	3.1	3.1	-0.8	2.2
Nigeria	6.4	5.3	7	8	7.2	7.1
Kenya	7	2	2.6	5.6	5	5.2
South Africa	4.8	5.1	-1.5	2.9	3.1	2.7

Source: World Economic Outlook (IMF), April 2012.

Sectoral Analysis of Growth

Table-16 reveals that Pakistan's economy depends upon commodity producing and service sectors. The former sector includes agriculture, mining and quarrying, manufacturing, construction and gas and electricity distribution. The service sector includes transport, storage, communication, finance and insurance etc. Over the period of years, the percentage share of various sectors of the economy has been subject to change. In early 1990's the share of agricultural sector was dominant in GDP. The change in composition started and the share of industrial and services sector grew at a steady pace. Table 16 presents growth performance of various sectors and sub-sectors of Pakistan economy during 2006-07 to 2011-12.

Table-16: Growth Performance of Components of Gross National Product

(% Growth at Constant Factor Costs of 1999-2000)

Sectors/Sub-Sectors	2006-07	2007-08	2008-09	2009-10	2010-11 R	2011-12 P
Commodity Producing Sector	6.6	1.3	1.8	3.56	1.47	3.28
1. Agriculture	4.1	1	4	0.62	2.38	3.13
-Major Crops	7.7	-6.4	7.8	-2.28	-0.23	3.18
-Minor Crops	-1	10.9	-1.2	-7.72	2.68	-1.26
-Livestock	2.8	4.2	3.1	4.28	3.97	4.04
-Forestry	-5.1	9.2	2.3	2.2	-0.4	0.95
-Fishing	15.4	-13	-3	1.47	1.94	1.78
2. Mining & Quarrying	3.1	4.4	-0.5	2.23	-1.28	4.38
3. Manufacturing	8.3	4.8	-3.6	5.46	3.06	3.56
-Large Scale	8.7	4	-8.1	4.79	1.15	1.78
-Small Scale	8.1	7.5	7.5	7.51	7.51	7.51
-Slaughtering	-	-	-	4.33	4.38	4.46
4. Construction	24.3	-5.5	-11.2	16.34	-7.09	6.46
5. Electricity & Gas Distribution	4.7	-23.6	59	6.16	-7.25	-1.62
Services Sector	7	6	1.7	2.63	4.45	4.02
6.Transport,Storage and Communication	4.7	3.8	3.6	1.89	0.87	1.25
7. Wholesale & Retail Trade	5.8	5.3	-1.4	4.49	3.53	3.58
8. Finance & Insurance	14.9	11.1	-7.6	-12.16	-1.41	6.53
9. Ownership of Dwellings	3.5	3.5	3.5	3.51	1.79	3.51
10. Public Administration & Defense	7.1	1.2	3.6	2.52	14.17	2.61
11. Social, Community & Public Services	7.9	9.8	8.9	7.83	6.9	6.77
12. GDP (Constant Factor Cost)	**6.8**	3.7	1.7	3.07	3.04	3.6

P : Provisional, R : Revised, - : Included in Small Scale

Source: Pakistan Bureau of Statistics

Commodity Producing Sector

The commodity producing sector (CPS) comprises of agriculture and industry. It is the most important sector of the economy, with relatively stronger forward and backward linkages for economic development and prosperity of the country. It accounted for 46.5 percent of GDP during 2011-12. This is a decline from 49.1 percent of GDP in 2001-02, indicating that the share of the non-commodity producing sector has increased. The commodity producing sector has performed much better in 2011-12 compared to last year as its growth rate in 2011-12 was 3.28 percent against only 1.47 percent in last year. However, the growth of the commodity producing sector remained far below its potential due to largely unforeseen climatic factors.

Agriculture Sector

Agriculture is a key sector of Pakistan's economy. Agriculture is an integrated sector comprised of sub-sectors like cultivation of crops, rearing of animals, management of rangelands, raising of forests and aqua-culture. Agriculture provides food items and raw materials for industrial units and accounts for 21 percent of GDP, 45 percent of employment and 60 percent of exports. In the inevitable process of structural transformation its share shrank to 21.1 percent in fiscal year 2011-12 compared to 24.1 percent ten years earlier in 2001-02. Despite its declining share, it is the single largest sector of

Pakistan's economy. Moreover, an overwhelming majority of the population depends directly or indirectly on income generated by this sector. The agriculture sector has strong backward and forward linkages. As a result its growth has a larger impact on the overall economic performance. The performance of the agriculture sector remained weak due to recent catastrophic floods. However, the government's supportive polices in this sector resulted in a growth of 3.13 percent against the growth of 2.38 percent last year and 0.62 percent in fiscal year 2009-10. The improved performance is mainly attributed to a sharp pick-up in the production of rice; cotton, and sugarcane. Livestock also registered a significant growth. The agriculture sector consists of various sub-sectors which include crops, livestock, fisheries and forestry. The crop sub-sector is further divided into major crops, namely, wheat, cotton, rice, sugarcane, maize and gram and minor crops namely, pulses, potatoes, onions, chilies and garlic etc.

Crops

Major crops account for 31.87 of agricultural value added and registered an accelerating growth of 3.18 percent compared to a negative growth of 0.23 percent last year and -2.28 percent in fiscal year 2009-10. The major crops including cotton, sugarcane and rice witnessed growth in production of 18.6 percent, 4.9 percent and 27.7 percent respectively. However, wheat registered a negative growth of -6.7 percent. The main reason for the negative growth of wheat is the 2.6 percent decline in area under cultivation. In lower Sindh, in particular, sowing was delayed mainly because of late receding rain water which resulted in a decline in both the acreage as well as the yields. Moreover, in Punjab also the extended fog season delayed the planting of seed beyond the optimal period. The other major crops bajra, jowar, maize, sesamim, gram, barley, rapeseed and mustard and tobacco showed mixed trends but their share in the overall sector is small. Minor crops contributed 10.11percent to value addition in overall agriculture. Production in this sub-sector declined by -1.26 percent. This negative growth is far below the 2.68 percent positive growth last year. The main reason for this negative growth of minor crops is the heavy flood in Sindh and Balochistan provinces. The growth of pulses is estimated at -3.50 percent, vegetables -10.0 percent, chilies -78.4 percent, onion -15.4 percent and oil seeds -26.9 percent.

Livestock

Global integration, rising income and living standards as well as changing dietary patterns across regions have brought a paradigm structural shift. This shift is visible in Pakistan also. The share of livestock in agriculture has increased to 55 percent. Livestock includes cattle, buffalos, sheep, goat, camel, horses, asses, mules and poultry and their products. The demand for livestock has grown at a phenomenal pace. The increase in prices has provided incentive for greater production and spurred growth. The importance of this sector may be recognized by the fact that the majority of people living in rural areas depend directly or indirectly on the livestock and dairy sector. This sub-sector is highly labour intensive. It has also emerged as a major source of income for the small farmers as well as the landless rural poor. Livestock has witnessed a marginally higher growth of 4.04 percent against the growth of 3.97 percent last year. The production of milk, poultry products and other livestock items has increased at the rate of 3.3 percent, 7.1 percent and 2.24 percent respectively.

Fisheries

The fisheries sector witnessed a growth of 1.78 percent against the growth of 1.94 percent last year. Components of fisheries such as marine fishing and in-land fishing, contributed to an overall increase in value addition in the fisheries sub-sector. The gross value addition of marine fish increased by 1.35 percent and that of inland fish by 1.96 percent.

Forestry

The growth of the forestry sub-sector is recorded at 0.95 percent as compared to the contraction of -0.40 percent last year. Forests are a key component of our environment and degradation of forests can pose severe socio-economic challenges for the coming generations. The main components of forestry, timber and fire wood, grew at 0.90 percent and 0.46 percent respectively.

Manufacturing Sector

The manufacturing sector contributes much to the progress of our economy. The manufacturing sector has remained under stress for the last several years, due to energy shortages, poor law and order situation. The heavy floods also depressed the supply chain and affected market demand. The share of the manufacturing sector in GDP was 17.7 percent in 2001-02. This has increased in 2011-12 to 18.6 percent of GDP. The manufacturing sector has been hard hit by international and domestic factors, which caused the slowing down of its output. The growth of the manufacturing sector was 3.56 percent compared to the growth of 3.06 percent last year. Manufacturing has three main sub components; namely the Large-Scale Manufacturing (LSM), Small Scale Manufacturing and Slaughtering. Small scale manufacturing maintained its growth of last year at 7.51 percent and slaughtering growth is estimated at 4.46 percent against 4.38 percent last year. Large Scale Manufacturing (LSM) has also witnessed a slight improvement. It has shown a growth of 1.78 percent against the growth of 1.15 percent last year. The major LSM industries which registered notable growth include; refrigerators 7.56 percent, sugar 27.09 percent, beverages 10.60 percent, liquid/syrup 15.93 percent, injection 6.53 percent, soaps and detergents 8.15 percent, buses 25.0 percent, electric bulbs 15.02 percent, electric transformers 27.72 percent etc. On the whole 38 major industries group recorded positive growth. The industries which reported negative growth include; cooking oil -1.61 percent, motor tyres -25.73 percent, T.V. sets -22.19 percent and deep freezers -49.47 percent etc.

Construction Sector

The construction sector has shown 6.46 percent growth as compared to negative growth of -7.09 percent in last year. The increase in growth is due to rapid execution of work on the rehabilitation of the flood affected areas, increased investment in small scale construction and rapid implementation of PSDP schemes which are near completion.

Mining and Quarrying

Extraction of minerals and ores through efficient mining and quarrying provides convenient and economical access to raw materials and a competitive edge to the country. The mining and quarrying sector recorded positive growth of 4.38 percent during the year 2011-12 against the negative growth of -1.28 percent last year. The contribution of this sector in GDP has expanded remarkably and now accounts for 9.45 percent of the industrial value addition. The output of chromite, bauxite, gypsum, chalks and fluoride increased by 591.54 percent, 82.15 percent, 24.43percent, 82.18 percent and 111.28 percent respectively. This growth was also made possible in some part due to the increase in natural gas production. The extraction of bentonite, however, registered substantial decline of -47.82 percent. Much of the country’s mining reserves exist in remote areas. Infrastructure improvements are necessary to sustain and achieve higher growth rates in future. Improvement in the security situation in the country would also lead to greater production.

Services Sector

The importance of the services sector has been recognized all over the world. This sector has emerged as the main driver of economic growth. The services sector also plays a vital role in sustaining economic activities in Pakistan. The economy has gone through a major transformation in its economic structure. The share of the services sector has increased to 53.5 percent in 2011-12. In developed countries the share of services sector in GDP is around 75 percent. This share is 65 percent in Singapore, 52 percent in India and 42 percent in Indonesia. The services sector consists of the following sub-sectors: Transport, Storage and Communication; Wholesale and Retail Trade; Finance and Insurance; Ownership of Dwellings; Public Administration and Defense; and Social Services. The Services sector has registered a growth rate of 4.02 percent in 2011-12. This performance is dominated by Finance and Insurance at 6.53percent, Social and Community Services 6.77percent and Wholesale and Retail Trade 3.58percent. The contribution of transport, storage and communication is estimated at 1.25 percent. The recovery in agriculture and industry have resulted a positive impact on the performance of the whole sale and retail trade. Our services sector has a great potential to grow at a rapid pace. In order to develop the services sector, Pakistan has recognized the needs to liberalize operating rights and has separated regulators from operators.

Finance and Insurance Sector

The finance and insurance sector comprises the State Bank of Pakistan; all scheduled banks (domestic and foreign), Development Financial Institutions (DFIs), all insurance (life and general) companies, Modaraba /Leasing companies, Money Changers and stock exchange brokers. The financial sub-sector consists of all resident corporations principally engaged in financial intermediations or in auxiliary financial activities related to financial intermediation. Pakistan's financial sector is integrated with the world economy and this is reflected in its performance. Finance and Insurance sector recorded positive growth of 6.53 percent in 2011-12 as against contraction of -1.41 percent last year

Transport, Storage and Communication

The role of Transport, Storage and Communication (TS&C) sector is very important in boosting the economic activities of the country. The current global economic crisis and the level of integration of these sub-sectors in the globalized economy including the presence of multi-national enterprises (MNEs) in the markets of all countries of the world puts a greater need for major investments in physical and qualitative terms to meet expected demand. Information and Communication Technologies (ICTs) is perhaps the most critical tool for a dynamic and flexible services sector. The TS&C sub-sector grew at 1.25 percent as compared to 0.87 percent last year. Water Transport has declined by -3.14 percent during2011-12, and Air Transport by a massive -27.93 percent. Sub-sectors that showed a positive growth are; pipeline transport 34.64 percent, road transport 2.88 percent, storage 2.10 percent and communication 0.93 percent.

Wholesale and Retail Trade Sector

The wholesale and retail trade sector is based on the margins taken by traders on the transaction of commodities traded. In 2011-12, this sector grew at 3.58 percent as compared to 3.53 percent in the last year.

Public Administration and Defense

Public Administration and Defense posted a growth of 2.61 percent as compared to 14.17 percent last year. The positive change in the wage component of public sector employees, and an increase in defense and security related expenditures were largely responsible for this growth.

Ownership of Dwellings

Ownership of Dwellings has recorded a growth of 3.51 percent during the year 2011-12 compared to 1.79 percent last year. Social Services grew by 6.77 percent against the last year's growth of 6.90 percent. The rise in the growth of Ownership of Dwelling and social services is mainly due to the fast track work on reconstruction and rehabilitation of flood affected areas by government, NGOs and private sectors.

Contribution to Real GDP Growth (Production Approach)

As in previous years the improvements in economic growth in the fiscal year 2011-12 came mainly from the services sector. The services sector contributed 58.58 percent to overall economic growth; while the commodity producing sector (CPS) contributed only 41.4 percent. The agriculture sector contributed 17.98 percent to economic growth compared to 23.43 percent contribution by the industrial sector. The overall growth of 3.67 percent is shared between the Commodity producing sector and Services sector. Within the commodity producing sector, agriculture contributed 0.66 percentage points to overall GDP growth, while industry contributed 0.86 percentage points. The services sector contributed the remaining 2.15 percentage points. The percentage share of agriculture, manufacturing and services in overall growth was 17.98 percent, 23.43 percent and 58.58 percent respectively. The sectoral contribution to the GDP growth is shown below in Table-17.

Table-17: Sectoral Contribution to the GDP growth (% Points)

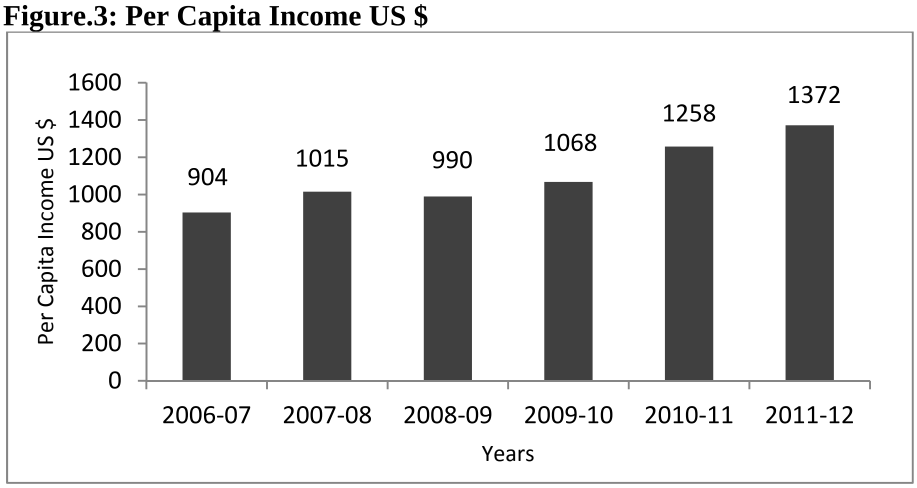
Sectors	2007-08	2008-09	2009-10	2010-11	2011-12
Agriculture	0.23	0.86	0.13	0.5	0.66
Industry	0.38	-0.03	1.57	0.18	0.86
- Manufacturing	0.92	-0.69	0.1	0.57	0.66
Services	3.08	0.89	1.37	2.36	2.15
Real GDP (Fc)	3.68	1.72	3.07	3.04	3.67

Source: Pakistan Bureau of Statistics

Per Capita Income

Per capita income, defined as Gross National Product at market price in dollar term divided by the country's population, grew at a much slower pace of 1.4 percent per annum in the 1990s, mainly due to slower economic growth, declining trend in workers' remittances and fast depreciating exchange rate. The pendulum swung to other extreme during the last few years and the per capita income grew at a tremendous pace. Per capita income is defined here as Gross National Product at market price in dollar term divided by the country's population. Per capita income is widely used and recognized as one of the important indicators of economic growth and general well-being of a society. Per Capita Income in dollar terms grew at a modest rate of 9.1percent in 2011-12 compared to 17.8 percent growth last year. The per capita income in dollar terms has increased from $ 582 in 2002-03 to $ 1,372 in 2011-12. The major factors, which contributed in the rise of per capita income, include acceleration in real GDP growth, inflows of worker's remittances and the stable exchange rate. Figure 3 shows the improvement in per capita income during the last six years.

Figure.3: Per Capita Income US $



Source: Economic Survey of Pakistan 2011-12

II. B.2 Inflation

Inflation refers to general increase in prices of products. Inflation seemed to be a chronic problem in Pakistan as in many other parts of the world. There is a wide spread recognition that inflation results in inefficient resource allocation and hence reduces potential economic growth. Inflation imposes high cost on economies and societies; disproportionately hurts the poor and fixed income groups and creates uncertainty throughout the economy and undermines macro-economic stability.

High inflation has always penalized the poor more than the rich because the poor are less able to protect themselves against the consequences, and less able to hedge against the risks that high inflation poses Prices remained volatile during the decade of the 1990s, ranging between 5.7 percent and 13.0 percent mainly because of decelerating economic growth, expansionary monetary policies, output setbacks, higher duties and taxes, a depreciating Pak Rupee, frequent adjustments in the administered prices of gas, electricity and POL products, etc. The changes introduced in the economy added a major element of distortion in economic relations with an inevitable pressure on prices, GDP growth and the performance of the large-scale industrial sector. The pressure on prices intensified in 1994-95 when inflation went up to 13 percent. Both the food and non-food inflation contributed to the persistence of double digit inflation, averaging 12.2 and 10.7 percent.

The global economy experienced significant financial crises in 2007-08. The financial crisis emanated in subprime mortgage loan portfolio and shocked the confidence of the international institutions and markets which in turn badly deteriorated the economic development and balance of payments across the world. In the developing countries, the crisis was seen at the time when they were already experiencing severe terms of trade and slower economic growth. The financial meltdown led to a backlash on consumer markets and broadly on the process of investment in the production of goods and services. This coupled with spike in commodity and oil prices led to a decline in the aggregate demand and raised inflation the world over. In Pakistan the affect was felt much severely as the country was also experiencing internal security issues and campaign against terrorism. The surge in food and commodity prices witnessed during 2008-09 pushed the consumer prices index (CPI) to a record level of 25.3 percent in August 2008.

But recent rising trend in domestic prices in tandem with global food and fuel prices affect several macro-economic dynamics- consumption, investment, inflation, trade and fiscal balances and ultimately resulted in slow down of GDP growth. Asian Development Bank (ADB) report of 19th March, 2012 titled “Food Price Escalation in South Asia” noted that the region suffers from a higher overall food inflation rate than the rest of developing Asia. The report further pointed out that the region, with a large number of people already living close to the poverty line, is one of the most vulnerable regions in the world to food price shocks. The World Bank has also rated high food prices as the biggest challenge facing most developing countries. This rising trend in inflation is not specific to Pakistan. Regional inflation is estimated to have also risen in India, Bangladesh and Thailand as shown in Table-18.

Table-18: Regional Countries Food Price Inflation Sectoral Contribution to the GDP growth

(% Points)

	Pakistan		India		Bangladesh		Thailand		Sri Lanka	
	CPI	Food	CPI	Food	CPI	Food	CPI	Food	CPI	Food
11-Jul	12.4	17.1	8.4	8.2	11	13.4	4.1	7.2	7.4	9.3
11-Aug	11.6	13.2	9	9.6	11.3	12.7	4.2	8.4	7	8.2
11-Sep	10.5	9.9	10.1	9.6	12	13.8	4.1	8.9	6.4	6.6
11-Oct	11	11.7	9.4	10.2	11.6	10.9	4.2	9.9	5.1	3.8
11-Nov	10.2	10	9.3	8.5	11.6	12.5	4.1	10.2	4.7	2.1
11-Dec	9.7	9.5	6.5	0.7	10.6	10.4	3.6	9.1	4.9	2.5
12-Jan	10.1	9.2	5.3	-0.5	11.6	10.9	3.4	7.7	3.8	-0.2
12-Feb	11	10.5	8.8	6.1	10.4	8.9	3.4	7.2	2.7	-4.1
12-Mar	10.8	9.8	9.5	9.9	10.1	8.3	3.4	7.1	5.5	-2.5
12-Apr	11.3	10.7	-	-	9.9	8.1	2.7	4.9	6.1	0.2

Source: PBS, BBS, Ministry of Commerce & Industry India, Bank of Thailand.

The period July-April 2011-12 witnessed both demand pull and cost push inflation when viewed in the backdrop of the affects of the floods of 2010 and heavy rains in 2011 as is evident from Table -19, which almost wiped out the major and minor standing crops in Sindh province, created disruption in the supply chain which resulted in surging inflation. The global spikes in commodities and fuel prices also exerted pressure on domestic inflation. Inflation on year to year basis reveals that the CPI was highest in to single digit at 9.7 percent. Thereafter it increased steadily and reached 11.3 percent in April 2012. Food inflation on a year to year basis was highest in July 2011 and lowest in January 2012 at 9.2 percent. Non-food inflation was lowest in July 2011 at 9.2 percent and highest at 11.6 percent in April 2012. Core inflation during the last nine months of the year remained almost at double digit levels except in July 2011 when it dropped to single digit at 9.5 percent. The main factor contributing to the rise of non-food inflation was the upward adjustment of energy, gas and fuel prices.

Table-19: Inflation on year on year (Y-o-Y) Basis %Change

Commodity	11-Jul	11-Aug	11-Sep	11-Oct	11-Nov	11-Dec	12-Jan	12-Feb	12-Mar	12-Apr
CPI	12.4	11.6	10.5	11	10.2	9.7	10.1	11	10.8	11.3
Food	17.1	13.2	9.9	11.7	10	9.5	9.2	10.5	9.8	10.7
Non-Food	9.2	10.4	10.9	10.4	10.3	9.9	10.7	11.5	11.5	11.6
Core	9.5	10	10.6	10.4	10.4	10.1	10.2	10.6	10.8	10.8
WPI	20.3	18.7	17	15.4	12	8.3	8.7	7.2	4.5	3.8
SPI	12.7	11.9	8.7	8.2	5.9	5.1	6.8	8.3	8.4	9.7

Source: Economic Survey of Pakistan 2011-12

The Consumer Price Index (CPI) on average basis recorded as 10.8 percent during July-April 2011-12 as compared to 13.8 percent during the same period last year. The two broad component of CPI, food and non-food inflation recorded an increase of 11.1 percent and 10.7 percent respectively compared to 18.8 percent and Wholesale Price Index (WPI), during July-April 2011-12 recorded as 11.2 percent as against 21 percent last year. Food and non-food under WPI was noted as 6.7 percent and 13.3 percent during current period whereas it was recorded to be 23.5 percent and 19.9 percent during the same period last year. The following table represents the trends in the CPI, WPI and SPI.

Table-20: Rate of Inflation on the basis of various price indices

(Average Percent)

Items	2010-11(Jul-Apr)	2011-12(Jul-Apr)
Consumer Price Index	13.8	10.8
Food	18.8	11.1
Non-Food	10.8	10.7
Wholesale Price Index	21	11.2
Food	23.5	6.7
Non-Food	19.9	13.3
Sensitive Price Indicator	18.1	8.5

Source: Economic Survey of Pakistan 2011-12

Both supply and demand side factors are responsible for food price escalation. These included supply disruption on account of the natural calamities during the year as well as the increase in transportation cost due to high fuel prices; on the demand side, the price hike is the consequence of the inflationary gap measured as the difference between monetary expansion and growth of overall national productivity.

The reasons for the rising food prices are manifold. The demand and supply side factors responsible for the food price hike in 2007-08 also seem to continue in the current food price hike. These include rapid economic growth in emerging countries leading to the increase in international food demand, lower agricultural productivity due to the scarcity of water in certain regions, supply short fall in the global food markets and oil supply shocks resulting from geopolitical instability in the Middle East etc.

The non-food prices increased at a slower pace of 10.7 percent than food prices. The divergent trend is due to different factors influencing these two broad components of CPI differently, such as items coverage, nature of items and impact of seasonal variation and availability etc. Among the non-food items, the hike in fuel related items such as diesel, petrol, gas, CNG and power tariff rates pushed the production and transportation cost up thereby accelerating inflation. Core inflation which is nonfood - non-energy is estimated at 10.4 percent during Jul-Apr 2011-12. A detailed data on rise of food and non-food inflationary trends for the year 2008-09, is given in Table-21.

Table-21: (Percent) Change In Price Indices

Commodity	Weights	On Average Basis		(%) Point Contribution	
		July –Apr 2010-11	July –Apr 2011-12	July –Apr 2010-11	July –Apr 2011-12
General (CPI)	100	13.8	10.8	13.8	10.8
Food, & Non Alcoholic Beverages	34.8	18.8	11.1	6.6	3.9
Alcoholic Beverages& Tobacco	1.4	11.8	7.5	0.2	0.1
Non-Food	65.2	10.8	10.7	7	6.9
Non-Food Non Energy	53.5	9.3	10.4	5	5.6
Clothing & Foot wear	7.6	11.4	14.9	0.9	1.1
Housing, Water ,Elec. Gas & other Fuel	29.4	11	7.5	3.2	2.2
Furnishing &Household Equip. Maintenance	4.2	9.2	17.4	0.4	0.7
Health	2.2	8.1	11.1	0.2	0.2
Transport	7.2	11.2	15.5	0.8	1.1
Communication	3.2	13.8	0.6	0.4	0.02
Recreation & culture	2	5.3	5.7	0.1	0.1
Education	3.9	6.6	12.3	0.3	0.5
Restaurant & Hotels	1.2	16.5	13.7	0.2	0.2
Miscellaneous	2.1	13.3	19.9	0.3	0.4

Source: Pakistan Bureau of Statistics (PBS)

II. B.3 Consumption

Consumption is the largest and relatively smooth component of aggregate demand; the other two components are investment and net exports. In every economy of the world consumption may be disaggregated into the public and private sector consumption. Similarly investment may be classified into public and private investment. Aggregate demand is the sum of consumption, investment and net exports (exports minus imports) of the goods and services. Pakistani society like other developing countries is a consumption oriented society, having a high marginal propensity to consume. As a result private consumption is the major sub-component of aggregate demand. Private consumption expenditure has increased to 75 percent of GDP, whereas public consumption expenditures are 13 percent of GDP. Total consumption has reached 88.35 percent of GDP in fiscal year 2011-12 compared to 83 percent in the last fiscal year. Private consumption has increased on the back of sustained growth in remittances. Furthermore, increase in rural income due to higher production of crops and the sharp increase in commodity prices also supported the consumption demand. The share of investment in GDP growth remained negative. A number of factors may be responsible for this decline. These include: slow down in global business activities affecting foreign direct investment, the decline in the external demand of the domestic production, serious energy shortages, unstable law and order situation and higher interest rates in the recent years. The contribution of net exports has also been negative. The balance between investment and consumption has been disturbed from 2008-09 onwards due to domestic and external shocks. The composition of aggregate demand highlights an alarming factor. The contribution of fixed investment to economic growth has become negative since 2008-09. Domestic demand continued to be the most significant driving force for economic growth, with private consumption being the major driver for sustaining aggregate demand. Table-22 presents composition of GDP growth.

Table-22: Composition of GDP Growth

Point Contribution

Flows	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Private Consumption	3.4	-1.9	8.3	-1.5	2.3	8.5
Public Consumption	-1.1	3.8	-4.2	5.1	0.4	0.9
Total Consumption [C]	2.3	1.9	4.1	3.6	2.7	9.4
Gross Fixed Investment	2.2	1.3	-2.7	-1.5	-1.3	-1.5
Change in Stocks	0.1	0	0.1	0.1	0.1	0.1
Total Investment [I]	2.3	1.3	-2.7	-1.4	-1.2	-1.4
Exports (Goods & Serv.) [X]	0.4	-1	-0.6	2.2	2.4	-2.1
Imports (Goods & Serv.) [M]	-0.7	0.6	-2.7	0.9	0.9	1.7
Net Exports [X-M]	1.1	-1.6	2.2	1.3	1.5	-3.8
Aggregate Demand (C+I+X)	5	2.2	0.9	3.5	3	5.9
Domestic Demand (C+I)	4.6	3.2	1.4	2.2	1.5	8
GDP MP	5.7	1.6	3.6	3.5	3	4.2

Source: Pakistan Bureau of Statistics

II. B.4 Investment and Savings

Investment plays an important role in the economic growth of a country. It raises the productive capacity of the economy, affects the employment levels, and promotes technological progress through embodiment of new techniques. Investment spending is usually volatile, because it depends on multiple factors. That is why it is responsible for much of the fluctuations of the GDP. Investment has been hard hit by international and domestic factors during the last few years. Total investment has declined from 22.1 percent of GDP in 2007-08 to 12.5 percent of GDP in 2011-12. Fixed investment has decreased to 10.9 percent of GDP in 2011-12 from 20.5 percent of GDP in 2007-08. Private investment witnessed a contraction of 7.9 percent in 2011-12 compared to 15.0 percent of GDP in 2007-08. Public investment as a percent of GDP also declined to 3.0 percent in 2011-12 against the 5.4 percent in 2007-08. The composition of investment between the private and public sector has also changed during the period.

The contribution of national savings to domestic investment is indirectly the mirror image of foreign savings required to meet investment demand. The requirement of foreign savings needed to finance the saving investment gap, reflects the current account deficit in the balance of payments. National savings are 10.7 percent of GDP in 2011-12 compared to 13.6 percent in 2007-08. Domestic savings have also declined from 11.5 percent of GDP in 2007-08 to 8.9 percent of GDP in 2011-12. Net foreign resource inflows are financing the saving investment gap. Theoretically, there are two ways of improving the savings investment gap. One is through increasing savings and the other is through decreasing investment. Pakistan needs to gear up both savings and investment to enhance the employment generating ability of the economy as well as increase resource availability for investment. Public sector investment is crucial for catalyzing economic development. It creates spillover effects for private sector investment because private sector development is facilitated through public sector development spending particularly on infrastructure.

However, curtailment of development expenditures limits private sector development. Public sector investment decreased from 5.4 percent of GDP in 2007-08 to just 3.0 percent in 2011-12. Savings and Investment as percentage of GDP are presented in Table-23.

Table-23: Structure of Savings and Investment (As Percent of GDP)

Description	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12 P
Total Investment	22.1	22.5	22.1	18.2	15.4	13.1	12.5
Changes in Stock	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Gross Fixed Investment	20.5	20.9	20.5	16.6	13.8	11.5	10.9
-Public Investment	4.8	5.6	5.4	4.3	3.6	2.9	3
-Private Investment	15.7	15.4	15	12.3	10.2	8.6	7.9
Foreign Savings	3.9	5.1	8.5	5.7	2.2	-0.1	1.8
National Savings	18.2	17.4	13.6	12.5	13.2	13.2	10.7
Domestic Savings	16.3	15.6	11.5	9.8	9.3	13.3	8.9

P: Provisional Source: EA Wing Calculations

II. B.5 Capital Market

The capital market, like the money market plays a significant role in the national economy. A developed, dynamic and vibrant capital market can contribute significantly in the speedy economic growth and development. It mobilizes funds from people for further investments in the productive channels of an economy, activating idle monetary resources and puts them in proper investments. Capital market also helps in capital formation. Capital formation is net addition to the existing stock of capital in the economy. Through mobilization of ideal resources it generates savings; the mobilized savings are made available to various segments such as agriculture, industry, etc. This helps in increasing capital formation. It raises resources for longer periods of time. Thus it provides an investment avenue for people who wish to invest resources for a longer period of time. It provides suitable interest rate return also to investors. Instruments such as bonds, equities, units of mutual funds, insurance policies, etc. definitely provide diverse investment avenues for the public.

The capital market enhances production and productivity in the national economy. As it makes funds available for long periods of time, the financial requirements of business houses are met by the capital market. It helps in research and development. This helps in increasing production and productivity in the economy by generation of employment and development of infrastructure. The lack of an advanced and vibrant capital market can lead to underutilization of financial resources. The developed capital market also provides access to foreign capital for domestic industry. Thus the capital market definitely plays a constructive role in the overall development of an economy.

Capital markets consist mainly of Stock (equity) and Debt markets. The capital market provides an avenue for raising the long-term financing needs of business through equity and long term debt by attracting investors with a long term investment horizon. The Karachi Stock Exchange (KSE) is the biggest and most liquid exchange in Pakistan with an average daily turnover of 254 million shares and market capitalization of US $ 41.0 billion as of the first week of May, 2012. The international magazine 'Business Week' declared the KSE as the best performing world stock market in 2002. Since then, international investors have given due considerations to the KSE in making decisions regarding foreign investment in equity markets.

Since 1991, foreign investors have an equal opportunity together with local investors to operate in the secondary capital market on the Karachi Stock Exchange. The establishment of the new policy for foreign investors and the privatization initiated in Pakistan has accelerated the development of the KSE, which had 591 companies listed in 2012.

The Karachi Stock Exchange trades the KSE-100 Index. It is a highly diversified index of 100 largest capitalization companies' stocks from all sectors of Pakistan's economy. A constantly revised index is a good indicator of the overall exchange performance over a period of time. In May, 2012, 92 percent of the KSE total market capitalization was represented by the KSE-100 Index.

The Lahore Stock Exchange is the second stock exchange established in Pakistan in 1971. Today, the LSE is the only domestic exchange to have more than one trading floor and is also the only exchange in the region to have established a unified order book with another domestic stock exchange in the country. The institution was established to facilitate the investors of Punjab and Northern areas by providing them an access to the capital market and enabling them to take part in the progress of the corporate sector of the country. The Lahore Stock Exchange Twenty Five company index, the LSE25, calculates the performance of stocks of major companies.

The third stock exchange, the Islamabad Stock Exchange, was incorporated as a guarantee limited company in 1989 in Islamabad with the main object of setting up a trading and settlement infrastructure, information system, skilled resources, accessibility and a fair and orderly market place. The purpose for establishment of the stock exchange in Islamabad was to cater to the needs of less developed areas of the northern part of Pakistan. ISE10 index monitors the performance of the ISE.

The Pakistan stock markets remained range bound during the first half with a predominantly declining trend. The obscure movement of the stock market statistics was consequent to various challenges faced by the country including escalating political upheaval, uncertainty due to worsening law and order situation as well as rumours on the economic front pertaining to reduction in military and civil aid from international donors, the Pak rupee depreciation and increasing fiscal deficit of the government. However, the KSE-100 index resumed its momentum during the 3rd quarter of 2011-12 owing to certain encouraging measures like considerable reduction in discount rate by the SBP during latter period of the first half of Current Financial Year and increase in foreign exchange reserves. Further, the market sentiment was boosted by the proposed promulgation of the Capital Gain Tax Ordinance under which the National Clearing Company of Pakistan Limited (NCCPL) has been appointed as an intermediary entity to compute, determine, collect and deposit the Capital Gain Tax (CGT) on listed securities. The subject Ordinance was finally promulgated on the 24th April, 2012.

In Pakistan, securities trading remained exempt from CGT for 36 years till June 30, 2010. The imposition of CGT on securities from July 1, 2010 has not only impacted the tax revenue (less than 10 percent of figure three years ago) but also reduced average traded value to the lowest level during the last ten years. During the period of exemption, the investors kept making gains from the securities trading which remained undocumented due to exemption from requirement of filing of income tax returns relating to exempt income. In 2010, after the imposition of CGT, investors were required to file the income tax returns along with declaring the source/evidence of investments for which they did not have the documented details. Due to this the investors reduced investments in the stock markets and the average daily turnover reduced along with the reduction in the share prices.

To address the distress condition of share trading in the stock market, some mechanism was required to provide relief to the investors who were subjected to 100 percent documentation of the gains and increase in the tax revenue. This has now been done with the promulgation of the CGT Ordinance under which NCCPL has been appointed as an intermediary entity to compute, determine, collect and deposit the CGT on listed securities. NCCPL is a clearing company where all the amounts relating to the trading activity in the stock markets in Pakistan are settled. Therefore the NCCPL can capture and tax all the transaction in which capital gain arises under the income tax law. The NCCPL will compute tax for all type of investors except the few financial intermediaries, foreign institutional investors and any other person specified by FBR. The tax rate for CGT will be 8 percent and 10 percent for investment holding up to six months and 12 months respectively till June 30, 2014. NCCPL will be depositing the tax with the FBR on an annual basis. In addition, no question relating to the source/nature of money will be asked by the tax authorities if the money remains invested in the stock market for a period of 45 days (till June 30, 2012) and 120 days (till June 30, 2014) before and after the promulgation of CGT Ordinance with a condition that the investor files with FBR a statement of investment, wealth statement, income tax returns and statement that the due tax has been paid. Further the automated system of the NCCPL will be audited on a quarterly basis and the NCCPL will submit quarterly statements to FBR relating to the CGT.

Performance of Karachi Stock Exchange

A total of 591 companies were listed at the Karachi Stock Exchange (KSE) as of May 04, 2012 with a total listed capital of Rs1, 059.087 billion. The aggregate market capitalization as on May 04, 2012 stood at Rs. 3,730.489 billion which remained below 18.1 percent of the provisional estimates of GDP, fiscal year 2012. Market performance in terms of volumes also remained sluggish during the first half of the 2011-12 as shown in the Table-24.

Table-24: Profile of Karachi Stock Exchange

Description	2007-08	2008-09	2009-10	2010-11	2011-12
Total listed companies	652	651	652	639	591
New companies listed	7	8	8	1	3
Fund mobilized (Rs. in billions)	62.88	44.95	111.83	31.04	107.29
Total Listed Capital (Rs. in millions)	706,419.98	781,793.81	909,893.67	943,732.85	1,058,455.26
Total Market Capitalization (Rs. in millions)	3,777,704.89	2,120,650.87	2,732,373.61	3,288,657.32	3,528,143.84
Total Shares Volume (million)	63,316.12	28,332.78	42,959.12	28,018.14	23,633.28
Average Daily Share volume (million)	256.34	115.64	172.53	111.63	127.75

Source: Karachi Stock Exchange

Performance of Lahore Stock Exchange

The top market indicators witness an encouraging trend at the Lahore Stock Exchange (LSE). The turnover of shares on the LSE during Jul-March, 2011-12 was 0.587 billion shares compared to 0.923 billion during the same period last year. The total paid-up capital with the LSE increased from Rs. 888.2 billion in June, 2011 to Rs. 981.7 billion in March, 2012. The LSE25 index which was at 3,051.1 points level in June, 2011, increased to 3,707.6 points in March, 2012. The market capitalization of the LSE has increased from Rs. 3,166 billion in June, 2011 to Rs. 3,294.1 billion in March, 2012. Two new companies were listed with the LSE during Jul-Mar 2011-12 in addition to listing of seven Open End Funds and one TFC and Bond during the same period as apparent in the Table-25.

Table-25: Profile of Lahore Stock Exchange

Description	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12**
Total Number of Listed Companies	520	514	511	510	496	460
New Companies Listed	10	2	9	25	9	2
Fund Mobilized (Rs billion)	38.8	29.7	32.8	67.5	18.1	5.5*
Listed Capital (Rs billion)	594.6	664.5	728.3	842.6	888.2	981.7
Turnover of Shares (billion)	8.2	6.5	2.7	3.4	1.1	0.6
LSE 25 Index	4,849.90	3,868.80	2,132.30	3092.7	3,051.10	3,707.60
Aggregate Market Capitalization (Rs	3,859.80	3,514.20	2,018.20	2622.9	3,166.00	3,294.10

*: Funds mobilized through Right issues. **: July-March

Source: Lahore Stock Exchange

Performance of Islamabad Stock Exchange

The Islamabad Stock Exchange (ISE) witnessed a mixed trend during the first nine months of 2011-12. The ISE-10 index started at 2,722.8 points on July 01, 2011 and closed at 2,821.9 points level at the end of March, 2012 showing an increase of 99.1 points (3.6 percent). The highest level of the index 2,907.97 was witnessed on March 05, 2012 as compared to the lowest level of 2,302.8 as on August 23, 2011. The average daily turnover of shares in the ISE during Jul-March, 2011-12 was 0.11 million shares as compared to 0.14 million shares during 2010-11. ISE index however increased to 2,942.01 points on May 07, 2012 as given in Table-26. .

Table- 26: Profile of Islamabad Stock Exchange

Description	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12*
Number of Listed Companies	246	248	261	244	236	254
New Companies Listed	12	7	15	2	-	-
Fund Mobilized (Rs. billion)	30.7	24.6	24.8	76.7	17.8	20.8
Listed Capital (Rs. billion)	488.6	551	608.6	715.7	727	830.5
Turnover of Shares (billion)	0.2	0.6	0.3	0.2	0.04	0.01
ISE 10 Index	2,716	2,749.60	1,713	2,441.20	2,722.80	2,821.90
Aggregate Market Capitalization (Rs billion)	3,060.60	2,872.40	1,705.10	2,261.70	2,621.10	2,824.40

*: July-March

Source: Lahore Stock Exchange

II. B.6 Money Supply

Supply of money has important repercussion for the economy because increased in money supply than demand of money will cause depreciation of the currency vis-a-vis currencies of the other countries. Depreciation of domestic currency will increase price of foreign goods and decrease price of domestic goods. But if the exports of domestic country are not too much diversified and are not composed of high value added products, the benefits of increasing trade volume due to decreased prices of domestic goods cannot be achieved as expected in the case of developed countries of the world whose exports are comprised of high value added products and are too much diversified. Table 27 presents income velocity of money in Pakistan during the period 1980-81 to 2011-12. M1 consists of the outstanding stock of currency in circulation, the demand deposits of scheduled banks and the other deposits with the State

Bank of Pakistan. During the period of 1980-81 to 2011-12, M1 increased by 48.92 percent against 15.98 percent of the fiscal year 2006-07.

M2 is M1 plus the outstanding stock of time deposits of scheduled banks and the outstanding stock of the Resident Foreign Currency Deposits (RFCDs). M3 includes: the outstanding stock of the M2, outstanding deposits of the national saving schemes (NSS), and outstanding deposits of the provincial cooperative banks of the Punjab, Sindh, NWFP, Balochistan, Azad Jammu & Kashmir, and the Northern Areas. M2 recorded a growth of 15.9 percent during the year 2010-11 compared to 12.5 percent the previous fiscal year 2009-10. Table-27 shows the circulation of money in the country from 1980-81 to 2010-11.

Table.-27: Income Velocity of Money

(Rs billion)

End June Stock	Narrow Money M1	Monetary Assets (M2) (Rs million)	Growth Percentage	Income Velocity of Monetary Assets (M2)
1980-81	73.56	104.62	13.2	2.7
1981-82	80.93	116.51	11.4	2.7
1982-83	96.54	146.03	25.3	2.7
1983-84	103.45	163.27	11.8	2.7
1984-85	118.97	183.91	12.6	2.7
1985-86	134.83	211.11	14.8	2.6
1986-87	159.63	240.02	13.7	2.5
1987-88	185.08	269.51	12.3	2.6
1988-89	206.36	290.46	7.8	2.7
1989-90	240.16	341.25	17.5	2.7
1990-91	265.14	400.64	17.4	2.7
1991-92	302.91	505.57	26.2	2.7
1992-93	327.82	595.39	17.8	2.3
1993-94	358.77	703.4	18.1	2.4
1994-95	423.14	824.73	17.2	2.4
1995-96	448.01	938.68	13.8	2.4
1996-97	443.55	1,053.23	12.2	2.5
1997-98	480.33	1,206.32	14.5	2.3
1998-99	643.04	1,280.55	6.2	2.4
1999-00	739.03	1,400.63	9.4	2.2
2000-01	1,275.61	1,526.04	9	2.6
2001-02	1,494.14	1,751.88	14.8	2.5
2002-03	1,797.36	2,078.48	18.6	2.3
2003-04	2,174.74	2,485.49	19.6	2.3
2004-05	2,512.21	2,960.64	19.1	2.4
2005-06	2,720.68	3,406.91	15.1	2.4
2006-07	3,155.63	4,065.16	19.3	2.3
2007-08	4,339.50	4,689.14	15.3	2.3
2008-09	3,621.22	5,137.21	9.6	2.6
2009-10	-	5,777.23	12.5	2.7
2010-11 R	-	6,695.20	15.9	2.9

Source: State Bank of Pakistan

II. B.7 Employment

Achieving full employment level is one of the key objectives of every government. Full employment ensures internal balance in the economy. In Pakistan, employment comprises of all the persons of ten years of age and above who work at least one hour during the reference period and was either “paid employed” or “self-employed”. Persons employed on permanent / regular basis who have not worked for any reason during the reference period are also treated as employed regardless of the duration of the absence or salary received during the absence. During the period 1999-2000 to 2010-11, 17.52 million work opportunities were created, mainly due to the strong economic growth during 2006-07 and 2005-06 and 2007-08. However, there is only 0.63 million work opportunities have been created during 2009-10 to 2010-11 compared to 2.42 million in the previous year 2009-10. During 2010-11 to 2009-10, 0.6 million work opportunities were created in rural areas as compared to 0.03 million in urban areas, as shown in Table-28. This is indicative of a weaker labor market situation, especially in the urban areas of country.

Table-28: Employment Trend and Changes from 1999-00 to 2010-11

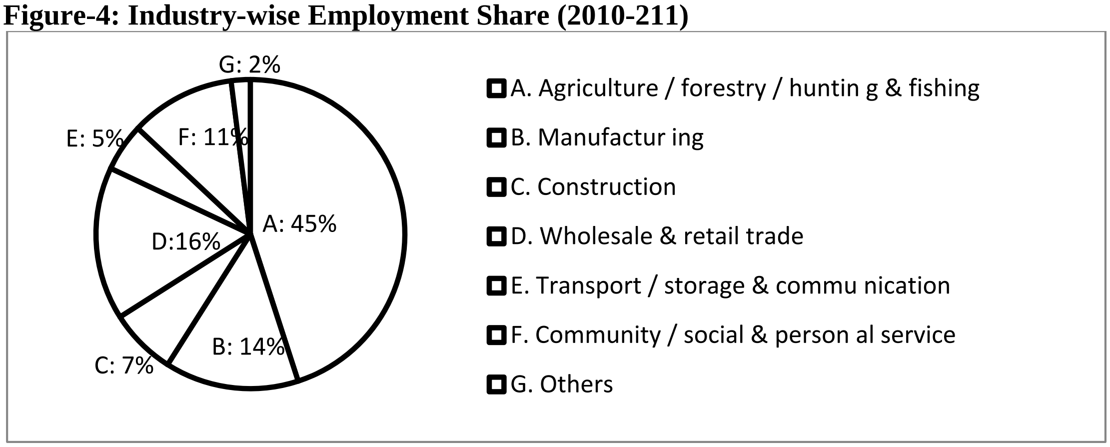
(million)

Year	Pakistan		Rural		Urban	
	Employed	Change	Employed	Change	Employed	Change
1999-00	36.32	2.19	25.55	1.68	10.77	-0.01
2001-02	38.88	2.56	26.66	1.11	12.22	1.45
2003-04	42	3.12	28.81	2.15	13.19	0.97
2005-06	46.95	4.95	32.49	3.68	14.46	1.27
2006-07	47.65	0.7	33.11	0.62	14.54	0.08
2007-08	49.09	1.44	34.48	1.37	14.61	0.07
2008-09	50.79	1.7	35.54	1.06	15.25	0.64
2009-10	53.21	1.08	37.25	0.79	15.96	0.29
2010-11	53.84	0.63	37.85	0.6	15.99	0.03

Source: Various issues of Labour Force Survey (2010-11) Pakistan Bureau of Statistics

Agriculture is the major source of employment. It employs 45 percent of total labour force as apparent from Figure-4. About 16 percent of labour force is associated with wholesale and retail businesses. Other important sub-sectors of economy are manufacturing and community, social and personal service which employs about 14 percent and 11 percent, respectively.

Figure-4: Industry-wise Employment Share (2010-211)



Source: Pakistan Bureau of Statistics, Labour Force Survey 2010-11

II. C. Fiscal Position

Government raises revenue to finance its budget through taxes and non-taxes legislation. However, taxes are major source of revenue, which along with growth plays a vital role in building up institutions and markets. A good tax system not only helps in equitable distribution of economic benefits for social justice but also attracts investment at all levels of business activities. The absence of an efficient tax system discourages well documented investment and compels the country to rely on continuous borrowing from internal and external sources to finance the budgetary deficit, which may crowd out private investment. For more than a decade now the low tax to GDP ratio has been a major economic issue confronting Pakistan. The overall tax to GDP ratio has varied between 9.5 to 11.4 percent mainly due to structural deficiencies in the tax and administration system.

Pakistan is characterized as having the lowest tax to GDP ratio not only amongst the peer countries but also in the region. During the five years from 2000-01 to 2005-06, tax collection by the FBR increased by 81.0%. The Federal Board of Revenue (FBR) for the first time in history of the country surpassed a figure of rupee one trillion (Rs.1025 million) tax collections in the year 2007-08. The tax revenue for the year 2008-09 remained at Rs.1250 million which shows a growth of 16 percent compared to 12 percent of the previous year. Fiscal year 2008-09 had been a difficult year for Pakistan's economy due to many unexpected events on both foreign and domestic fronts.

Notwithstanding difficulties faced by the economy during the year 2008-09, better fiscal discipline and improving management led to substantial improvement in the fiscal outlook. Total expenditure has fluctuated between 17 and 20 percent of GDP in the past six years. During 2008-09, expenditure remained 18.6 percent of GDP compared to 22.2 percent in the previous year. The spike during 2007-08 was mainly due to unprecedented expenditures incurred on account of subsidies and political expediencies by the outgoing government in the election year. The year 2008-09, however, witnessed correction on this account and expenditure control measures brought significant downward adjustment in expenditure. Interest payments decline from as high as 6.8 percent of GDP or Rs.262 billion in 1999-2000 to 4.8 percent of GDP or Rs.624 billion for 2008-09. The war on terror in some parts of the country has placed a burden on security related expenditure. Growth in total expenditure witnessed significant decline at the expense of substantial fall in development spending to the extent of 15.1 percent. Elimination of oil subsidies and a decline in development spending led to a significant reduction in public expenditure growth during the first half of the year 2008-09.

As a share of GDP, development expenditure dropped to one percent in the first half of 2008-09 which is the lowest level of spending in the last five years. Current expenditure grew by 18.3 percent as compared to 33.3 percent increase in the same period of last year. However, the first half current expenditure growth is still high and needs to be brought down for sustained fiscal consolidation. The main reason for this rise is the tremendous rise in security related expenditure.

However, the government is committed to increase this ratio by introducing various additional tax measures such as: monitoring and risk based audit, strengthening electronic payment, close watch on Afghan transit trade and recovering arrears etc. These measures helped the FBR to collect Rs. 1,558 billion during 2010-11 against Rs. 1,008 billion in 2007-08. FBR Tax collection has shown a significant growth of 54.6 percent since 2007-08. For the current fiscal year 2011-12, the target of Rs. 1,952.0 billion has been set. During first ten months of 2011-12, total tax revenue collection stood at Rs.1, 426.0 billion excluding Rs19 billion of sales tax on services collected by the Sindh Revenue Board against Rs.1, 149. 8 billion in the comparable period of last year. This is an increase of 24.0 percent. Table-29 summarizes fiscal indicators as percent of GDP.

Table-29: Fiscal Indicators as Percent of GDP

Year	Real GDP Growth	Overall Fiscal Deficit	Expenditure			Revenue		
			Total	Current	Development	Total	Tax	Non-Tax
FY01	2	4.3	17.4	15.3	2.1	13.1	10.5	2.6
FY02	3.1	4.3	18.5	15.7	2.8	14	10.7	3.3
FY03	4.7	3.7	18.8	16.2	2.6	14.8	11.4	3.4
FY04	7.5	2.3	16.5	13.7	2.8	14.2	11	3.2
FY05	9	3.3	16.8	13.3	3.5	13.8	10.1	3.7
FY06	5.8	4.3	18.4	13.6	4.8	14.1	10.5	3.6
FY07	6.8	4.4	20.6	15.8	5	14.9	10.2	4.7
FY08	3.7	7.6	22.2	18.1	4.4	14.6	10.3	4.4
FY09	1.7	5.3	19.9	16	3.8	14.5	9.5	5.1
FY10	3.1	6.3	20.3	16.8	3.5	14	10.1	3.9
FY11	3	5.9	19.2	16.1	2.8	12.5	9.5	3.1
FY12[B]	3.7	4	18	14.4	3.6	13.9	10.4	3.5

B: Budget

Source: Economic Survey of Pakistan 2011-12

II. C.1 Government Expenditure

Public expenditures are significant for provision of social services, economic stabilization and growth. Public expenditure may broadly be categorized as development expenditure and non-development expenditure. However, in Pakistan, public expenditures remained under tremendous pressure during 2011-12 owing to flood related expenses, continued security related issues and higher subsidies. During July-March, 2011-12, actual disbursement against the budgeted subsidy of Rs. 166.4 billion set for the current fiscal year 2011-12 stood at Rs.103 billion (excluding Rs. 391 billion on account of debt consolidation). It is expected to increase further on account of a settlement of circular debt issue. The permanent solution of the circular debt issue requires the rationalization of electricity tariff and improving the overall efficiency of the energy sector. Trends in total expenditure, current expenditure, interest payments, defense expenditure and development expenditure during fiscal year 2001 to fiscal year 2012 has been given in Table-30.

Table-30: Trends in Components of Expenditure (as % of GDP)

Year	Total Expenditure (A)	Current Expenditure (B)	Interest Payments (C)	Defence Expenditure (D)	Development Expenditure (E)	Fiscal Deficit
FY01	17	15.3	5.9	3.1	2.1	4.3
FY02	18.5	15.7	6.1	3.3	2.8	4.3
FY03	18.4	16.2	4.8	3.3	2.6	3.7
FY04	16.9	13.7	4	3.3	2.8	2.3
FY05	17.2	13.3	3.4	3.2	3.5	3.3
FY06	18.4	13.6	3.4	3.2	4.8	4.3
FY07	20.6	15.8	4.4	2.9	5	4.3
FY08	22.2	18.1	5	2.7	4.4	7.6
FY09	19.9	16	5.2	2.6	3.8	5.4
FY10	20.3	16.8	4.5	2.5	3.5	6.3
FY11	19.2	16.1	4	2.5	2.8	5.9
FY12[B]	18	14.4	3.8	2.4	3.6	4.0*

B: Budgeted * Budgeted number is revised to 4.7 percent of GDP
Source: Economic Survey of Pakistan 2011-12

Total expenditures (TE) stood at Rs. 3,455.1 billion or 19.2 percent of GDP in 2010-11 as compared to Rs.3, 006.7 billion or 20.3 percent of GDP in 2009-10. It is worth mentioning that despite the unplanned expenditures due to flood related activities at the start of the current fiscal year, the expenditures as percent of GDP remained at 12.8 percent (Rs.2,641.9 billion) during July-March 2011-12. Total expenditures are expected to decline by 18.0 percent.

Current expenditures (CE) are expected to remain at 14.4 percent of GDP in fiscal year 2011-12. During fiscal year 2010-11, current expenditure were Rs.2,900.8 billion or 16.1 percent of GDP compared to Rs. 2,481.0 billion or 16.8 percent of GDP in 2009-10. The decline came from non-interest-non-defense spending. During July-March, 2011-12 current expenditures stood at Rs.2, 154.1 billion or 10.4 percent of GDP compared to Rs.1, 909.8 billion or 10.6 percent of GDP in the same period of fiscal year 2010-11.

Development expenditures in fiscal year 2010-11 remained at Rs. 506.1 billion or 2.8 percent of GDP as compared to Rs.517.9 billion or 3.5 percent of GDP in 2009-10. In the current fiscal year's budget, the allocation for development expenditure is 3.6percent of GDP. The share of current expenditure in total expenditure has declined significantly from 89.9 percent to 84percent in 2010-11. These are expected to decline further by 4 percent due mainly to the substantial fall in interest payments. Defense expenditures accounted for 15.5 percent of current expenditure in 2010-11. As a percentage of GDP defense expenditures were 2.5 percent in 2010-11 and are likely to remain slightly below this level in 2011-12. However in absolute terms defense expenditure rose to Rs.450.6 billion during 2010-11 from Rs.375.0 billion in 2009-10. Nevertheless the budget target is set at Rs. 495.2 billion for 2011-12 which is around 2.4 percent of GDP. The federal government overall budgetary position is given in Table-31.

Table-31 presents the overall budgetary position of the federal government during July-March 2011-12. The gross revenue receipts stood at Rs.1, 665,161 million and the total expenditure at Rs.1, 807,911 million. It shows the government has been facing sizeable fiscal deficit. So it is apparent from the budgetary position that there is likelihood of downward pressure on Pak Rupee vis-à-vis dollar in the coming fiscal year, in case the government could not able to collect enough from external sources to finance this fiscal deficit.

Table-31: Federal Government Overall Budgetary Position

(Rs Million)

Item	2011-12 July-March
A. REVENUE	
FBR Tax Revenue (1 +2)	1,280,397
1 Direct Taxes	478,661
2 Indirect Taxes	801,736
i. Custom	148,547
ii. Sales Tax	568,384
iii. Federal Excise	84,805
Others	41,139
Non-Tax Revenue	343,625
Gross Revenue Receipts	1,665,161
B. EXPENDITURE	
Current Expenditure	1,525,428
i. Defence	347,956
ii. Interest	624,499
iii. Grants	204,081
vi. Others	348,892
Development Expenditure and Net Lending	282,483
Total Expenditure	1,807,911

Source: Budget Wing, Finance Division, Islamabad

Table-32: Summary of Public Finance (Consolidated Federal and Provincial Governments)

(Rs Million)

Item	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Total Revenues (i+ii)	1,297,957	1,499,380	1,850,901	2,078,165	2,260,712	1,747,036
Federal	1,215,730	1,380,599	1,721,028	1,955,457	2,133,832	1,653,432
Provincial	82,227	118,781	129,873	122,708	126,880	93,604
i) Tax Revenues	889,685	1,050,696	1,204,670	1,498,814	1,707,191	1,379,183
Federal	852,866	1,009,902	1,158,586	1,444,000	1,642,632	1,321,536
Provincial	36,819	40,794	46,084	54,814	64,559	57,647
ii) Non-Tax Revenues	408,272	448,684	646,231	580,000	553,521	367,853
Federal	362,864	370,697	562,442	512,000	491,200	331,896
Provincial	45,408	77,987	83,789	68,000	62,321	35,957
Total Expenditures (a+b+c)	1,799,968	2,276,549	2,531,308	3,006,662	3,455,120	2,641,910
a) Current	1,375,345	1,853,147	2,041,570	2,481,000	2,900,784	2,154,077
Federal	973,130	1,416,015	1,495,873	1,854,000	2,088,124	1,478,698
Provincial	402,215	437,132	545,697	627,000	812,660	675,379
b) Development	433,658	451,896	480,282	517,919	506,103	421,037
c) Net Lending to PSE's	-9,035	-28,494	6,911	39,383	7,904	6,948
d) Statistical Discrepancy	-124,510	0	2,545	-31,640	40,329	59,848
Overall Deficit	-377,501	-777,169	-682,952	-929,061	1,194,409	894,874
Financing (net)	377,501	777,169	680,407	879,000	1,194,409	894,874
External (Net)	147,150	151,311	149,651	138,000	107,705	47,412
Domestic (i+ii)	230,351	625,858	529,466	741,000	1,086,704	847,462
i) Non-Bank	8,100	56,905	104,302	223,846	435,610	471,575
ii) Bank	70,900	101,982	519,906	305,620	304,562	615,129
iii) Privatization Proceeds	97,300	71,464	1,650	1,290	0	0
Memorandum Item						
GDP (mp) in Rs. Billion	8,673	10,243	12,724	14,804	18,033	20,654
(As Percent of GDP at Market Price)						
Total Revenue	15	14.6	14.5	14	12.5	8.5
Tax Revenue	10.3	10.3	9.5	10.1	9.5	6.7
Non-Tax Revenue	4.7	4.4	5.1	3.9	3.1	1.8
Expenditure	20.8	22.2	19.9	20.3	19.2	12.8
Current	15.9	18.1	16	16.8	16.1	10.4
Development	4.9	4.4	3.8	3.5	2.8	2
Overall Deficit Incl. E.quake Exp.	4.4	7.6	5.3	-6.3	5.9	4.3

Source: Budget Wing, Finance Division, Islamabad

Table-33 shows the overview of provincial budgets. The total outlay of the four provincial budgets for 2011-12 stood at Rs.1, 435 billion; 21.7 percent higher than the outlay of Rs. 1,179 billion last year. Punjab witnessed the highest increase of 24.4percent in budgetary outlay, followed by Sindh (22.3 percent), Baluchistan (20.3 percent) and KPK (14.5 percent). The overall provincial revenue receipts for 2011-12 are estimated at Rs 1,404 billion, which is up by 20.5 percent compared to last year. During 2010-11 provincial revenues witnessed a growth of 34 percent compared to 20.4 percent in 2009-10.

Table-33: Overview of Provincial Budgets

(Rs Billion)

	Punjab		Sindh		KPK		Baluchistan		Total	
Fiscal Years/ Items	2011 RE	2012 BE	2011 RE	2012 BE	2011 RE	2012 BE	2011 RE	2012 BE	2011 RE	2012 BE
A. Total Tax Revenue	502.6	625.4	310.6	359.4	160.2	195.4	100.5	111.5	1073.9	1291.7
Provincial Taxes	39	48.6	32.7	35	3.3	3.6	1.2	1.3	76.2	88.5
Share in Federal Taxes	463.6	576.8	277.9	324.4	156.9	191.8	99.3	110.2	997.7	1203.2
B. Non-Tax Revenue	26	20.6	12.4	19.9	5.4	5.9	2.8	3.5	46.6	49.9
C. All Others	-7.5	21.2	11.3	17.9	37.6	23.9	3.8	-0.2	45.2	62.8
Total Revenues (A+B+C)	521.1	667.2	334.3	397.2	203.2	225.2	107.1	114.8	1165.7	1404.4
a) Current Expenditure	387.6	434.8	281.2	283.1	139.5	149	74.3	90.6	882.6	957.5
b) Development Expenditure	138.7	220	65.6	141.1	65	85.1	27.1	31.4	296.4	477.6
i) Rev. Account	81.4	127.2	3.9	51.7	10.3	13.1	0	0	95.6	192
ii) Cap. Account	57.3	92.8	61.7	89.4	54.7	72	27.1	31.4	200.8	285.6
Total Exp (a+b)	526.3	654.8	346.8	424.2	204.5	234.1	101.4	122	1179	1435.1

Source: Provincial Finance, Budget Wing

Public Debt

Pakistan’s public debt grew at an average rate of 18 percent and 15 percent per annum during the 1980s and 1990s, respectively – much faster than the growth in nominal GDP (11.9% and 13.9% respectively). Resultantly, public debt rose from 56 percent of GDP at the end of the 1970s to 92 percent by the end of the 1980s. The root cause of rising debt burden has been the persistence of large fiscal and current account deficits. Pakistan, on average, sustained fiscal and current account deficits of almost 7 percent and 5 percent of GDP, respectively during 1990-99. In many developing countries including Pakistan, the “twin deficits” have been the prime cause of low economic growth. Large fiscal and current account deficits led to the accumulation of domestic and external debt which increased country’s vulnerability to external shocks, reduced investment rate, and consequently slowed economic growth. Thus, there exist a strong negative relationship between fiscal deficits and economic growth. When a country like Pakistan sustains such a large fiscal and current account deficits for so long a period is bound to experience decrease in economic growth.

It is in this background that the first and foremost challenge for the government six years ago had been to arrest the rising trends of debt. The government had set-up a high level Debt Committee which examined the root cause of the rising debt burden and suggested debt reduction strategy to stabilize debt situation. The government is following the debt strategy as suggested by the Committee. Reduction in the fiscal and current account deficits, lowering the cost of borrowing, raising revenue and foreign exchange earnings, and debt re-profiling from the Paris Club have been the key features of the debt reduction strategy. To provide legal cover to debt reduction strategy a Fiscal Responsibility and Debt Limitation Act 2005 was promulgated in June 2005. As a result of the credible strategy being followed by the Government, the public debt-to-GDP ratio, which stood at almost 85 percent in end June 2000, declined substantially to 61.4 percent by the end of June 2005, 23.6 percentage points decline in country’s debt burden in 5 years. As far year 2008-09, total public debt increased by Rs.1367 billion in the first nine months, reaching a total outstanding amount of Rs.7268 billion; an increase of 23.2 percent in nominal terms. Total public debt had been growing at an average of 12 percent per year since 1999-2000.

The increase in total public debt is shared between rupee and foreign currency debt in the ratio 0f 40:60. The rise in foreign currency debt is mainly is massive depreciation of Pak rupee in the start of fiscal year 2008-09. In absolute terms $3.1 billion are added to the public external debt in the period July-March 2009, however, big chunk of Rs.246 billion has come from depreciation. In the first nine months of 2008-09, the depreciation of rupee against the dollar has been responsible for approximately 18 percent addition to total increase in public debt and 30 percent to public external component. The rupee has lost 20 percent of its value against the dollar in just nine months.

The structure of public debt has also experienced subtle changes since 2001-02. The focus has been shifted more towards domestic borrowings which inched up its share from 48.9 percent in 2001-02 to 54.4 percent in 2007-08. The massive borrowings from the State Bank of Pakistan (SBP) has not only fueled inflationary pressures in the economy but also responsible for fiscal indiscipline resulting in dire consequences for debt management. The government has placed a restraint of net zero quarterly borrowing from the SBP.

Total public debt is a measure of government indebtedness. It includes all government and government guaranteed obligations denominated in rupee as well as foreign currency. It is an important means of bridging government financing gaps. However, excessive reliance on public debt and inappropriate public debt management raise macroeconomic risks, impede economic growth, and hinder economic development. Domestic and external debt should be treated separately. Domestic debt is a charge on the budget and must be serviced through government revenues and/or additional borrowings whereas external debt (both public and private) in addition to government revenues is also a charge on the balance of payment and must be serviced from foreign exchange earnings, reserve drawdown, and additional borrowings. As at end of March 2012, public debt stood at Rs. 12,024 billion registering an increase of Rs. 1,315 billion or 12.3 percent as compared to fiscal year 2011. The increased amount includes Rs.391billion consolidated by the government into public debt against outstanding previous years subsidies related to the food and energy sectors. Public debt as a percent of GDP stood at 58.2 percent by end-March 2012 compared to 55.5 percent of GDP during the same period last year. Table-34 gives public debt as percent of GDP.

Table-34: Public Debt

% of GDP

	2007	2008	2009	2010	2011	2012*
Domestic Currency Debt	30	32	30.3	31.4	33.4	34.9
Foreign Currency Debt	25.4	27.1	29.4	28.9	26	23.3
Total Debt	55.4	59.1	59.7	60.4	59.4	58.2

* End-March

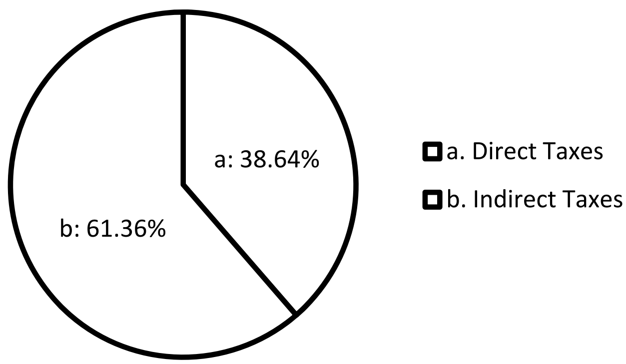
Source: State Bank of Pakistan, Budget Wing, Economic Adviser's Wing & Debt Policy Coordination Office

II. C.2 Aggregate Tax Revenue

Federal Board of Revenue (FBR) is the authority at federal level to collect tax revenues. It is headed by Chairman who is also the Secretary Revenue Division. The structure of Pakistan's taxation changed considerably since the 1990s. Under the present tax system, some sectors are under-taxed and others are not taxed at all. This distortion is being addressed. Moreover, the internal tax system has undergone substantial changes as the share of income tax has risen significantly from around 32 percent in 2000-01 to 38.64 percent during July-March 2011-12. On the other hand the composition of taxes has been rationalized with a gradual decrease in the dependence on foreign trade taxes and a simultaneous increase in GST. Customs and excise duties have registered a gradual decline on account of the tax and tariff reforms with excise and custom comprising only 8.5 percent and 10.6 percent respectively in 2011-12. Pakistan's tax to GDP ratio stood at around 8.6 percent in 2010-11 and expected to be about 9.5 percent of GDP in 2011-12. The indirect tax to GDP ratio stood at around 5.3percent and direct tax to GDP ratio at around 3.3 percent in 2010-11. During July-April, 2011-12 indirect tax-to-GDP ratio stood at 4.3 percent and direct tax to GDP ratio recorded at 2.6 percent. The ratio can only be increased substantially if the major contributors to GDP growth not included in the tax net can be brought into the tax system.

Figure-5 shows the structure of collection of federal taxes during 2010-11. The direct taxes largely income tax contributed 38.64 percent to total federal tax revenue. On the other, indirect taxes including general sales tax, federal excise duty and customs duty contributed 61.64 percent. It indicates that the focus of tax administration is largely on indirect taxes.

Figure-5: Structure of Federal Taxes (2010-11)



Source: FBR Year Book 2010-11

Table-35 gives total tax collection during 2002-03 to 2010-11. The table indicates that percent tax collection has increased every year. The increase was 14 percent in 2002-03 and 17.40 percent in 2010-11. In absolute terms, total tax collection was Rs.461billion in 2002-03 that has been increased over the years and reached at Rs.155,8 billion in 2010-11.

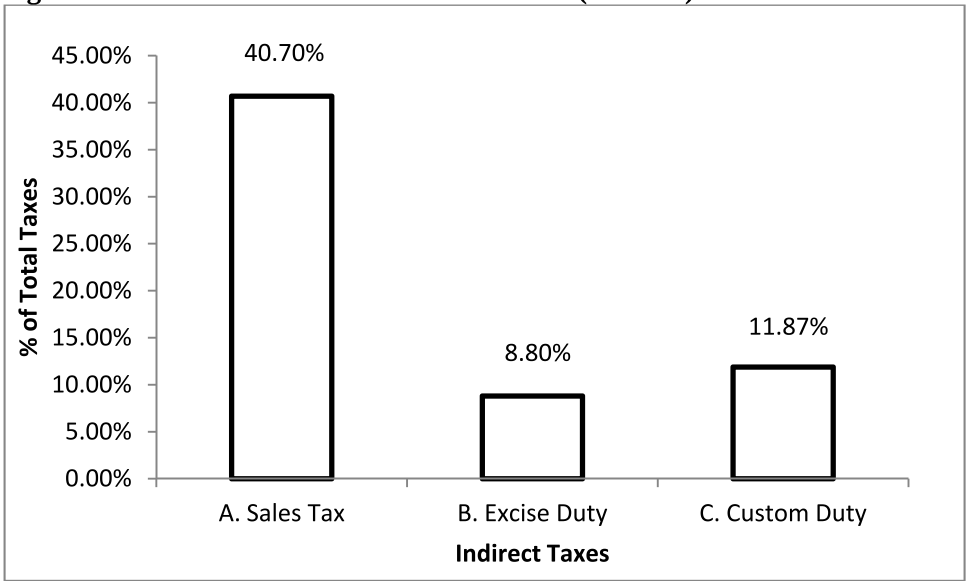
Table-35: Trend of Federal Taxes

Year	Tax Collection (Billion Rs)	% Annual Increase
2002-03	461	14%
2003-04	519	12.58%
2004-05	589	13.50%
2005-06	713	21.05%
2006-07	847	18.80%
2007-08	102,5	21%
2008-09	116,1	13.27%
2009-10	132,7	14%
2010-11	155,8	17.40%

Source: Federal Board of Revenue, Pakistan

Figure-6 shows the structure of indirect taxes collected at federal level. In 2010-11, the total collection of indirect taxes was 61.38 percent. The contribution of sales tax, excise duty and customs duty was 40.7 percent, 8.8 percent and 11.87 percent, respectively.

Figure-6: Structure of Federal Indirect Taxes (2010-11)



Source: FBR Year Book 2010-11

III. Tax Structure

What is a good tax structure? According to Shirazi and Shah (1991), tax structures must be:

i. Simple: easy to administer and comply with,
ii. Elastic: be responsive to growth and the changing structure of economic activity,
iii. Efficient: not to create serious economic distortions and raise sufficient revenue,
iv. Equitable -treats individuals and businesses in similar circumstances same, and
v. Fair: tax administration and enforcement are non-selective.

An efficient tax system should raise enough revenue to finance essential expenditures without excessive public sector borrowing; and raise the revenue in ways that are equitable and that minimize its disincentive effects on economic activities. In Pakistan, the establishment of effective and efficient tax system faces some serious challenges. The first of these challenges is the structure of the economy that makes it difficult to impose and collect certain taxes. For example, the economy of Pakistan is often characterized by a large share of agriculture in total output and employment; by large informal sector activities and occupations' by many small establishments; by a small share of wages in total national income, and so on. All these factors reduce the possibility of relying on certain modern taxes such as income tax, sales tax etc. The structure of the economy in association with low literacy and low human capital make it difficult to develop a good tax administration. When the officials of tax administration are not well educated and well trained, when resources to pay good salary and to establish necessary infrastructure are limited, when the tax payers have limited ability to keep accounts, when the use IT is limited, it is difficult to collect tax effectively.

In consequence all above said factors, Pakistan often ended up with small tax sources, heavy reliance on custom duties, and not on direct taxes. The non-availability of reliable statistics from the businesses makes it even more difficult for tax administration to assess the potential taxes that need to be collected. As a consequence, marginal changes are often preferred over major structural changes. This perpetuates the inefficient tax structure. Uneven income distribution is also a major constraint in developing efficient tax system.

To generate higher tax revenue, the high income earners are supposed to be taxed significantly more proportionately than the low income group. But the economic and political powers are concentrated in the top brackets which set the goals of the tax administration rather more difficult to collect taxes from high income earners. This is one of the major reasons that the number of income tax payers in Pakistan is very low.

The above discussed factors and difficulties prevented Pakistan to raise its tax-to-GDP ratio in line with the average of developing countries at 17%. As a result, Pakistan sustained a large budget deficit throughout the 1990s. Realizing the weaknesses of Pakistan's tax structure, a concerted reform effort was launched in the early 2000. The government began wide-ranging tax and tariff reforms and worked on fiscal transparency, aimed at reducing tax rates, broadening the tax base to hitherto untaxed or under taxed sectors, and shifting the incidence of taxes from imports and investment to consumption and incomes.

The reduction in tax rates was intended to stimulate investment and production and promote voluntary tax compliance. Broadening of the tax base was intended to ensure the fair distribution of the tax burden among various sectors of the economy. Among the various tax policy reforms, the most significant are the continuous raising of the basic threshold of income tax, reduction of corporate tax rate to ensure parity between the rates applicable to private, public, and banking companies, re-introducing uniformity of General Sales Tax rate, and continuous reduction and rationalization of tariff rates.

The wide-ranging tax and tariff reforms as well as reforms in the tax administration have started paying dividends. Tax collection by the Federal Board of Revenue (FBR) has gone up, the overall budget deficit as percentage of GDP has declined; the revenue deficit has been narrowed. An improved tax structure will reduce the deadweight loss associated with raising a given amount of revenue and a reduction in the relative share of trade taxes, and increase in the relative shares of taxes on income and consumption could be an ample evidence of an improvement in the tax system. Structure of federal tax revenue during fiscal year 2000-01 to July-March 2012 is given in Table-36.

Table- 36: Structure of Federal Tax Revenue

(Rs. Billion)

Year	Total (FB R)	Tax Rev as % of GDP	Direct Taxes	Indirect Taxes			
				Customs	Sales	Excise	Total
2000-01	39 2.3	9.4	124.6 [31.8]	65 {24.3}	153.6 {57.4}	49.1 {18.3}	267.7 [68.2]
2001-02	40 4.1	9.2	142.5 [35.3]	47.8 {18.3}	166.6 {63.7}	47.2 {18}	261.6 [64.7]
2002-03	46 0.6	9.6	151.9 [33.0]	68.8 {22.3}	195.1 {63.2}	44.8 {14.5}	308.7 [67.0]
2003-04	52 0.9	9.2	165.1 [31.7]	91 {25.6}	219.2 {61.6}	45.6 {12.8}	355.8 [68.3]
2004-05	59 0.4	8.9	183.4 [30.1]	115.4 {28.4}	238.5 {58.6}	53.1 {13.0}	407 [68.9]
2005-06	71 3.5	9.4	225 [31.5]	138.4 {28.3}	294.8 {60.3}	55.3 {11.3}	488.5 [68.5]
2006-07	84 7.2	9.7	333.7 [39.4]	132.3 {25.8}	309.4 {60.3}	71.8 {14.0}	513.5 [60.6]
2007-08	1,008.10	9.8	387.9 [38.5]	150.7 {24.3}	377.4 {60.9}	92.1 {14.9}	620.2 [61.5]
2008-09	1,161.10	9.1	443.5 [38.2]	148.4 {20.7}	451.7 {62.9}	117.5 {16.4}	717.6 [61.8]
2009-10	1,327.40	9	526 [39.6]	160.3 {20.0}	516.3 {64.4}	124.8 {15.6}	801.4 [60.4]
2010-11	1,558.20	8.6	602.5 [38.7]	184.9 {19.3}	633.4 {66.3}	137.4 {14.4}	955.7 [61.3]
2011-12B	1,952.00	9.5	745 [38.2]	215 {17.8}	852 {70.6}	140 {11.6}	1207 [61.8]

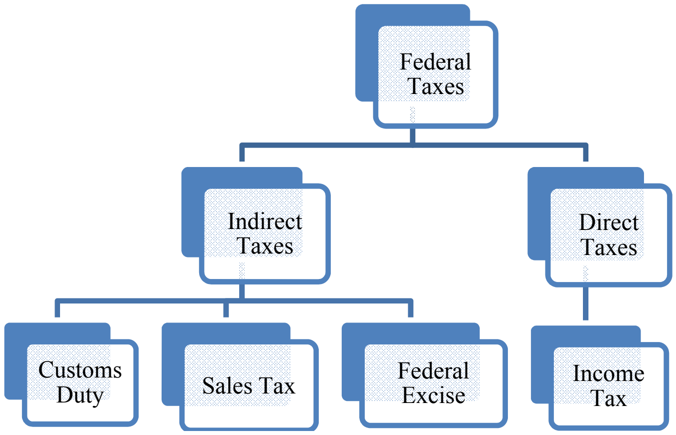
[ ]as % of total taxes, { } as % of indirect taxes

Source: Federal Board of Revenue

The basic principles of tax policy have been set as widening the tax base by reducing exemptions, incentives and concessions, reducing multiplicity of rates, lowering tax rates, shifting the incidence of tax burden from production to consumption, moving away from the excessive reliance on manufacturing and taxing all value additions including services, and re- engineering business process of the tax system to overcome the culture of tax avoidance and evasion; introducing business process changes in tax administration to establish an efficient tax system. It is the continuous policy and effort of the government to implement these principles. But unfortunately despite the recent reforms, the tax effort remained modest in Pakistan on account of various structural problems. The administrative reforms envisaged by the FBR, especially moving towards a functional organizational structure, has helped to enhance tax efficiency, as well as improving the tax climate and governance. However, expanding taxation gradually into the agricultural and service sectors would bring greater yields, as would efforts to reduce evasion.

Figure-7 presents the flow chart of organization of the federal taxes. It is apparent that like many countries, the sources of tax revenue in Pakistan also comprise of direct taxes as well as indirect taxes. Sales tax, federal excise duty and customs duty are the indirect taxes and income tax is the direct tax as on June 30, 2012.

Figure-7: Structure of Federal Taxes



Why tax-to-GDP ratio in Pakistan is low in comparison to many developing countries? Despite better growth performance in recent past Pakistan's tax-to-GDP ratio could not rise. The main reason is that GDP grew at a faster pace than tax revenue. If we analyze the contribution of various sectors of the economy in GDP growth vis-à-vis their share in taxes, we can easily identify the answer. Almost one fourth of contribution to growth came from agriculture but its contribution to tax revenue is as low as 1.2 percent whereas the contribution in GDP by manufacturing is 17.9% but its contribution in tax revenue is close to two-third of the total. The reason behind this disparity is the fact that agricultural income is exempt from taxation under the Constitution of Pakistan. This uneven incidence of taxation among major sectors tells the reasons of low tax to GDP ratio. Ideally speaking all efforts to enhance tax-to-GDP ratio should begin from equitable distribution of tax burden among various sectors according to their contribution in the economic activity including agriculture. Extensive informal economy is yet another contributor to low tax to GDP ratio that needs to be addressed. The base of sales tax is eroded over the years because of exemptions, multiplicity of rates, concessions, etc. The revenue performance of sales tax in terms of its share to GDP, the VAT-Efficiency, the C-Efficiency and the Gross Collection Ratio.

III.1 Federal Board of Revenue (FBR)

The Central Board of Revenue (CBR) was created on April 01, 1924 through enactment of the Central Board of Revenue Act, 1924. In 1944, a full-fledged Revenue Division was created under the Ministry of Finance. After independence in 1947, this arrangement continued up to 31st August 1960 when on the recommendations of the Administrative Re-organization Committee, CBR was made an attached department of the Ministry of Finance. In 1974, further changes were made to streamline the organization and its functions. Consequently, the post of Chairman CBR was created with the status of ex-officio Secretary Revenue division and Secretary Finance was relieved of his duties as ex-officio Chairman of the CBR. The organization was re-structured and re-named as Federal Board of Revenue through enactment of Federal Board of Revenue Act, 2007, a law passed by the Parliament of Pakistan.

III.1.1 Functions

Federal Board of Revenue is the apex tax collection organization in Pakistan. It has the responsibility of direct and indirect tax collection at federal level. Its exercises powers and functions as assigned to it by the Act. In the existing setup, the Chairman, FBR, being the executive head of the Board as well as Secretary of the Revenue Division has the responsibilities of:

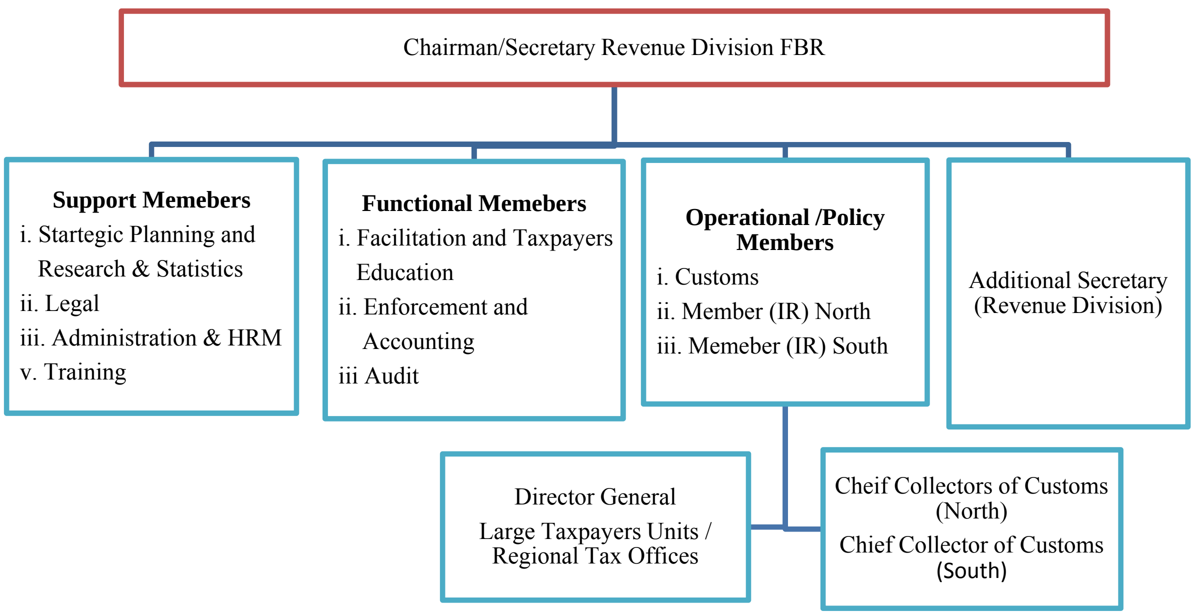
i. Formulation and administration of taxation policy;
ii. Levy and collection of federal taxes;
iii. Quasi-judicial function of hearing of appeals;
iv. Enter into double-taxation treaties with other countries;

v. Liaise with all Ministries as well as Chambers of Trade and Industry; and
vi. Provide an up-date on FBR activities to the President and the Prime Minister of Pakistan.

III.1.2 Functions of Various Members and Director Generals

Functional wings have been created in Federal Board of Revenue as a result of administrative, structural, and institutional reforms brought about with the assistance of World Bank and other multi lateral donors. Prior to July 2009, the main operational activity in the FBR was carried out under a Direct Tax Wing supervised by Member (Direct Taxes) and an Indirect Tax Wing, supervised by Member (Sales tax) and Member (Customs). The functions and wings of Sales Tax and Federal Excise have been merged with Income Tax wing, and a new occupational service cadre, named as Internal Revenue Service (IRS) has been notified on September12, 2009 by the federal government. Consequent upon these changes, various wings in the FBR have been reconstituted and their supervisory Members re-designated as shown in Figure-8:

Figure-8: Organizational Structure of FBR (HQ)



Source: FBR Year Book 2010-2011

III.1.2.1 Operational/ Policy Members

They are responsible for looking after the field operations in their given domain.

Member Customs

The duties and functions of Member Customs include:-

i. Reforms
ii. Trade Facilitation
iii. Policy Formulation
iv. Collection of Revenue
v. Administration of Collectorates
vi. Co-ordination with different ministries and organization

Member Customs is assisted by Chief, Secretaries and Second Secretaries in discharge of his responsibilities. There are two Chief Collectors for customs operations in the North and South with different areas of territorial jurisdiction in the country.

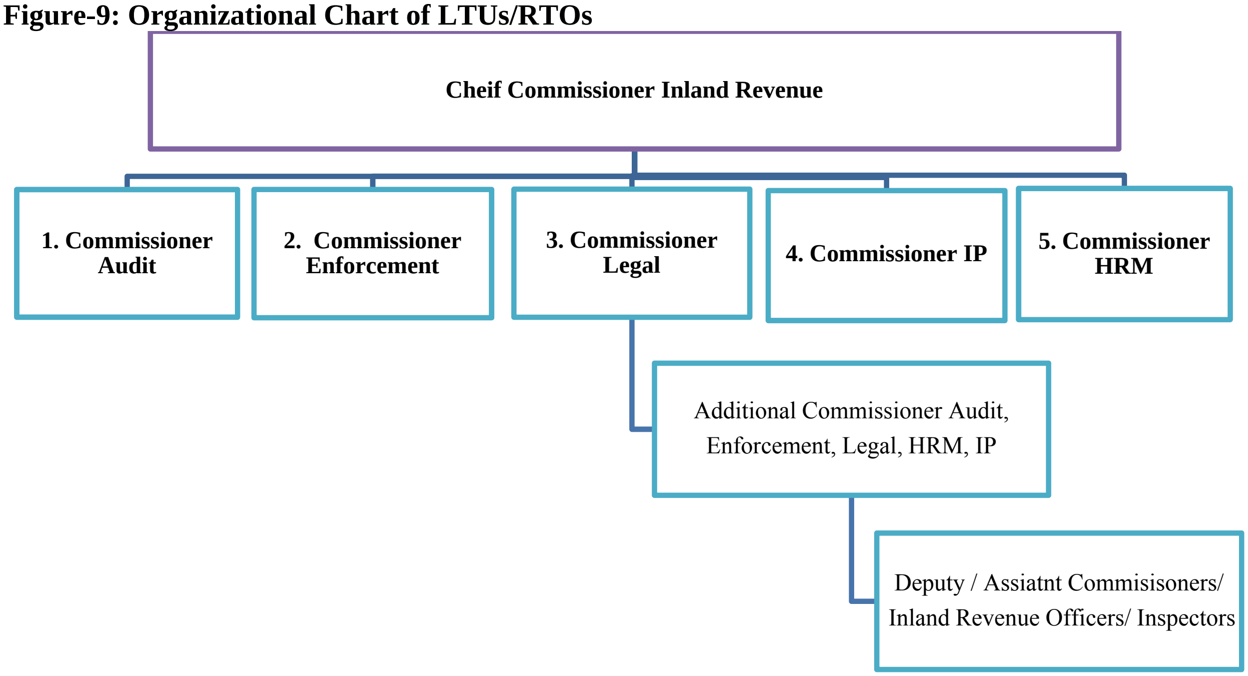
Member Inland Revenue: North & South

Member Inland Revenue is responsible for:-

i. All policy, rules and regulation matters relating to Inland Revenue and Interpretation of Inland Revenue Laws
ii. Dealing with all matters relating to Inland Revenue with International Organizations and agencies
iii. Duties assigned by Chairman FBR

He supervises all Inland Revenue operations in the fields conducted through Large Taxpayers Units (LTUs) and Regional Tax Offices (RTOs). LTUs and RTOs are headed by Chief Commissioners (BPS 21/20), who in turn are assisted by Commissioners (BPS-20). In each LTU/RTO, there is a commissioner for each division viz. Audit, Legal, Enforcement & Accounting, Taxpayers Facilitation (TFD) and Information Processing (IP). Each commissioner is assisted by a team of Additional Commissioners (BPS-19), Deputy Commissioner (BPS-18), Assistant Commissioners (BPS-17), Inland Revenue Officers (BPS-16), Inspectors (BPS-14) and other staff. The organizational chart of LTU/RTO is given below:

Figure-9: Organizational Chart of LTUs/RTOs



Prior to establishment of LTUs/RTOs, two main wings existed with dealing with the implementation of taxation laws and collection of due taxes in the country at federal level. One of these was Direct Tax Wing headed by a Member Direct Taxes who operated through five Regional Commissioners. Generally there were five to six zones under a Regional Commissioner headed by a commissioner. Then there were Ranges normally four to five in a zone which constituted five to six circles that used to be the actual working unit of the taxation matters at gross root level. The circle was normally headed by and ITO, Assistant Commissioner, or a Deputy Commissioner depending on the type and importance of the circle.

III.1.2.2 Functional Members

These members perform function based assignments.

Member Facilitation & Taxpayers' Education

The responsibilities of Member Facilitation & Taxpayers' Education include:

i. Development of strategy for education of taxpayers through publications newsletters, media, seminars, workshops and education/professional institutions and facilitation of taxpayers by simplifying the laws, rules and business processes.
ii. To provide one window operation through service centers and telephone help-lines in a taxpayer friendly environment for greater satisfaction.
iii. Updating the websites.
iv. Development of explanatory literatures, advertising campaign/ media liaison.
v. Processing of grievances of received under section 7 of FBR Act 2007.
vi. Development /operation of call center.
vii. Any other duty assigned by chairman FBR.

Member Facilitation & Taxpayers' Education is assisted by Chief, Secretaries and Second Secretaries in discharge of his responsibilities.

Member Enforcement & Accounting

He is responsible for:

i. Evaluating enforcement activities for all domestic taxes and advise member Operations North/South.
ii. Maintaining communication with field offices through Operations North/South.
iii. Dealing with all matters relating to Public Accounts Committee/Departmental Accounts Committees.
iv. Any other duties assigned by Chairman FBR.

He is assisted by Chief, Secretaries and Second Secretaries in discharge of his responsibilities.

Member Taxpayer Audit

The responsibilities of Member Audit include:

i. Planning and designing procedures and evaluating tax audits for all domestic taxes.
ii. Devising and implementing a National Audit Plan.
iii. Designing case selection criteria for audit.
iv. Developing audit methodology to assure audit quality.
v. Dealing with and coordinating the responses to Audit objectives/Para and presentations made before the Public Accounts Committee.
vi. Any other duty assigned by Chairman FBR.

He is assisted by Chief, Secretaries and Second Secretaries in discharge of his responsibilities.

III.1.2.3 Support Members

These members perform support functions:

Member Strategic Planning and Research & Statistics

Member (Strategic Planning and Research & Statistics) is responsible for:

i. Formulation of revenue targets and strategic planning for their achievements.
ii. All work relating to fiscal research and statistics in the FBR fall under his job description.
iii. He is also Project Director of Tax Administration Reforms Project (TARP) and similar projects to be carried out in future.
iv. Any other duties assigned by Chairman FBR.

He is assisted by Chief, Secretaries and Second Secretaries in discharge of his responsibilities.

Member Legal

Member legal is responsible for carrying out following activities:

i. Monitoring the quasi-judicial functions of Collectorates of Adjudication, Commissioners of Income Tax (Appeals) and Appellate Additional Commissioners of Income Tax, and for the administrative requirements of these functionaries.
ii. Monitoring performance of Department Representatives appearing before the Appellate Tribunal of Indirect Taxes and assesses the quantum and quality of their work.
iii. Acting as Appellate Authority in quasi-judicial matters of Indirect Taxes falling outside the jurisdiction of the Appellate Tribunals.

iv. Coordinating with the line Members in matters pertaining to changes in law.

He is assisted by Chief, Secretaries and Second Secretaries in discharge of his responsibilities

Member Human Resource, Finance & Administration

Member HRM

Responsibilities of Member HRM include:-

i. Work on reform related policies and procedures i.e. performance linked Bonus Schemes, job descriptions and organization structure.
ii. TARP Coordination with SP &S Wing, World Bank missions
iii. Appraisal/Evaluation of HR Related TARP projects
iv. Monitor process of IJP, approval and selection
v. Conduct/organize/facilitate awareness campaign regarding FBR related changes and issues
vi. Processing , short listing and nominations for foreign and local training
vii. Providing policy guidelines to the Directorate of Training for Inland Revenues (Direct Taxes) and Customs for Specialized Training and refresher courses
viii. Inland Revenues (Direct Taxes) and Customs for Specialized Training and refresher courses
ix. Monitoring of Capacity Building and Orientation Programmes
x. Initiation of new training modules, syllabus keeping in view the very technical and ever changing nature of duties performed by the offices of FBR
xi. Organize HR/Business process related Seminars
xii. Work Force Planning in Liaison with BPR teams, line managers in reformed units
xiii. Liaison with Admin Wing on re-designation of posts.
xiv. Any other duties assigned by Chairman FBR.

Finance & Administration

Member Administration is responsible for overall administration of FBR, including appraisal, processing and monitoring of all development projects. He also performs all responsibilities relating to Budget Management of FBR and any other duty assigned by Chairman FBR. He is assisted by Chief, Secretaries and Second Secretaries in discharge of his responsibilities

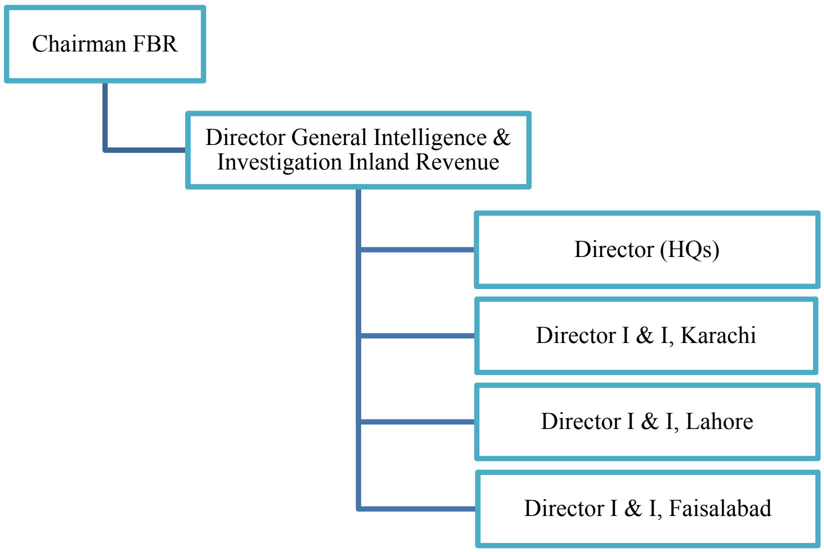
Various positions of Director General are also there to perform the allied functions like training, valuation, internal inspection system, Intelligence and investigation. These are the external or attached organs of the FBR. They directly report to the Chairman.

III.1.2.4 Director General Intelligence & Investigation Inland Revenue

Directorate of Intelligence & Investigation Inland Revenue was established on 25th March, 2011. It is headed by Director General Intelligence & Investigation, Inland Revenue. The functions of the Directorate Include:

i. Broadening of Tax base aims at bringing potential taxpayers in the tax net.
ii. Linkages with all Major National, Provincial, Regional Data Base.
iii. Cross matching for the purposes of countering non-reporting and under reporting.
iv. Cross matching for the purposes of countering non-reporting and under reporting.
v. Complaint handling. Complaints (relating to the above areas) referred by the Chairman FBR (under FBR Act).
vi. Preliminary investigation as entrusted by FBR, so as to determine the possible loss of revenue or the real revenue potential in cases as may be identified by the organization.
vii. Discreet information gathering on all Tax related issues, Non reporting, under reporting, tax evasion, connivance between tax evaders and tax collectors, fiscal frauds and revenue leakages.

Figure-10: Organizational Chart of Directorate I & I, Inland Revenue



Directorate Karachi has jurisdiction of Sindh and Balochistan, whereas Directorate Lahore exercise jurisdiction over civil divisions of Lahore, Gujranwala and Sahiwal of Punjab Province while Directorate Faisalabad has jurisdiction over civil divisions of Faisalabad, Sargodha, Multan, Bahawalpur and D.G. Khan of Punjab Province. Directorate HQs has jurisdiction over civil division of Rawalpindi and KPK province in addition to its own duties. I & I-IR has been designated as Sales Tax and Excise authority through finance act 2011. The scope of I & I-IR in respect of other direct taxes is restricted to information gathering, processing, segregation, and dissemination and monitoring.

III.1.2.5 Director General (Internal Audit) Inland Revenue

The directorate of Internal Audit Inland Revenue has to perform following functions:

i. To carry out Audit and Inspection of field officers of the FBR to ensure correct, judicious and legal application of rules and procedures in order to maintain internal controls and ensure high standard of statutory audit, amendment of assessments and detection of cases of incorrect determination of income and taxes
ii. To carry out internal Audit and Inspection of the field officers of the FBR in order to ensure implementation of FBR’s tax policies and to rule out maladministration and inefficiency.
iii. To examine qualitative aspects of taxpayers’ declarations of income/ taxes and statutory statements in order to create deterrence against tax evasion.
iv. To examine qualitative aspects of tax functionaries’ work in order to ensure judicious application of tax laws and creating transparent and independent working environment to enhance revenue generation capability of the FBR in Inland Revenues.
v. To guide, assist and educate the FBR field formations to improve overall quality of work.
vi. To exercise vigilance to prevent tax evasion and malpractices.
vii. To prepare and present Annual Report to the Chairman, FBR depicting the detection of loss of revenue and the revenue retrieved to highlight performance of field formations in taking remedial actions.

The Directorate General is assisted by three Regional Directorates at Karachi, Lahore and Islamabad.

III.1.2.6 Director General Valuation and Post Clearance Audit (PCA)

This directorate was established in 2008 vide Board's letter C.NO. 3(24) SSM/2008 dated 03.112008. Presently, the Directorate General of Post Clearance Audit consists of two Directorates based at Karachi and Lahore. The Directorate at Karachi has jurisdiction over all the custom collectorates in the province of Sindh and Balochistan whereas the Directorate at Lahore has jurisdiction over all the custom collectorates in the provinces of Punjab and KPK.

The primary function assigned to Directorate General is to conduct post clearance audit of all imports into and exports from Pakistan in order to examine whether due duty and taxes leviable thereon have been paid correctly and the applicable rules and regulations have been followed.

III.1.2.7 Director General (Internal Audit) Customs

This Directorate is based at Karachi and carries out inspection and audit of the customs. He assisted by four Directors, two at Karachi and one each at Lahore and Islamabad.

III.1.2.8 Director General (Training & Research)-IR

This Directorate is based at Lahore and is responsible for:

i. Imparting training to the fresh recruited officers in the Income Tax Department.
ii. Imparting in-service training to the incumbent officers/ officials through refresher courses, workshops and seminars.

III.1.2.9 Director General (Training & Research) Customs

This Directorate is based at Karachi with offices at Islamabad, Lahore and Karachi and is responsible for imparting training to the personnel of Customs, Federal Excise and Sales Tax Departments, respectively.

Vision Statement

FBR has a vision and mission statements like all other modern organizations as depicted in Figure-11

Figure-11: Visions Statement

> **Vision Statment**
> To be modern, progressive, Effective, Autonomous and Credible Organisation for Optimizing Revnue by Providing Quality Service and Promoting Compliance with Tax and Related Laws

Mission Statement

Enhance the Capacity of the Tax System to Collect Due Taxes through Application of Modern Techniques, Providing Taxpayer Assistance and by Creating a Motivated, Satisfied Dedicated and Professional Workforce.

Core Values of FBR

i. Integrity
ii. Professionalism
iii. Teamwork
iv. Courtesy
v. Fairness
vi. Transparency
vii. Responsiveness

III.2 Basic Structure and Functions of Tax Offices

As discussed earlier, the basic structure of an income tax office was based on the concept of one unit performing all basic functions being carried out in a tax office. This basic tax office was called circle. It was headed by a circle officer. This system of administration was inherited from the British India immediately after the independence in 1947. Since then only minor changes were brought in this basic structure from time to time and according to the need but the basic concept was never changed. The circle was normally staffed by few inspectors, one office superintendent, two or three upper division clerks, two or three lower division clerks, a notice server, a bailiff, a *daftari* and few peons. The total number of the staff usually remained between 12 to15. Normally following main functions were performed by a circle officer.

i. Receiving of Returns
ii. Assessment of the cases selected for audit
iii. Collection of raised assessment and other delinquencies.
iv. Monitoring of withholding taxes falling in its jurisdiction
v. Appellate issues
vi. Expanding the tax base in its area and general guidance of the taxpayers in its territory
vii. Reporting to the higher authorities on performance and other information.
viii. Human resource management and administrative matters of the circle.

Regarding types of circles, there were normally five types of circles in the department depending on the type of taxpayers it is dealing. The first type was salary circle dealing with the salary cases falling in an income tax zone. There are normally two to three salary circles in a zone. There used to be a specialized circle which normally dealt with certain classes of taxpayers. There were also few special circles dealing with corporate cases. They also dealt with the salary affairs of the directors of these companies. Then finally all cases which do not fell in any of the above category they would constitute a territorial circle. Territorial circles consisted of a specific territory or area. All the persons doing business activity in there area came in their jurisdiction. There were normally four to five thousand taxpayers in the jurisdiction of a tax circle. Circle offices were monitored and supervised by an Inspecting Additional Commissioner.

Additional Commissioners would report to the Commissioner who was in charge of the zone comprising a few ranges. The Commissioner was the head of the zone. He was given a certain target of collection of taxes for a financial year. He normally divided his target to the ranges and also subsequently the range additional commissioners would fix the targets of the circles under their jurisdiction. The commissioner also monitored every legal and administrative aspect of circles and ranges in his zone. He was also financial head of the zone and also hire and fire authority for the non-gazetted staff. Five to six zones are monitored by a Regional Commissioner. There were five Regions in the country. With a manifold expansion in population and business activity it was difficult for an officer to handle such a large number of cases efficiently. He also had no support of information technology and other adequate resources to run the affairs. The system had become redundant in view of changed circumstances with the advent of new technologies and business activities. The change was therefore necessary to maintain the credibility of the tax system and to enhance the efficiency of the department. A comprehensive program of tax reform was therefore launched to change the age old system based on single unit performing all the functions to functional divisions in a Regional Tax Office. Under the reformed system, the functions of tax offices that is LTUs and RTOs are discussed as under:-

III.2.1 Large Taxpayers Units

There are three LTUs at Karachi, Lahore and Islamabad. LTUs are established to provide convenience to the Large Taxpayers. Each LTU is headed by Chief Commissioner (BPS-21/20) who is responsible for:-

i. All matter relating to administrative control.
ii. Generation of revenue with in jurisdiction.

iii. Enforcement/collection of revenue.
iv. Facilitation of Taxpayer.
v. All legal issues pertaining to the jurisdiction.
vi. Any other assignment by the chairman.

Each LTU has jurisdiction over Income Tax, Sales Tax and Excise cases not assigned to RTOs. As given in the Figure-7, Chief Commissioner is assisted by Commissioners, Additional Commissioners, Deputy Commissioners, Assistant Commissioners and Inland Revenue Officers.

III.2.2 Regional Tax Offices

There are 18 Regional Tax Offices in the country to provide efficient service to taxpayers. These have jurisdictions over Income Tax, Sales Tax and Excise cases except those assigned to Large Taxpayers Units. Chief Commissioner (BPS-21/20) is the In-charge of the RTO and responsible for:-

i. All matter relating to administrative control.
ii. Generation of revenue with in jurisdiction.
iii. Enforcement/collection of revenue.
iv. Facilitation of Taxpayer.
v. All legal issues pertaining to the jurisdiction.
vi. Any other assignment by the chairman.

As given in the Figure-7, Chief Commissioner is assisted by Commissioners, Additional Commissioners, Deputy Commissioners, Assistant Commissioners and Inland Revenue Officers.

III.2.3 Tax Process

The process of tax starts with the filing of returns on or before due date by all the tax payers liable to file a return under the provisions of the Income Tax Ordinance 2001. After the due date the returns and all allied materials is consolidated and sent for the entry of data to the Central Data Entry Centre located in Islamabad. After data entry the returns are received back in the offices. In the meantime when returns are with the data entry centre the tax offices issue delinquency notices to the non-filers of returns and works out the amounts of penalties for non-filing of returns. After receipt back of the returns an exercise of desk audit is conducted to identify the risk areas since all the returns are accepted under universal self-assessment system at the time of its filing. As a result of desk audit returns are classified in categories for the purpose of selecting some of them for detailed audit. A separate criterion is generally announced for selection of cases for audit every year. After completion of audit the taxpayers are served with the demand raised and are asked to pay it within statutory limits failing which entails penalties and additional taxes.

The taxpayer can also avail appellate remedies if he is not satisfied with the assessment raised against him. There are appellate forums starting from commissioner appeals to Supreme Court of Pakistan.

III.3 Taxpayer's Rights and Obligations

III.3.1 Rights

The taxpayers have following rights and acceptations from the Federal Board of Revenue.

To be fair, reasonable and courteous FBR treats the taxpayers fairly and equitably. This includes:-

i. Handling of their tax affairs professionally and impartially;
ii. Paying respect and extending all possible help and assistance.
iii. Ensuring uniform interpretation and application of law in letter and spirit;
iv. Requiring the taxpayers to pay what is due under the law.
v. Treating the taxpayers as being honest
vi. The FBR treat the taxpayer and his representative as honest in tax affairs unless proved otherwise.
vii. Be accountable for what the FBR functionaries do.

viii. The functionaries of FBR are obliged to act and behave in a professional manner and within the legal framework.

The taxpayers can expect the FBR to:

i. Facilitate and educate them.
ii. Provide information and extend all cooperation to help them to understand and meet their tax obligations.
iii. Keep the information confidential.
iv. Maintain confidentiality of their tax affairs and any details, documents, or declarations given during the course of any tax proceedings.

Provide access to information. It includes:

i. Right to have access to the information or documents about your tax affairs relied upon by the Federal Board of Revenue; and
ii. Right to have access to explanatory circulars and public rulings given by the Central Board of Revenue.

Taxpayers can expect from FBR to allow opportunity of being heard. It includes:

i. Allowing reasonable opportunity of being heard before concluding their tax affairs;
ii. True appreciation of facts and circumstances relevant to your case; and
iii. Allowing sufficient / reasonable compliance time to respond to queries concerning their tax affairs.
iv. Accept their right of representation

Taxpayers can expect FBR to accept their right of appeal, review and alternate dispute resolution

FBR accepts the taxpayer's right to object:

i. On disagreements over facts, figures or interpretation of law; or
ii. For any mistake, error or mal-administration that occurred during the conduct of their tax affairs.

The taxpayers can expect FBR to minimize their compliance cost

This is ensured by:

i. Good governance with a view to facilitate, educate and help the compliant taxpayers in resolving their tax affairs;
ii. Charging the taxes strictly in accordance with law;
iii. Simplifying the tax laws and processes and introducing the concepts of self- assessment in its true spirit;
iv. Conducting meetings with them or their representative at agreed time;
v. Finalizing proceedings in minimum possible time;
vi. Introducing taxpayers friendly, simple and easy to fill tax forms; and
vii. Providing facilitation and tax education tools (literature, brochures, leaflets, software, website, workshops, seminars, help line etc).

III.3.2 Obligations

The FBR as tax administration organ of the government on the other hand expect from the taxpayers to discharge their tax obligations correctly and faithfully.

The FBR expects from the taxpayers to voluntarily;

i. Register themselves;
ii. Comply with tax laws;
iii. File correct, complete and candid returns and statements within the prescribed time;
iv. Pay due taxes;
v. Maintain accounts, documents and records of their transactions;
vi. Be truthful and honest in their dealings with tax authorities; and
vii. Provide complete and accurate information and records, if required, as per law.

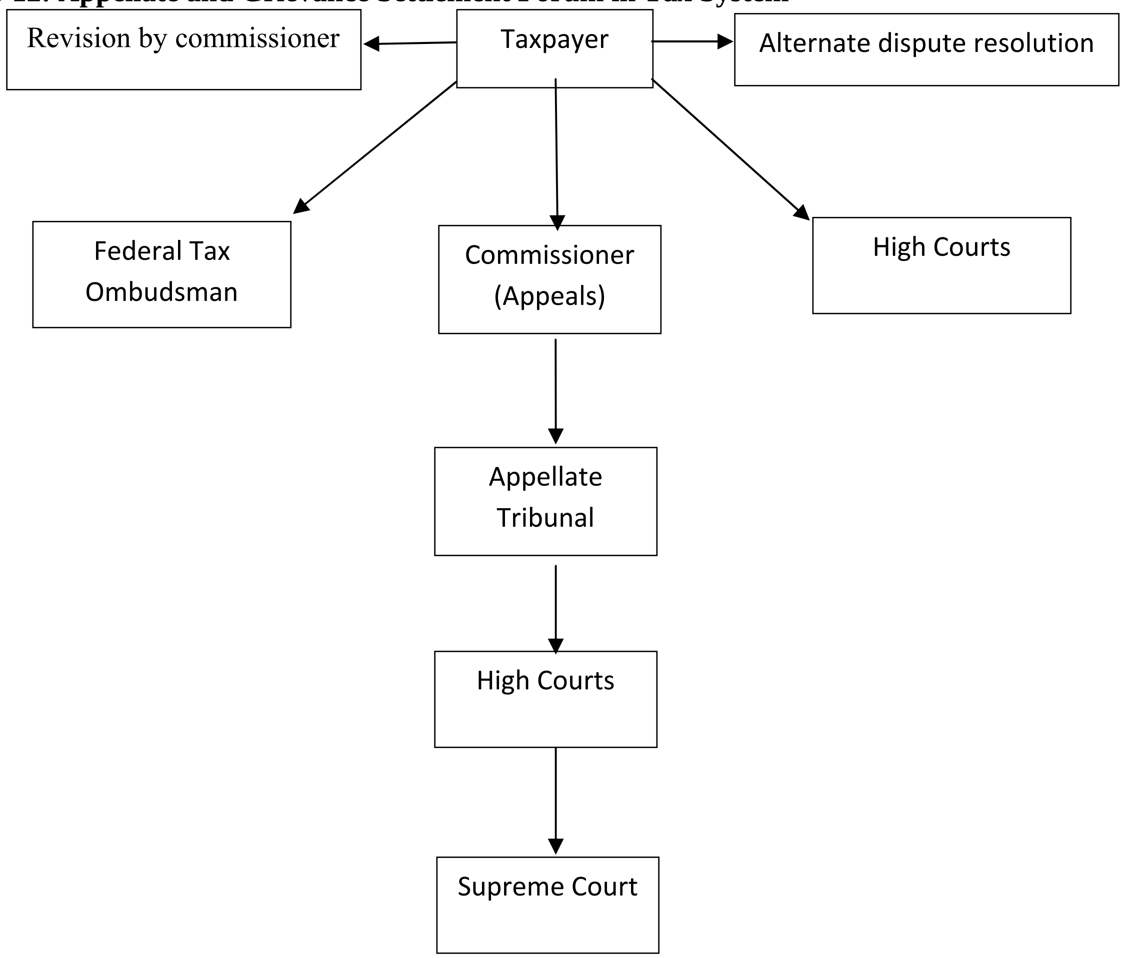
III.4 Process of Appeals

A taxpayer aggrieved with the assessment made by the department can choose to prefer for appeal against the treatment by having resort to various options available to him.

i. He can apply to the commissioner to review the order of the subordinate authority. In this case, the Commissioner of Income tax may review the order. In this case, the appellant must waive his further right of appeal to the Commissioner (Appeals).
ii. The taxpayer can file an appeal before Commissioner of Appeals to redress his grievance.
iii. If the taxpayer is still unsatisfied with the order passed by the appellant authority, he can choose to appeal against the order of Commissioner Appeals in Income Tax Appellate Tribunal. This appellate authority is independent from the income tax department and is under the Ministry of Law and justice. This is the highest appellate authority to probe the factual matters involved in the issue before it.
iv. If the appellant is still aggrieved with the decision of Income Tax Appellate Tribunal, with enough legal ground he can further make a reference to the High and finally if high court feels that the issues still requires to be thrashed out by the Supreme Court It may refer the matter to the Supreme Court of Pakistan. The verdict of the Supreme is final.
v. The taxpayer can also prefer to consult the newly created forum of Alternate Dispute Resolution at the same time even his case is pending before some higher court. This mechanism is governed by the provisions of section 134 of the Income Tax Ordinance 2001. Separate Committees have been created for all major areas of the country. A significant aspect of these committees is that representatives of business community are also members of these committees. This not only enhances the trust of the taxpayers on the sanctity of the committee but also makes them convinced to believe in the transparency of the whole process.
vi. A few years back, in order to improve the business friendly environment and to create a judicious approach in the tax collector’s behaviors, government has also created an office of Federal Tax Ombudsman. This office has been very effective and successful since its inception in containing the unbridled use of authority by the tax functionaries. It has also been able to create a better atmosphere for respect of the law both among the taxpayers and tax collectors. A retired judge of court or a renowned person is appointed as Tax Ombudsman for tenure of four years. This institution by resorting to the principles of equity, justice, impartiality and speedy trials has gained confidence of the taxpayers. Any taxpayer aggrieved of any maltreatment or maladministration by any tax functionary can seek remedy from this office.

There is no fee for seeking remedy before this forum, and it has become the cheapest and most reliable source for the taxpayers in the cases of maladministration. As a matter of perception in the very start of its establishment, this institution was conceived to have a tilt towards the taxpayers and seemed to treat the tax collectors more harshly. It also gave some decisions against which the affected tax functionaries even preferred appeals before the office of the President of Pakistan who is the appellate authority against his decisions but with the passage of time it has attained more balanced approach and is considered to be more impartial, and in significant number of cases it has given its verdicts in the favor of the department as well. Further, with the continuous process of appeals against its decisions, it has been helpful in distinguishing maladministration from purely legal issues.

Figure-12: Appellate and Grievance Settlement Forum in Tax System



III.5 Latest Income Tax Rates

A system of simplified self-assessment has been introduced specially for salary and property income earners. Most of the exemptions in salary cases and all in the case of property income have been abolished and tax payers have to offer their gross incomes for the purpose of application of tax rates. On the other hand the tax rates have been slashed to minimum and number of progressive slabs has also been revised.

But the biggest facility to the taxpayers is that they do not to be involved in lengthy calculation or to have the knowledge of complicated tax provisions to arrive at their taxable income. All they have to do gross up their incomes by whatever name they receive and apply the tax rates to work out the tax payable. This policy has been welcomed by majority of taxpayers especially low income earners from property or salary who could not afford to engage a tax advisor.

The rates of tax imposed on the taxable income of every individual except a salaried individual and association of persons are given in Table-37. Previously there were more slabs rates but for the tax year 2012-13, the slabs rates have been reduced to five.

Table-37: Tax Rates for the Individuals and AOPs

S	Taxable Income	Rates of Tax
1	Where the taxable income does not exceed Rs.400,000	0%
2	Where the taxable income exceeds Rs.400,000 and does not exceed Rs.750,000	10% of the amount exceeding Rs.400,000
3	Where the taxable income exceeds Rs.750,000 but does not exceed Rs.1,500,000	Rs.35,000 + 15% of the amount exceeding Rs.750,000
4	Where the taxable income exceeds Rs.1,500,000 but does not exceed Rs.25,000,000	Rs.147,000 + 20% of the amount exceeding Rs.1,500,000
5	Where the taxable income exceeds Rs.25,000,000	Rs.347,500 + 25% of the amount exceeding Rs.25,000,000

Source: Income Tax Ordinance, 2001 as amended by the Finance Act, 2012

The tax rates imposed on the income of an individual chargeable under the head salary are set out in Table-38.

Table-38: Tax Rates for Salaried Individuals

S.No	Taxable Income	Rates of Tax
1	0 to Rs.400,000	0%
2	Rs.400,000 to Rs. 750,000	5% of the amount exceeding Rs.400,000
3	Rs.750,000 to Rs.1,500,000	Rs.17,500 + 10% of the amount exceeding Rs.750,000
4	Rs.1,500,000 to Rs.20,000,000	Rs.95,000 + 15% of the amount exceeding Rs.1,500,000
5	Rs.20,000,000 to Rs.25,000,000	Rs.175,000 + 17.5 % of the amount exceeding Rs.20,000,000
6	Rs.25,000,000 and above	Rs.420,000 + 20% of the amount exceeding Rs.25,000,000

Source: Income Tax Ordinance, 2001 as amended by the Finance Act, 2012

The tax rates imposed on the taxable income of a company are set out in the Table-39.

Table-39: Tax Rates for Corporate Sector

Tax Year	Banking Company	Non Banking Public Company	Non Banking Private company
2002	50%	35%	45%
2003	47%	35%	45%
2004	44%	35%	41%
2005	41%	35%	39%
2006	38%	35%	37%
2007	35%	35%	35%
2008	35%	35%	35%
2009	35%	35%	35%
2010	35%	35%	35%
2011	35%	35%	35%
2012	35%	35%	35%

Source: Income Tax Ordinance, 2001(as amended from time to time).

Rates of tax imposed on disposal of immoveable property are given Table 40.

Table.40: Tax Rates on Capital Gains on Disposal of Immoveable Property

S.No	Period	Rates of Tax
1	Where holding period of immoveable property is up to one year	10%
2	Where holding period of immoveable property is more than years but not more than two years	5%

Source: Income Tax Ordinance, 2001 as amended by the Finance Act, 2012

III.6 Withholding Taxes

Like other countries in the world, tax at source or withholding tax has also been used as convenient and popular mean to collect tax in advance and at source. Pakistan came into existence on August 14, 1947 and Income Tax Act, 1922 was inherited from the British Administration. There were only two provisions of deduction of tax at source in that Act: salary income and interest income on securities. Over the period of time, different provisions of withholding taxation were introduced in the income tax laws to broaden the withholding tax base. All the withholding provisions of the repealed Income Tax Act, 1922 were brought in the Income Tax Ordinance, 1979. However, withholding tax net was expanded extensively in the 1990s when withholding tax on a wider variety of transactions was levied and most of these provisions were made presumptive. Withholding tax provisions of the Income Tax Ordinance, 2001, are more or less the same, except for a few changes and additions.

It becomes a source of irritation for the taxpayers, when it is treated as full and final discharge of their tax liabilities as the option of adjustment of their tax withheld at source is not provided under the law to certain classes of taxpayers. Some major sectors of the economy at present are covered under presumptive tax regime (or final tax regime).

Under final tax regime, receipts / turnover of taxpayers are treated as their income in accordance with the deeming provisions of tax code. More than half of income tax revenue is collected through withholding activity. Corporations, the federal and provincial governments, local authorities, foreign companies and missions and the employers paying taxable salary are treated as withholding agents under the law. They are obliged to withhold tax from certain payments and deposit it in the government treasury within seven days of tax deduction. A detailed account of withholding taxes is given in Table-41.

Table-41: A Summary of Withholding Rates and Relevant Transactions

Person Liable	Tax Base	Tax Rate
Shareholder	Gross amount of dividend	10%
Non resident	1. Gross amount received or receivable from shipping business 2. Gross amount received or receivable from air transport business	8% for shipping 3% for air transport
Every employee	Annual average rate (to be calculated as per rate card subject to applicable reductions in tax)	Progressive rates in First Schedule to the ITO, 2001
Importer of goods	Value of goods as determined under Section 25 of the Customs Act, 1969	5%
Recipient	Yield or profit (profit on debt) on an account, deposit or a certificate under the National Savings Scheme or Post Office Savings	10%
Recipient	Profit on debt on an account or deposit	10%
Recipient	Profit on debt on any bond, certificate, debenture, security or instrument of any kind	10%
Non-resident	Gross amount of royalty or fee for technical services	15% or lower rate as per agreement for avoidance of double taxation
Non-resident	Gross amount of payment: - on execution of contract - of insurance or re-insurance premium	6% (contract), 5% (insurance), 20% (others), or lower rates in accordance with agreement for avoidance of double taxation
1. Resident	Gross amount of payment on account of:	1. Sale of: Rice, cotton seed or edible oils 1.5%, any other goods 3.5%
2.Permanent establishment in Pakistan of a non-resident	1. Sale of goods (inclusive of sales tax);	2. 2% for transport service, for other services 6% (made minimum taxation from July 1, 2009)
	2. Rendering or providing of services and;	3. 6%
	3. Execution of contract, other than a contract for the sale of goods or rendering of services	
1.Exporter of goods 2. Foreign indenting commission agent	Foreign exchange proceeds	1% (exporter) 5% (indenting commission agent)
Recipient of rent	1. For company, on rent ≤ Rs.400,000, (Rs.40,001-Rs.1,000,000) and > Rs.1,000,000/- 2. For others, , Rs. 150,000, (Rs.150,001 - Rs.400,000), (Rs.400,001-Rs.1,000,000) and (>Rs.1,000,000).	1. 5%, Rs.20,000 + 7.5% and Rs.65,000 + 10%. 2. 0, 5%, Rs.12,500 + 7.5% and Rs.57,500 + 10%
Recipient of prize or winnings	1. Gross amount of prize on prize bond or cross-word puzzle 2. Gross amount of winning from a raffle, lottery, prize on winning a quiz, prize offered by a company or promotion of sale	1. 10% 2. 20%
Petrol pump operator	Gross amount of commission or discount allowed to the operator on sale of petroleum products	10%
Owner of compressed natural gas station	Gas consumption charges	4%
Recipient of brokerage and commission	Gross amount	10%
Purchaser of shares, seller of shares, trader of shares, financer of carry over trading	Purchase value of shares Sale value of shares Traded value of shares Carry over charge	0.01% 0.01% 0.01% 10%

Consumer of electricity	Monthly bill Rs.400, Rs.401-Rs.600, Rs.601-Rs.800, Rs.801-Rs.1,000, Rs.1,001-Rs.1,500, Rs.1,501-Rs.3,000, Rs.3,001-Rs.4,500, Rs.4,501-Rs.6,000, Rs.6,001-Rs.10,000, Rs.10,001-Rs.15,000, Rs.15,001-Rs.20,000 and greater than Rs.20,000/-	Tax Rs.0, Rs.80, Rs.100, Rs.160, Rs.300, Rs.350, Rs.450, Rs.500, Rs.650, Rs.1000, Rs.1500, and 10% for commercial consumer and 5% for industrial consumer
Recipient of cash from bank	Gross amount withdrawn exceeding 25,000 per day	0.20%
Telephone users	Amount of bill or sale price of a pre-paid card	In the case of telephone subscriber (other than mobile phone), 10 % of the amount of monthly bill exceeding Rs.1,000/-
Purchaser of motor cars and jeeps	Engine capacity up to 850cc, 851cc-1000cc, 1001cc-1300cc, 1301cc-1600cc, 1601cc-1800cc, 1801cc-2000cc and above 2000cc	Tax at Rs.7,500, Rs.10,500, Rs.16,875, Rs.16,875, Rs.22,500, Rs.16,875 and Rs.50,000/- In the case of subscriber of mobile, telephone and prepaid telephone card - 10% of the amount of bill or sales price of pre-paid telephone card
Purchaser of property or goods by auction	Gross price of any property or goods sold by auction	5%
Recipient of ticket	Gross amount of air ticket	5%

Source: Income Tax Ordinance, 2001 (as amended up to 30th June, 2011)

III.7 Treaties for Avoidance of Double Taxation

Pakistan is an active member of various world organizations. The government of Pakistan has executed convention with other countries for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. Until today, It has entered with sixty countries such full scope bilateral treaties for avoidance of double taxation, the latest with Ukraine and Spain executed on 26th October, 2011. The treaties are also re-negotiated regularly in accordance with change in the nature of relations and to respect various protocols entered into. Being the secretary Revenue Division, the Chairman FBR has been given complete responsibility to negotiate the treaty with the tax authorities of the other states.

III.8 Advance Ruling

With a view to remove any confusion and to avoid disputes in respect of determination of the income tax liability of a non-resident person, a procedure of Advance Rulings has been brought on statute by way of incorporating Section 206A into the Income Tax Ordinance, 2001, with effect from 1.7.2003. Through this facility non-residents can obtain, in advance, a binding ruling on the issues that could arise in determining their tax liabilities at a later stage. Therefore, time consuming and expensive legal disputes can be avoided. The Federal Board of Revenue is empowered to determine any question of law or of fact as specified in the application made before it in respect of a transaction which has been undertaken or is proposed to be undertaken by a non-resident in Pakistan on its own or in combination with a resident concern. The application for advance rulings is considered and decided upon by a committee headed by the Chairman, Federal Board of Revenue, after due opportunity to the applicant of explaining his case. Other members of the committee are Member Inland Revenue, FBR, and Additional Secretary, Law, Justice, and Human Rights Division, Government of Pakistan.

III.9 An Analysis of Direct Taxes Collection and Performance

The direct taxes collection is the second major source of federal taxes revenue after sales tax. The net collection of Direct taxes has been Rs. 602.4 billion during 2010-11, indicating a growth of 14.5% over the collection of corresponding period last year. The collection from income tax has increased by 15.2%. Its share has also upsurge from 94.4% to 96.7%. However, the decline in CVT collection by Rs. 4.0 billion has slightly affected the overall growth in direct taxes.

Table-42: Direct taxes Collection with Components

Rs.Billion

Tax Head	2010-11	2009-10	% Growth	% Share in Direct Taxes 2010-11	% Share in Direct Taxes 2009-10
Income Tax	582,424	505,494	15.2	96.7	94.4
CVT	132	4,002	-96.7	0	0.8
Worker's Welfare Fund	19,886	16,458	20.8	3.3	4.8
Wealth Tax	9	23	-60.9	0	0
Direct Taxes	602,451	525,977	14.5	100	100

Source: FBR Year Book 2010-11

The component-wise collection of income tax is given in the following table. A significant increase has been observed in collection from WHT and voluntary payments. The percentage share of WHT and VP has also increased by 4.1% and 1.6% respectively, as compared to last year. However, a substantial reduction of Rs.26.3 billion in collection from demand, have shrunk its share by 6.1%.

Table-43: Components of Income Tax Collection and Performance

Rs. Million

Tax Head	2010-11	2009-10	% Growth	Point Contr. in total growth -15.2
(A) Collection Out of Demand	72,182	98,529	-26.7	-4.7
(B) Voluntary payments	196,065	165,801	18.3	5.4
(C) Withholding Taxes	357,836	295,249	21.2	11.2
Misc.	3,019	119	2,436.10	0.5
Gross	629,102	559,698	12.4	12.4
Refund	46,678	54,204	-13.9	2.8
Net	582,424	505,494	15.2	15.2

The details of Income tax indicates that the withholding taxes collection, having the major chunk of the pie, has contributed 11.2 points in total growth of 15.2 percentage point. Its share has also increased from 52.8% in 2009-10 to 56.9% in 2010-11. Voluntary payments with component's growth of 18.3%, has added 5.4 point whereas a decline of 26.7% in collection "out of demand" has reduced the total growth by 4.7 points only. However, the role of refund payments has been positive as a reduction of 13.9% in refund payments has further contributed 2.8 points in the total growth, making it 15.2%.

Withholding Tax

Withholding tax is an accepted mechanism for holding the leakages in income tax collection and is levied at source of certain types of economic movements in the economy. It is a sort of advance tax in nature. Unlike the income tax, the impact of withholding taxation gets transferred to the consumer due to its time of applicability. Continued non-automation of business activities together with existing huge un-organized sectors in the economy further emphasizes the importance of withholding tax regime. The share of withholding taxes in gross income tax collection has declined from 64.2% in 1995-96 to 56.9% in 2010-11.

The growth pattern within WHT collection has been presented in the following table. A substantial increase in percentage growth has been observed in collection from exports, imports, salaries, dividends and telephone bills. The contribution from top 12 WHT heads has been included in the following table. The collection from electricity bills and cash withdrawal has declined during the period under reference. The rest of all the major collection heads have posted a positive growth. The major addition, in absolute terms, in collection has been observed from imports (Rs.16.1 billion), Salaries (Rs.11.5 billion), contracts (Rs.7.7 billion) followed by exports (Rs.7.1 billion).

Table-44: Major Heads of Withholding tax Collection

Rs. Million

Sr. No.	Description	2010-11	2009-10	Growth
1	Contracts (U/s 153)	99,319	91,656	8.40%
2	Imports (U/s 148)	66,399	50,253	32.10%
3	Salaries (U/s 149)	45,581	34,073	33.80%
4	Telephone (U/s 236)	28,672	23,405	22.50%
5	Exports (U/s 154)	24,061	16,964	41.80%
6	Bank Inter.& Secur. (U/s 151)	23,584	19,938	18.30%
7	Electricity Bills (U/s 235)	14,313	15,471	-7.50%
8	Dividends (U/s 150)	12,003	9,283	29.30%
9	Cash Withdrawal (U/s 231)	10,630	12,886	17.50%
10	Technical Fee (U/s 152)	7,789	6,867	13.40%
11	Surcharge (U/s 4A)	7,389	-	-
12	Commission (U/s 233)	4,590	2,955	55.30%
13	Transport (U/s 234)	3,387	3,200	5.90%
	Sub-Total	**347,717**	**286,951**	**21.20%**
	Others	10,119	8,298	21.90%
	Withholding Tax (Total)	**357,836**	**295,249**	**21.20%**

Source: FBR Year Book 2010-2011

III.10 Indirect Tax Administration

Presently, there are two groups within the Federal Board of Revenue. One is Inland Revenue Service dealing with direct taxes such as Income Tax and indirect taxes such as Sales Tax and Excise Duty. These taxes are called internal or inland taxes and are managed under one roof of LTUs and RTOs. Direct taxes has already been discussed. Sales Tax and Federal Excise are administered through Sales Tax Act, 1990 and Federal Excise Act, 2005 respectively. The other groups is called Pakistan Customs Service that administers Customs Duty. The activities of levying customs duties are carried out within the four corners of Customs Act, 1969 as amended from time to time, whereas

III.10.1 General Sales Tax

Sales Tax was introduced for the first time in 1949 at a very limited level and on few items. It remained very insignificant until 1990 when Sales Tax Act was enacted that introduced its value added version renamed as General Sales Tax (GST). This was levied on goods only (with many exemptions) and that too at the manufacturing and import stages. A major leap forward was taken in 1995-96 when GST was converted into a full-fledged VAT mode tax with all its basic features; self-assessment, functional distribution, input tax credit facility and audit based procedures. To further increase its base, its coverage was extended to importers in 1997 and to wholesalers and retailers in 1998.

The sales tax has gradually become the largest single tax of FBR. Many excisable items were replaced by Sales tax gradually. The mechanism of sales tax is somewhat similar to that of a modern VAT. Under VAT system, value added component at each stage of business transaction could be taxed. The VAT is a destination-based tax on domestic supply consumption and imports. Under this destination principle, exports are zero-rated while imports and supply of taxable goods subject to tax. The tax paid on raw materials and other goods purchased in the course of business is adjusted as input tax while determining the tax liability. Tax credit or input tax is allowed when the registered person keeps proper record of claim regarding tax invoice and bill of entry. VAT rate was 15% for fiscal year 1998 till fiscal year 2008, which was increased to 16% for the fiscal years 2009 and 2010, and 17% for the fiscal year 2011. VAT is currently imposed at a standard rate of 16%. However, there are some items which are chargeable to VAT at 18.5% or 21% of value of supplies. VAT is chargeable on all locally produced and imported goods except computer software, poultry feeds, medicines and unprocessed agricultural produce of Pakistan and other goods specified in Sixth Schedule to the Sales Tax Act, 1990. Sectors required to get registration for VAT include manufacturing, import, services, distribution, wholesale & retail. In present system of VAT, there is a single threshold for manufacturers and retailers at Rs.5 million during the last twelve months. However, another threshold for the manufacturers is at Rs.700,000 utility bill during the last twelve months. However, there is no threshold for importers, wholesaler (including dealer) and distributer.

The items exempted from sales tax include basic food items including wheat, rice, pulses, vegetables, fruits, live animals, meat and poultry etc. Edible oil is also exempt from GST. Exemptions are also available for philanthropic, charitable, educational, health or scientific research purposes or under international commitments/agreements including grants-in-aid will also continue. Moreover, lives saving drugs, books and other printed materials including newspapers and periodicals have been kept exempt.

Sales Tax is the top leading source of federal tax revenue and has gained importance over time. The sales tax share in federal tax revenues during the fiscal year 2010-11 has been recorded around 40.7 percent. In the budget 2010-11, the GST rate was also increased from 16 percent to 17 percent. The net collection of sales tax stood at Rs.633.4 billion entailing a growth of 22.7 percent over last year. The revised target of sales tax has been achieved to the extent of 96.7 percent. The refund payments at Rs.50.8 billion, has increased by 76.7 percent as compared to previous year. The substantial increase in refunds payments during 2010-11 has been due to implementation of automated refund payments system that has accelerated the disposal of refund claims.

Sales Tax Domestic contributes 51 percent in total sales tax collection during 2010-11. An overview of the sales tax (domestic) collection indicates that it remained highly concentrated. The top fifteen commodities, despite a decline in its share by 1.4 percent, have generated 86.0 percent of total Sales Tax collection during fiscal year 2010-11. POL product alone has contributed 41.4 percent in collection. Telecommunication has been the second source with double digit contribution in collection of sales tax domestic collection. The share of remaining major revenue spinners has been in single digit. A look on the collection from other than top 15 commodities shows that its share in collection has increased by 1.5 percent which indicates a movement towards diversification in collection. The performance of major revenue spinners of sales tax (domestic) for the fiscal year 2010-11 compared with 2009-10 have been given below.

Table-45: Major Revenue Spinners of Sales Tax (Domestic)

Rs. Million

S. No	Description	2010-11	2009-10	Growth %
1	POL Products	154,689	118,391	30.7
2	Telecommunication	53,256	44,853	18.7
3	Natural Gas	27,142	21,242	27.8
4	Services	20,141	16,798	19.9
5	Electric Energy	13,272	9,551	39
6	Cigarettes	11,527	10,933	5.4
7	Beverages	8,684	6,996	24.1
8	Sugar	7,314	9,548	-23.4
9	Tea	5,671	4,769	18.9
10	Cement	4,944	4,382	12.8
11	Iron & Steel Products	4,474	2,380	88
12	Food Products	2,706	2,179	24.2
13	Motor Cars	2,514	2,856	-11.9
14	Auto Parts	2,511	2,318	8.3
15	Scrap of Iron & Steel	2,272	2,028	12
Sub-Total		**321,117**	**259,224**	**23.9**
Share (%) in Total		**86**	**87.4**	
Others		54,381	38,627	41
Grand Total		**375,498**	**297,851**	**26**

Source: FBR Year Book 2010-2011

The collection of sales tax on imports (STM) depends on the volume and composition of imports. The details of STM collection also confirms the higher concentration as the fifteen major commodity groups have contributed 87.6% 2010-11 which was 88.9% last year. Increase in share of other than top 15 revenue spinners shows a spread in collection. The POL Products is again the top revenue spinner in Sales Tax Imports collection also, with 35.8% share and has increased by 11.1%. The other commodity groups that played vital role in achieving the growth of 24.7% in collection includes edible oil, plastic raisins, Mechanical Machinery, Vehicles and paper & Paperboard. The details of top 15 commodity groups in collection of sales tax imports are given in the Table-46.

Table-46: Major Revenue Spinners of Sales Tax at Imports

Rs. Million

No	Description	2010-11	2009-10	Growth (%)
1	POL Products	110,543	99,514	11.1
2	Edible Oil	28,598	18,709	52.9
3	Plastic Resins	24,578	19,017	29.2
4	Vehicles(Non-Railway)	19,795	16,089	23
5	Iron & Steel	19,010	17,578	8.1
6	Mechanical Machinery	12,640	8,167	54.8
7	Electrical Machinery	9,664	6,536	47.9
8	Organic Chemicals	8,374	6,778	23.5
9	Paper & Paper Board	7,964	4,909	62.2
10	Oil Seeds	6,437	6,419	0.3
11	Tea & Coffee	5,879	4,538	29.6
12	Rubber Products	5,397	3,483	55
13	Misc. Chemical Products	5,369	3,539	51.7
14	Aluminum Articles	3,587	3,013	19.1
15	Dyes & Paints	2,212	1,673	32.2
	Sub Total:	270,047	219,962	22.8
	Share (%) in total	87.60%	88.90%	-1.30%
	Others	38,647	27,311	40.1
	Grand Total:	308,694	247,273	24.7

Source: FBR Year Book 2010-11

III. 10.2. Federal Excise Duty (FED)

Federal Excise Duties are levied on domestic production, imports and few services rendered in the country. The FED is an important component of indirect taxes. The major excisable commodities include cigarettes, cement, beverages, natural gas and POL products, whereas excisable services like Services provided by property developers and promoters, and Air Travel.

The following graph indicates the importance of FED in tax revenue generation. The fall of its share from 1967-68 onward shows the impact of policy decisions of shifting the commodities from Federal Excise Mode to Sales Tax Mode. A strong desire of the financial managers prevailed for several years to reduce the number of taxes from four to three i.e. by abolishing of Federal Excise tax regime. However, the continued and rising financial constrains did not leave enough space for its implementation. The share of federal excise in total federal tax collection started increasing from 2005-06, with the addition of certain commodities in its tax net. Its contribution in total tax collection is still important, in term of revenue generation.

The collection of FED, during 2010-11 was Rs.137.4 billion as compared to Rs.124.8 billion last year and posted a growth of 10.1%. The target for FED collection has been surpassed by 3.4%. The collection from Cigarettes has been the major revenue spinner with 34.7% share in total FED collection during 2010-11. The other two sources with double digit share in collection have been 1% special excise duty and cement. The performance table indicates that the highest contribution in achieving the 10.1% growth in collection from FED has been made by 1% special excise duty (Rs.8.5 billion), followed by natural gas (5.4 billion) and cigarettes (Rs.2.3 billion). The improvement in collection from Natural Gas is associated with increase of duty rates from Rs.5.09 per MMBTU to Rs.10 per MMBTU in the budget 2010-11. The collection from services has shown a decrease of Rs.5 billion, followed by a decline of Rs.2.2 billion from beverages. The collection from Services has declined by 31.4% mainly due to shifting of heads of insurance and banking services from FED to Sales Tax regime. The major commodities of FED for the fiscal year 2010-11 have been compared with fiscal year 2009-10 in the following Table-47.

Table-47: FED Collection's Major Revenue Spinners

Rs. Million

Sr. No.	Description	2010-11	2009-10	Growth (%)
1	Cigarettes	47,069	44,748	5.2
2	Cement	15,469	15,764	-1.9
3	Natural Gas	11,636	6,205	87.5
4	Services	11,023	16,062	-31.4
5	Beverages	9,148	11,373	-19.6
6	POL Products	5,110	4,799	6.5
7	1% Special excise duty	24,614	16,084	53
	Sub Total	124,069	115,036	7.9
	Share (%) in Total	90.3	92.2	-2.1
	Other	13,287	9,773	36
	FED (Gross)	137,356	124,809	10.1
	Refunds	3	25	-88
	FED (Net)	137,353	124,784	10.1

III.10.3 Customs

The field offices of customs department are headed by a Member (customs) who operates through Chief Collector North and South. They are assisted by Collectorates headed by a Collector and staffed by Additional Collectors and Deputy/Assistant Collectors. Largest establishment of Customs department is in Karachi which is also the main port and largest business center of the country. There are also dry ports in up country in major cities of Hyderabad, Quetta, Multan, Faisalabad, Lahore, Sambarial, and Peshawar which facilitate the export and import activities. Pakistan Customs is the guardian of Pakistan borders against movement of contra band goods and is facilitator of bona fide trade. It provides a major source of revenue to the Government of Pakistan in the form of taxes levied on the goods traded across the borders. It also helps to protect the domestic industry, discourage consumptions of luxury goods and stimulate development in the under -developed areas. Pakistan became the member of WTO in 1995 as one of its founding members and is following the decisions of the organization. The share of revenue from customs has declined manifold since 1990. The collection from customs duty used to account for 45 percent of total collection and 55 percent of indirect taxes in 1990-91. It has contributed 19.3 percent in the indirect taxes and 11.9 percent in total taxes collection during the fiscal year 2010-11. The customs duty collection (Net) at Rs.184.9 billion has increased by 15.3 percent. The collection has surpassed the target of 173.3 billion by 6.6 percent. The volume of dutiable imports forms the tax base for customs duty collection. The size of customs duty collection also plays a vital role in forming the base for calculation of other taxes collection at import stage like sales tax on imports, Federal Excise duty at imports and withholding taxes at Imports.

The 15 major commodity groups (chapters) contributed 69.4% of the total customs duties during 2010-11 (Table-48). The share of collection from two commodity groups i.e., Vehicles (Ch.87) and POL Products (Ch.27) has been in double digit. The contribution from the rest of top 15 revenue spinners remained in single digit. Despite a shortfall in dutiable imports of mechanical machinery (Ch.84) and Electrical Machinery (Ch.85), the CD collection has shown a positive growth. The performance of Dairy products (Ch.04), textile material (Ch.54), staple fibers (Ch.55) and paper & paperboard (Ch.48) has been notable. The details of major fifteen sectors growth in CD collection and their contribution are presented in the following table. A cursory look at the collection pattern shows that the spread of collection has not changed during last two years. However, the improved effective rates in ten out of fifteen major revenue spinners indicates the imports of sub-commodity groups with higher slab of duty, during fiscal year 2010-11.

Table-48: Major Customs Duties Spinners

Rs. Million

Sr. No.	Description (Chapter's Head)	2010-11	2009-10	Growth %
1	Vehicles (Non-Railway) (87)	28,097	25,234	11.3
2	POL Products(27)	21,402	19,021	12.5
3	Edible Oil (15)	17,263	15,512	11.3
4	Machinery & Mechl. (84)	10,929	10,468	4.4
5	Iron & Steel(72)	9,528	9,443	0.9
6	Electrical Machinery (85)	8,832	7,219	22.3
7	Plastic Resins etc.	7,574	8,370	-9.5
8	Iron & Steel(72)	7,277	4,860	49.7
9	Paper & Paper Board(48)	4,453	2,331	91
10	Organic Chemicals(29)	3,923	3,794	3.4
11	Tea & Coffee (09)	3,542	2,736	29.5
12	Staple Fibre(55)	3,213	1,742	84.4
13	Dairy Products(04)	2,769	1,371	102
14	Cosmetic & Perfumery(76)	2,753	2,280	20.7
15	Dyes & Paints (32)	2,681	2,418	10.9
	Sub Total:	134,236	116,799	14.9
	Others	59,144	49,257	20.1
	Gross	**193,380**	**166,056**	**16.5**
	Refund/Rebate	8,527	5,783	47.4
	Net	**184,853**	**160,273**	**15.3**

Source: FBR Year Book 2010-2011

IV. Country-Specific Fiscal Issues

Although the economy of Pakistan reflected some recovery in FY2012 as GDP growth rate increased from 3 percent in FY2011 to 3.7 percent in FY2012, there are considerable challenges posed by deep rooted imbalances. While the domestic economy remained sluggish, the external contribution to the economy has shown some positive signs as the difference between GNP and GDP growth rates have slightly improved to 0.5 percent in FY12 as compared to negative 0.1 percent in FY11. The specific fiscal problems of Pakistan are discussed below:-

Current Account Deficit

Current account deficit is neither good nor bad as long as the world is happy to invest or lend money to country facing deficits. However, it will be bad if it results in capital flight. The persistent high current account deficit of Pakistan remains a major risk to the macro-economy of Pakistan. The current account deficit recorded during July-April 2012 was US$ 3.394 billion. The huge trade deficit to the tune of US$ 12.683 billion was the major contributor to current account deficit. On the other hand, capital and financial account during the same period stood at US$ 1.396 billion. The overall discrepancy in the balance of payment during July-April stood at minus US$ 2.542 billion. What are the sources with the government to finance this discrepancy in the balance of payment? The currency reserve with the central bank is one source. The currency reserves are of two types: domestic currency reserve and foreign currency reserve to offset the balance of payment discrepancy. The central bank of Pakistan uses US dollars to offset any discrepancy in the balance of payment. The increasing discrepancy in the balance of payment due to widening current account deficit is not only declining foreign exchange reserves but also printing money causing massive depreciation of rupee value. The second source available with the government to prevent balance of payment crises is to obtain loan from domestic as well as external sources. However, with overall contraction in global economy and precarious domestic macro-economic climate due to power shortage and law and order situation, to obtain loan from the external sources will become more and more difficult. Moreover, the debt has already reached to the extent (Rs.7.2 billion during July-March 2012) that debt servicing takes away big chunk of revenue every year. Secondly, the government can borrow from domestic sources. The government has borrowed Rs847.5 billion in July-March 2012 from domestic sources, compared to Rs.700.1 billion in the corresponding period of fiscal year 2011. The increased demand of funds by the government from domestic sources reduces availability of funds for private sector and, therefore, adversely affects the private investment.

High Debt Servicing

As also discussed in the preceding para, Pakistan is trapped in the vicious circle of huge debts having both foreign and local origin. The debt servicing charges has increased steeply by 72 percent during January-March 2012 on the scheduled repayment of International Monetary Fund and huge amount on account of external debt liabilities. According to State Bank Report 2012, debt servicing principal payment to international lenders and multiple exchange expenses surged to US$ 912 million in January-March 2012 as compared to US$ 530 million during the same period last year, an increase of US$ 382 million. Total debt servicing to total revenue ratio is a good measure to see the extent of debt servicing burden on national exchequer. Total revenue during fiscal year 2011 was Rs.2,260,712 million and the amount of total debt servicing was Rs.413,350.5599 million (US$ 4799 × 86.1326). Thus debt servicing to total revenue ration during fiscal year works out to be 18.28 percent. It means in 2010-11, almost 18.28 percent of total revenues were consumed for debt servicing. The foreign exchange liabilities of the country also witnessed a steep surge of $371 million or 458 percent on quarterly basis, which stood at $81 million in October to December 2011. The steep surge in foreign exchange liabilities is a matter of concern for the economy, which went unabated on the back of trade of goods and services deficits, commercial banks' crossing border limit increase and rupee's depreciation against the dollar. The foreign exchange reserves continue to decline due to increase in repayment of debt servicing and foreign exchange liabilities. As a result, the rupee will remain under pressure, which will further increase macro-economic problems. Higher debt servicing widens the fiscal deficit and leaves less revenue for development expenditure such as education, health, infrastructure etc.

Mounting Defense Expenditure

Pakistan's expenditure on defense and related areas has always been very high and disproportionate to its size of economy, area, population and resources. Defense expenditures accounted for 15.5 percent of current expenditure in 2010-11. As a percentage of GDP defense expenditures were 2.5 percent in 2010-11 and are likely to remain slightly below this level in 2011-12. However in absolute terms defense expenditure rose to Rs. 450.6 billion during 2010-11 from Rs. 375.0 billion in 2009-10. Nevertheless the budget target is set at Rs. 495.2 billion for 2011-12 which is around 2.4 percent of GDP. During 2007-08, defense related budget expenditure was allocated at Rs. 296 billion (almost 20 % of current expenditure). In 2011-12, the total defense expenditure was Rs507 billion, which was around 27 percent of the total tax revenue Rs.1906 billion collected by the FBR during the fiscal year. There are many contributing factors to this situation. The very first and most important factor is its relations with gigantic neighbor India on its east from the very independence of the country from the British rule in 1947. Due to dispute over Kashmir and others areas like Siachin and Sir Creak, the country has been even pushed into war three times by the eastern neighbor. In the wake of this history to incur disproportionately high defense expenditure is an unwanted necessity for a developing country like Pakistan. The result is the slow pace of overall social and economic development. The funds otherwise to be spent on building of infrastructure required for the accelerated growth of society are being diverted to this unproductive area. According to United Nation Report, 2011, Pakistan is spending more on debt servicing than on defense, and seven times more on arms than on primary schools. Recently, both India and Pakistan have agreed to allow the investors to invest in either country. The reconciliation would help to improve the situation. Likewise, the long mountainous, porous and troubled western border with Afghanistan and military operations against Taliban within the tribal areas of the country has also added to the security and defense concerns of the country in wake of the war on terror in the recent past.

Low Foreign Direct Investment

As every other developing country in the world Pakistan also aspires for inflow of foreign investment which not only supports the growth of and momentum of economic activities but also helps creation of employment opportunities and skills for the locals. The inflow of investment also improves the position of foreign exchange of a country. Pakistan is a large country with abundant human and natural resources but lacking financial resources. Pakistan is striving hard for creating conducive environment for foreign investors. Pakistan has also introduced many laws guaranteeing security of investments and other rights. Doing business is now very easy in Pakistan. Free mobility of foreign exchange and profits, hundred percent equity owned by foreign investors , creation of Board of Investment are few other important instances which shows the level of seriousness of the government of Pakistan for attracting foreign investment. Nevertheless, the government has still a lot do in many areas for creation of an environment such as 'curtailing the number of days required to start a business', installation of business friendly infrastructure, and improving prevailing law in order situation to create an investment friendly environment. Likewise, the control of 'terror threat perceptions' from the Taliban within the country, and also to overcome the 'terror spillover' from the extremist elements of Al Qaeda, and related groups from Afghanistan through its western boarders also remains as one of the key areas to encourage more foreign investors in a more peaceful and tolerant society. This is also one of the important issues facing country.

Extremely Low Tax-to-GDP Ratio

As discussed in the preceding topics, the tax system always plays the role of a backbone in the economy of a country. With the changing dynamics of world politics, self-reliance is the only way out for developing economies. The taxes are the main source of a country's income and an apparatus for resource mobilization. Federal Board of Revenue also requires comprehensive restructuring and administrative overhaul to raise the almost stagnant tax to GDP ratio since late nineties. The World Bank, in its Tax Policy Report on Pakistan, prepared by the Andrew Young School of Public Policy, Georgia State University and FBR, released on September 4, 2009, has estimated amount of tax evasion of Rs. 796 billion in the year 2007-08. The government initiated program named TARP (Tax Administration Reforms Project) with the assistance of the World Bank and multilateral donors but it will take four to five years when the reforms will start yielding results.

Trade Gap and Export Diversification

Major source of large current account deficit is trade deficit in Pakistan. Trade deficit comes from less growth in exports and more growth in imports. Pakistan's exports are limited to semi-finished or raw materials and also concentrated in few countries. One way to enhance exports is increase investment in real assets. In this territory, the government needs to encourage the export of value added products instead of semi-finished or raw materials. It also has to diversify in terms of destinations of its exports. This area also needs special attention.

V. Conclusion: Where we stand and where we go?

Pakistan is endowed with abundant resources including arable land, fresh water, plenty of sunshine, suitable climate, human resources etc. It has strategic importance politically as well as economically. It shares borders with two giant emerging economies of the world: China and India. It has coastal boundary that defines its trade routes to oil-rich resourced Middle Eastern countries of Asia as well as natural resource rich countries of Far East Asia. But Pakistan has not been adequately benefitted from good resource base and strategic location because of many domestic and external challenges, which have not been addressed at right time.

Pakistan has been facing serious fiscal crises from the last three to four years. The fiscal deficit is reaching around 6 to 7 percent. The government resort to printing money to finance the deficit that has given rise to serve inflation that has reached double digit. High inflation has created survival crises for the majority of the poor people, which has given rise to internal unrest. Immediate fiscal consolidation measures are needed to overcome the fiscal crises.

In FY 2012, the rates of investment and savings decreased by 0.6 percent and 2.5 percent respectively, highlighting structural weaknesses in the economy. Due to large fiscal deficit, there was negative contribution of public sector that considerably reduced the domestic savings. Large current account deficit further undermines the rate of national saving. Low rate of saving, high inflation and considerably reduced FDI during the year, resulted in steep decline in total investment. There is a need to further reduce the interest rates to encourage overall investment, especially in manufacturing and agriculture sectors.

The average growth rate of population was 2.03 percent (highest in the region) in 2012 whereas the average rate for GDP is 3.7 percent in the same period which is insufficient to support high population growth rate. The income generating resources have been declining over the years instead of expanding because of energy crises, poor law and order situation and political instability. The population explosion is a big challenge that requires immediate attention. In some fiscal years, population growth even surpassed the economic growth. The government has to launch multi-pronged strategy such educating the people by increasing expenditure on education to improve literacy rate, which is apathetically low, etc.

Political instability is another daunting challenge. Political instability means either the governments changes frequently before completion of the term or absence of mechanism for replacement of government. Pakistan has been suffering from political instabilities right from its creation. The foreign direct investment, being long run, comes in that country where the investors feel political certainty will continue and the laws governing the investments will not be frequently subject to changes. But besides having lot of potential in oil and gas exploration, mineral exploration and hydro power projects etc, Pakistan failed to attract foreign investment substantially. Had there been political stability from the beginning, Pakistan would have been a progressive and modern state with vibrant economy. After nine eleven incident it has been facing even more challenges on many fronts especially the rise of domestic extremism and the ongoing military operations against Taliban in its north western parts. Majority of the population is moderate in approach and desirous to live in peace with the global community.

Mobilization of revenue resources is another challenge. Pakistan's tax-to-GDP ratio is lowest among most of the developing countries besides having large consumption tax base and income tax base. The current tax-to-GDP ratio of 9 to 10 percent is lower than the international standards of 17.5 percent for the developing countries. The low tax-to-GDP ratio is due to various factors including large underground economy, sizeable tax avoidance and evasion, weak tax machinery, too many exemptions in the Income Tax and Sales Tax codes etc. Agricultural tax is the provincial subject but tax collection on account of agriculture is significantly lower as compared to potential. Another neglected area of revenue mobilization is property tax. Most of the world countries collect property tax around 0.7 percent of GDP but in Pakistan, property tax collection is less than 0.2 percent of GDP.

Another important area is to cultivate friendly ties with our neighboring countries by resolving all contentious issues. By doing this, Pakistan will be able to enhance volume of trade with India and China and other neighboring countries. This will help to overcome fiscal imbalances. This will not only ensure political stability of the region but would also channelize a more useful spending of the funds from defense towards the social sector and would also accelerate the development of infrastructure necessary for rapid growth.

Maintenance of law and order should be another priority of the government. Since no one in the world would endanger one's life and capital for reaping even heavy profits in a high demand market. Unfortunately, the government has not been actually successful on this score. The spillover effects of war on terror in Afghanistan and the military operations against local Taliban in the North West of the country are one of the greatest menaces. There is increasing number of cases of kidnapping of highly skilled professionals such as doctors, government officials etc. particularly in the province of Balochistan for ransom. Even otherwise, the general law and order situation is also not ideal. This situation not only prevents and discourages the foreign investors to bring their capital to Pakistan but also at times forces the local businessmen to establish their enterprise in the neighboring countries like the UAE. The government should not only take concrete steps to ensure safety of lives and properties of the people but also should make sincere endeavor to uproot extremism and terrorism in all forms and manifestations. Instead of imposing foreign borrowed 'one size fits all' policy, it should pay more attention to cope the menace on the 'domestically tailored' policies, specially designed in the context of the socio-cultural background of the tribal areas – the epicenter of the ongoing war against terror within the country. Likewise, the collateral damages of life and property of innocent population of these areas should be minimized and attempts should be made to bring them to zero. Such damages coupled with displacement of hundreds of thousands innocent migrants in the 'operation ridden' areas are igniting hatred towards the state policies and thereby adding more complications to the war on terror. The ultimate sufferings by wrong policy measures would no doubt distress the socio-economic fabric of the entire society.

Power is the main constraint for economic growth, as load-shedding has intensified and become less predictable. As per the report issued by the ADB, losses arising from power and gas shortages held down GDP growth between 3 to 4 percentage points in FY2012. The key factors that have caused this crisis include inefficient energy mix, with heavy reliance on highly expensive imported furnace oil, huge gap between cost and recovery of power, line losses, inefficient generation plants and unresolved circular debt. Cost recovery has not yet been achieved despite substantial increases in tariffs over the past 2 years, and measures to bring down costs have not been effective. Pricing of gas has remained extremely low resulting in excessive misuse of this precious resource that is fast depleting. The only way to alleviate this problem is to develop policies and plans that can attract large scale investment in the sector so as to gradually change the energy mix, enhance the use of hydro and indigenous coal as fuel for power generation rather than highly expensive imported furnace oil, and enhance the efficiency of generation, transmission and distribution systems through investment in latest technology together with drastic changes in the ways of governance in public sector.

Contrary to its growth potential and rich human and physical resource, Pakistan is consuming its own sources of natural gas and petroleum at a greater pace and is not developing other reliable alternate sources of energy, especially to hydel-energy. The government has not developed a single large water reservoir (dam) since 1976 because of lack of consensus among the regional political parties. Neither of the government has shown seriousness for resolving the contentious issue of building Kala Bagh Dam. Pakistan has a great potential for hydro-power generation because of its unique physical terrain. There are naturally available sites for construction of large dams. If the government is serious to enhance the economic growth and to attract foreign direct investment, immediate attention and long term planning is required to enhance energy generating resources because availability of cheap energy creates international competitiveness because of domestic goods would be cheaper in the world market. There are large natural gas and coal reserves in Sindh and Balochistan which are still untapped. The government can attract foreign direct investment in exploration of such resources through provisions of suitable environment to foreign investors. This would also create employment opportunities for the nationals.

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