2 Economic Growth, Savings and Investment

2.1 Overview

Overall economic activities slackened considerably in FY01. Growth in real gross domestic product (GDP) decelerated from 3.9 percent in FY00 to 2.6 percent in FY01 against the target of 5.0 percent. This slowdown, originating in the agriculture sector, was imminent due to the drought like situation caused by the acute shortage of water throughout the country. Lower than targeted production of cotton, rice, sugarcane and wheat, pushed the growth of agriculture down to negative 2.5 percent. Counterbalancing the impact of agriculture, industrial sector, with its impressive recovery of 4.2 percent during FY01 (against a decline of 0.1 percent last year), provided impetus to other allied sectors of the economy. Commodity producing sectors, primarily due to the fall in agriculture, witnessed marginal growth of 0.8 percent. On the other hand, services performed well at 4.4 percent, which is close to the past ten year annual average of 4.6 percent (see **Table 2.1**).

The depressed prospects for cotton and sugarcane, evident by the end of Q1-FY01, had already put into doubt the production target of major crops. By March 2000, unanticipated degree of water shortage, made it apparent that major crops would register negative growth for the year[1]. To deal with the mounting crises, provincial authorities resorted to alternate sources of irrigation. A greater volume of water was released to areas where tubewell irrigation was not feasible, while concessionary rates were maintained for electric consumption by tubewells. These steps helped to alleviate the problems brought about by the shortage of water.

Table 2.1: Sectoral Growth of Real GDP
at constant factor cost of 1980-81

	Growth rates		Sectoral shares	
	FY00[R]	FY01[P]	FY00[R]	FY01[P]
A. Commodity producing sector	**3.0**	**0.8**	**50.6**	**49.7**
I. Agriculture	6.1	-2.5	25.9	24.7
Crops	7.3	-7.3	15.7	14.1
Major crops	15.1	-10.5	11.4	10.0
Minor crops	-9.1	1.1	4.2	4.2
Livestock	2.4	4.8	9.1	9.3
Fishing	9.7	-3.6	0.9	0.9
Forestry	113.0	40.4	0.3	0.3
II. Industry	-0.1	4.2	24.7	25.1
Manufacturing	1.4	7.0	16.7	17.4
Large-scale	-0.2	7.8	11.6	12.2
Small-scale	5.3	5.3	5.0	5.2
Mining and quarrying	6.1	-0.4	0.5	0.4
Construction	5.2	-0.4	3.5	3.4
Elec. and gas distribution	-9.8	-3.1	4.1	3.9
B. Services sector	**4.8**	**4.4**	**49.4**	**50.3**
Wholesale and retail trade	2.9	3.8	15.0	15.2
Transport, storage and comm.	3.6	4.1	10.2	10.4
Finance and insurance	8.2	2.3	2.6	2.6
Ownership of dwellings	5.3	5.3	5.9	6.1
Public admin. and defence	7.0	3.0	6.3	6.4
Other services	6.5	6.5	9.3	9.6
Gross domestic product (A+B)	**3.9**	**2.6**	**100.0**	**100.0**

R = Revised, P = Provisional.
Source: Federal Bureau of Statistics

A broad based recovery was registered in large-scale manufacturing (LSM), with positive growth posted in all the industrial groups for the first time in the past seven years. The momentum in the 8.4 percent growth started to build early in the year.[2] Growth in LSM was 10.9 percent by end Q1-FY01, considerably higher than the 3.6 percent achieved during Q1-FY00. This trend continued throughout the year except in Q2-FY01, when late crushing of sugarcane and the closure of sugarmills in first half of December, had created a temporary vacuum. The timely decision regarding imports and processing of raw sugar in Pakistan saved the sugar industry from another crisis; during FY00, the sugar industry declined by 31.6 percent against positive growth of 14.8 percent this year. Items related to petroleum products, fertilizers, home appliances, automobiles and paper products, performed well and surpassed the growth registered last year.

[1] For reference, please see the past Quarterly Reports published by SBP during FY01.
[2] For 8.4 percent growth in LSM, see **section 2.3.1.**

The services sector grew by 4.4 percent during FY01 compared to 4.8 percent last year. Transport, storage and communication and wholesale & retail trade contributed with growth of 4.1 percent and 3.8 percent respectively. As shown in **Table 2.1**, services helped the economy, alongwith the industrial sector, in arresting the declining momentum brought about by agriculture.

Gross National Product (GNP), grew by 2.4 percent in FY01 compared to 3.5 percent last year. Negative value added by net factor income from abroad has persisted over the past six years, keeping GNP growth below GDP. With Pakistan's population growing at 2.3 percent, per capita income this year increased marginally by 0.9 percent compared to 1.8 percent last year.

National savings as a percent of GNP stood at 12.9 percent in FY01 compared to 13.9 per cent last year. Due to a fall in private and corporate savings, even the extraordinary growth in public savings (by more than 300 percent) could not sustain the ratio of national savings to GNP. The increase in public savings at Rs 310.3 billion was almost offset by the declines of Rs 276.6 billion in private savings and Rs 3.3 billon in corporate savings. Gross total investment declined from 15.8 percent of GNP in FY00 to 14.9 percent this year. A deterioration was also observed in the ratio of national savings to total investment, which fell to 86.5 percent in FY01 compared to 88.1 percent last year.

2.2 Agriculture

After achieving impressive growth of 6.1 percent last year, the agriculture sector could not meet the 2.6 percent growth target and ended FY01 with negative growth of 2.5 percent[3] (see **Table 2.2**). This reversal was mostly on account of the shortage of irrigation water that persisted both in kharif (May – September) and rabi (October – April) seasons, with supply 15.8 percent and 28.8 percent lower this year compared to already depressed levels during the corresponding seasons last year. In addition to losses in major crops, performance of fisheries also remained subdued due to lower water levels in rivers, lakes, reservoirs and dams. In absolute term, the loss on account of a decline in value addition by agriculture stood at Rs 4.2 billion during the year, which limited the increase in value addition in GDP to Rs 16.6 billion this year. Last year agriculture alone contributed Rs 9.8 billion to the Rs 24.3 billion increase in GDP.

Table 2.2: Value Added Growth and Shares
at constant factor cost of 1980-81

	Growth rates		Shares in agriculture	
	FY00 R	FY01 P	FY00 R	FY01 P
Agriculture	6.1	-2.5	100.0	100.0
Major crops	15.1	-10.5	44.0	40.4
Wheat	26.5	-20.0	14.1	11.6
Cotton	31.9	-6.3	12.7	12.2
Rice	12.7	-10.7	7.2	6.6
Sugarcane	-13.4	-7.7	5.8	5.5
Other crops	-4.8	5.9	4.1	4.4
Minor crops	-9.1	1.1	16.3	17.0
Livestock	2.4	4.8	35.1	37.7
Fishing	9.7	-3.6	3.6	3.5
Forestry	113.0	40.4	1.0	1.4

R = Revised; P = Provisional
Source: Economic Survey 2000-01

In a bid to ease the severity of drought, farmers and respective government departments acted jointly towards better water management. To their credit, they managed to maintain the same area under major crops as in FY95 (17.3 million hectares) when water supply was almost 33 percent higher than in FY01 (see **Figure 2.1**). Under these arrangements, the shortage of canal water (where feasible) was supported by groundwater through additional use of tubewells and deep turbines. Greater funds were made available to farmers by ADBP to finance the installation of tubewells (see **Chapter 5**). Consequently, units of electricity consumed by agriculture during July-March FY01 increased by 9.1 percent compared to the same period last year.

[3] Revised estimates on production of wheat at 19.0 million tonnes placed the growth of agriculture sector at negative 2.1 percent for FY01 instead of negative 2.5 percent estimated earlier with the crop size at 18.5 million tonnes.

Area irrigated using tubewells registered an increase of 4.0 percent during first nine months of FY01. Brackish underground water which is ecological endowment of the Sindh and not suitable for irrigation, limited the scope of tubewell usage. In Punjab, about 79 percent of the Indus Basin contains fresh groundwater compared to 28 percent in Sindh. Hence, the shortage of water in Punjab was managed by diverting irrigation water to areas with brackish groundwater, while restoring to tubewells in sweet water zones. In the province of Sindh however, the use of tubewells remained limited and, as such, cultivated area for cotton, rice and wheat declined more in Sindh than any other province of Pakistan.

Agriculture is the leading indicator of the growth in GDP (see **Figure 2.2**), but its internal composition is undergoing a change. Given the vulnerability to natural vagaries, the crops sub sector is gradually losing its share in agriculture. It declined from 65.1 percent in FY91 to 57.3 percent in FY01. On the other hand, the share of livestock in agriculture is continuously rising. It grew to 37.7 percent in FY01 from 29.8 percent in FY91; its share in GDP improved from 7.6 percent to 9.3 percent in the same period. This shift is beneficial as far as domestic food requirements are met indigenously and a sizeable surplus is left for exports (see **Figure 2.3**).

Compared to last year, area under cultivation by Pakistan's major crops registered a record decline of 4.4 percent during FY01. Although drought conditions started a year ago, depicting a fall of 2.0 percent in area under kharif crops, this was compensated by a 1.2 percent increase in area under rabi crops – primarily wheat (see **Figure 2.4**). This boost to the wheat crop followed a campaign launched by the government in FY00 to grow more wheat by increasing the procurement price by 25 percent and releasing more water for irrigation from dams. Such steps could not be repeated during rabi FY01, since water levels at dams were already low, while there was no genuine reason to increase the procurement price of wheat after the rise last year.

Figure 2.1: Water and Cropped Area

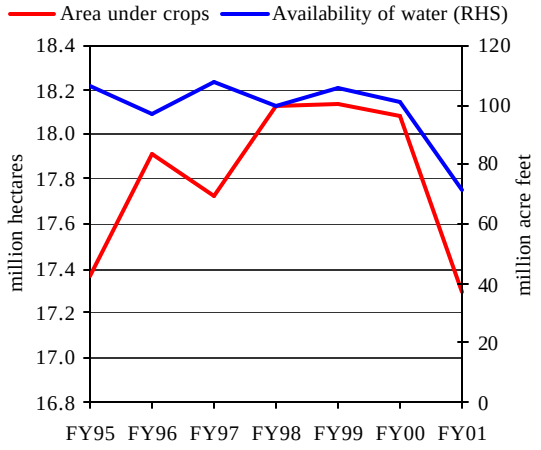


Figure 2.2: Growth in Agriculture and GDP

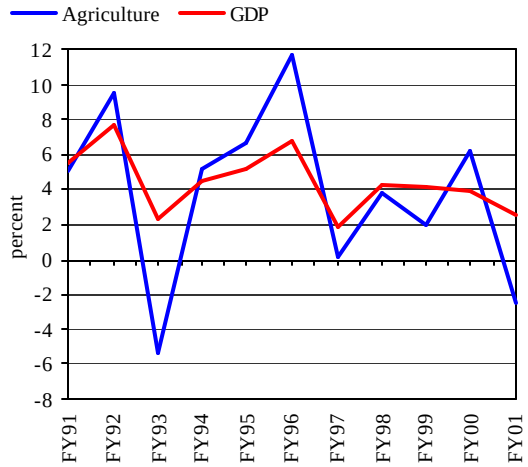
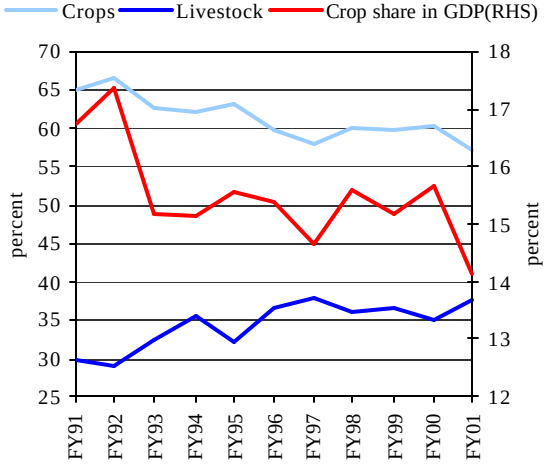
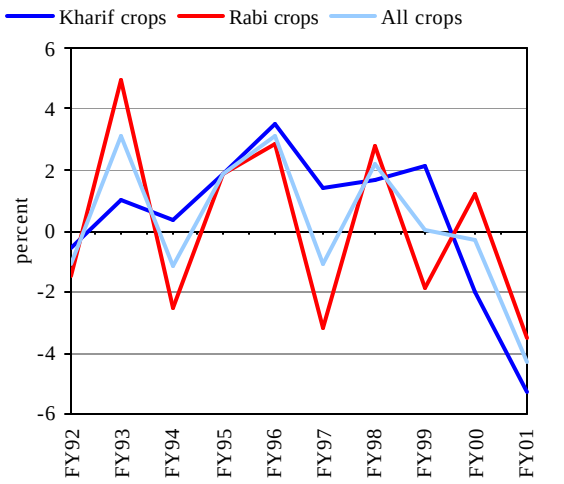


Figure: 2.3 Share of Crops and Livestock



Despite the fall in overall area under major crops, a shift within the crops was also customized to handle the situation in FY01. At some places, less water intensive crops substituted water intensive crops: although 187,000 hectares of land was intentionally dropped by rice and sugarcane growers, 93,000 hectares of this was added to bajra and moong cultivation. The remaining area was utilized for fodder – a part of minor crops, which grew by 1.1 percent during FY01.

Figure 2.4: Change in Area under Crops



2.2.1 Major Crops

This is the swing factor in the sharp reversal posted by agriculture this year. Although the country's major crops accounted for 40.4 percent of agriculture and around 10.0 percent of GDP in FY01, it could not repeat the 15.1 percent growth recorded last year. Pakistan's major crops posted negative growth of 10.5 percent this year. Among major crops, production of food grains (wheat, rice, bajra, jowar, maize, barley) decreased by 8.5 percent to 26.0 million tonnes during FY01, while sugarcane, cotton and mustard declined by 5.9 percent, 4.3 percent and 8.1 percent, respectively. Value added by Pakistan's four major crops – wheat, rice, sugarcane and cotton, which make up 36 percent of agriculture, dropped by12.2 percent in contrast to a sharp rise of 17.6 percent last year. Not only did the scarcity of water limit the farmers' ability to maintain area under cultivation at last year's level, it also adversely impacted the per hectare yield of these crops. A sharp decline of 6.7 percent was recorded in the yield of wheat, 2.7 percent in cotton, 1.4 percent in rice and 1.1 percent in sugarcane (see **Table 2.3**). Since the use of non-irrigated land constitutes around 16 percent of total cropped area under wheat, this also added to the overall decline in the yield.

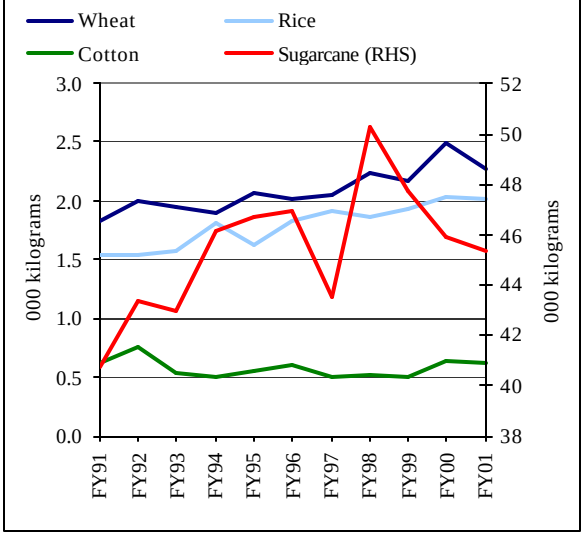
Table 2.3: Growth in Important Major Crops
percent

	Share in major crops[1]	Change in FY01 over FY00		
		Area	Production	Yield
Sugarcane	15.2	-4.9	-5.9	-1.1
Cotton	28.0	-1.9	-4.3	-2.7
Rice	16.3	-5.5	-6.8	-1.4
Wheat	30.0	-3.3	-9.8	-6.7
Total	89.4	-3.5	-7.0	-1.4

[1] = Five years average

Source = MINFAL (Economic Wing)

Figure 2.5: Yield of Crops



Despite year-on-year fluctuations in per hectare yield, a ten-year scan shows that the yield of wheat, rice and sugarcane, have shown marked improvement with the exception of cotton. The greatest achievement was in rice where per hectare yields increased by 31.0 percent, followed by wheat (26.3 percent) and sugarcane (11.4 percent). As mentioned above, no progress was possible for

cotton, which remained stagnant at around 615-640 kilograms per hectare (see **Figure 2.5**). The control gained over pestilence and viral attacks necessitated the use of viral resistant cottonseed, which is generally low yield. This could explain the 14.1 percent decline in the usage of improved (high yield) cottonseed during the course of the decade, which accounts for the almost stagnant per hectare yield of this crop. On the other hand, use of improved seed varieties by wheat and rice over the past ten years (by 141.4 percent and 100 percent, respectively) justifies the improvement in the productivity of these crops. Efforts are needed to improve the supply, price and availability of improved cottonseeds to farmers.

2.2.2 Minor Crops

Minor crops with 17.0 percent share in agriculture and 4.2 percent share in GDP, posted positive growth of 1.1 percent during FY01 against a decline of 9.1 percent last year. Given the variety of items included (e.g. vegetables, fruits, condiments, oil seeds and pulses – excluding gram), growth in individual crops showed a mixed trend. Production of oilseed declined by 3.4 percent while that of pulses increased by 6.2 percent. The other important minor crops: potatoes and onion registered declines of 9.2 percent and 9.7 percent, respectively.

A comparison of absolute numbers during the year, reveals that total value addition by minor crops was Rs 27.9 billion, which was marginally higher than Rs 27.5 million realized last year. Nevertheless, this was well below the Rs 30.3 billion and Rs 29.1 billion contributed during FY 99 and FY98, respectively. However, there was a useful degree of reshuffling amongst the components, with fresh fruits emerging as the leading item with production of 6.0 million tonnes during FY01, followed by vegetables (4.6 million tonnes), condiments (1.8 million tonnes), pulses (237 thousand tonnes) and oilseeds (214 thousand tones – see **Figure 2.6**). Contrary to its marginal share in major crops, the province of Balochistan produces a significant share of minor crops, particularly the fruit and condiments. This clearly helps improve income distribution amongst the provinces.

Figure 2.6: Crop Composition (Minor)

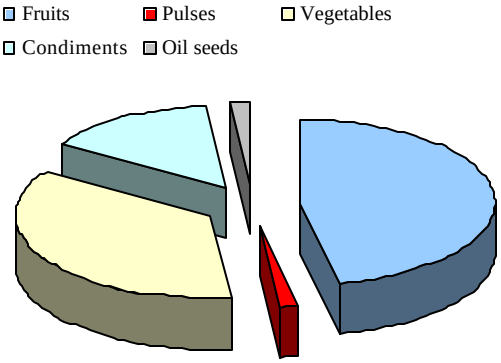
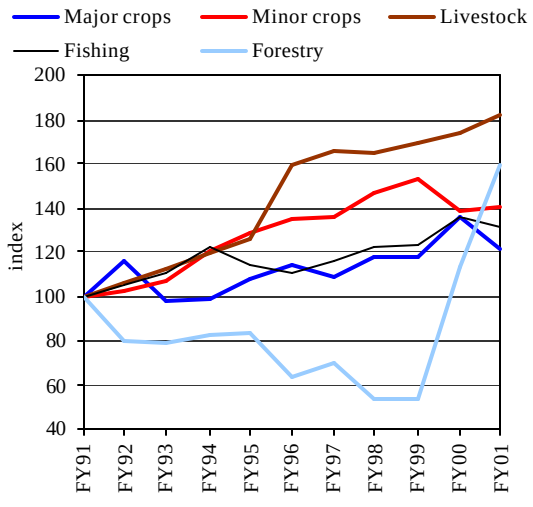


Figure 2.7: Comparative Growth in Livestock



2.2.3 Livestock

Livestock made up around 37.7 percent of agriculture and 9.3 percent of GDP this year, on the basis of a doubling of its growth rate (to 4.8 percent) compared to last year. As the second largest contributor to agriculture after crops, this year's performance compensated to some extent the fall in agricultural production. With strong growth in poultry products (white meat and eggs), all other components of livestock, both in terms of population and

products, showed positive growth (see **Table 2.4**).

Table 2.4: Livestock Population and Products

Selected Species	Million numbers		Percent change	Products	Thousand tonnes		Percent change
	FY00	FY01			FY00	FY01	
Cattle	22.0	22.4	1.8	Milk	25.6	26.3	2.8
Buffalo	22.7	23.3	2.6	Beef	985.0	1010.0	2.5
Sheep	24.1	24.2	0.4	Mutton	649.0	666.0	2.6
Goat	47.4	49.2	3.8	Poultry meat	322.0	333.0	3.4
Poultry	281.7	292.4	3.8	Eggs[1]	8,463.0	8,677.0	2.5

[1]: Million numbers.

Source: Ministry of Food, Agriculture and Livestock

Because livestock is less vulnerable to adverse weather conditions compared to crops, this creates an alternative source of rural income and thus is able to diversify the farmer's risk portfolio. Despite the limited policy attention on livestock, this sub-sector has grown by an average growth rate of 6.4 percent during the past ten years, and in doing so, clearly outperformed all other sub-sectors in agriculture (see **Figure 2.7**). The strong performance of minor crops and livestock indicates the robust growth potential particularly for exports. Furthermore, being less land intensive and comprising of a diversified basket of output, these two sub-sectors have attracted sufficient interest in terms of corporate farming. Given the emergence of thriving specialized markets in the West and Japan for organically produced foods, this interest may be further cultivated by developing organic farming methods in Pakistan (see **Box 2.1**).

2.2.4 Fishing

Value added by fishing declined by 3.6 percent in FY01 against positive growth of 9.7 percent last year. This includes all commercial and subsistence fishing in coastal & offshore waters, rivers, canals, lakes, ponds and inundated tracts. As detailed information on fishing this year is still not available, we will use export data on fish and fish preparation as a proxy to analyze growth in the sector. Compared to positive growth of 13.7 percent (in exports of fish and fish preparation) during FY00, a decline of 8.8 percent was registered this year. Despite this sharp fall in the quantity of export, receipts only fell by 0.8 percent (see **Chapter 9**). This was on account of a 8.7 percent increase in the unit value of such exports, which was made possible by maintaining better hygiene conditions at harbors, and improving processing procedures as recommended by the European Union during FY01.

2.2.5 Forestry

Forestry registered an impressive growth of 40.4 percent this year compared to an even higher growth of 113.0 percent during FY00; its share in agriculture value added is, however, miniscule (0.3%). Forestry covers logging and the gathering of uncultivated forest products and can be classified into two groups: (1) major products that include industrial wood like timber and firewood, and (2) minor products like grazing fodder, resin, medical herbs, etc. Although disaggregated data is sketchy, there is some evidence to say that these growth rates have been achieved on the basis of unsustainable deforestation.

2.2.6 Food Availability

Despite a shortfall in the production food grains, domestic availability of wheat, rice and pulses, remained satisfactory during the year mainly on account of carry over stocks from FY00 (see **Table 2.5)**. This year's production of wheat (at 19.0 million tones) coupled with the carry over of more than two million tonnes from last year, kept things easy. Furthermore, although the production of rice (at

Box 2.1: Potential of Organic Farming in Pakistan

With a variety of farmlands and farming practices, Pakistan has a vast opportunity to avail the benefit of emerging world demand of organically produced food items. In organic farming, strictly speaking, agriculture produce are obtained without using: i) chemical fertilizers, ii) pesticides and herbicides, and iii) genetically modified organisms (GMOs). In its less strict form, organic enterprise is supplemented only by the kinds of fertilizers and pesticides, which are not liable to kill or reduce the activity of soil organism. With intense use of labour and less of capital, organic farming is characterized as *low-input and low-output farming*, but with a high concern for the quality of produce.

In organic farms of all crops and fruits, fertility is restored by putting crop residues back into land, and replacing chemical fertilizers by compost, seaweed and fish manures, while control over weeds, pests and diseases is achieved as far as possible by observing the old principle of rotation of crops and maintaining high standard of management on farms. Further, under intact biological conditions pests remain in check by their natural predators. In organic livestock breeding, stocks are kept mixed and fed preferably on home-produced crops without using concentrated foods and artificial growth aids like hormone implants, etc. Use of antibiotics is kept limited and adopted only when some severe outbreak overcomes the natural immune systems of the stocks

Feared with the havoc of 'mad-cow' and 'foot and mouth' diseases, commonly understood, associated to GMOs technology, consumers in developed countries have even been increasingly becoming wary of the use of chemical fertilizers and pesticides -- the integral part of the modern farming. To avoid the risk of exposure to toxic and persistent chemicals, consumers in rich countries are increasingly inclining to buy organic foods and organic fiber products. Survey on Organic Consumer Trends 2001, published by the Natural Marketing Institute in cooperation with the Organic Trade Association mentioned that "retail sale of organic products in USA have grown steadily for the past ten years, showing compounded annual growth of 22.7 percent … assuming steady growth at conservative rate of 20 percent, retail sale of organics in 2001 are projected at a $9.3 billion. By 2005, sales are expected to reach nearly $20 billion". In view of the emerging demand, Netherlands authorities have planned to transform around 10 percent of their total cultivation to organic farming by the year 2005.

World trade in certified organic bananas increased markedly in 2000. Total exports were estimated at some 65,000 tonnes, up 50 percent from their level in 1999. This strong growth resulted from the combination of both supply and demand side factors. On the supply side, output of organic bananas continued to increase, as many banana companies that were previously in transition to organic production gained certification in 2000. The high price for organic bananas in 1998 and 1999 had given conventional banana growers incentives to convert their production areas to organic farms. On demand side, sales of organic bananas benefited from the rapidly growing demand for organic foods in major industrialized countries (Growing trade in organic bananas, Fruit World International 1/2001).

Pakistan being the agricultural country should make use of this emerging opportunity by producing higher exportable surplus of organically produced kitchen items, in the first phase, and production of staple crop (cotton), on the selected fields, in the second. In a sense, we enjoy a greater opportunity of exporting these items to the neighbouring rich countries of gulf region besides exporting to industrialized countries. In Pakistan, farming practices at some places are very much close to the organic approach. Most of the un-irrigated lands with their intact biological conditions can better be utilized for undertaking organic enterprises. As a matter of fact, a number of farmers in Pakistan are already engaged in producing organic agricultural products at least for their own use. Usually, they keep a certain piece of land apart for growing food crops without any application of chemical fertilizer and pesticides. Some other inherent advantages those lead towards exercising the option of organic farming favourably are: i) availability of labour at cheaper rates, ii) availability of unexploited resource of land and the least exposure of agriculture to the GMOs.

Pakistan is already exporting a sizeable quantity of vegetable and fruits to Europe and neighbouring countries. During FY01, US$ 115.6 million were earned through the export of fruits and vegetables. With domestic environment, conducive for producing organic vegetables, fruits and livestock products, Pakistan can be introduced as supplier of organic food items by launching a powerful marketing campaign in the international market. This is a good opportunity of earning foreign exchange through non-traditional exports because organically produced food items, at present fetch higher prices than their inorganic counterparts. The only thing that is required in addition to the norms is the certificate from the importing country authenticating the validity of organic farming.

4.8 million tones) was 6.8 percent less than last year, it was considerably higher than domestic consumption that is estimated at 2.5 million tones, leaving a smaller exportable surplus. The shortfall in the production of pulses, on the other hand, had to be met through imports.

Sugar production was hit on two counts: (1) the water shortage hit the sugarcane crop size, and (2) a lingering dispute between farmers and mill owners delayed the crushing season and resulted in the closure of sugarmills during first half of December 2000. Given the sensitivity of this crop, initial indications of the market shortage in November 2000, pushed wholesale prices up by 14.6 percent over the month before, and 68.4 percent compared with November 1999. As the situation eased following the arrival of imported raw sugar, which helped boost operations of the sugarmills, market prices fell by 22.7 percent by end-December 2000, compared to the month before.

Table 2.5: Per Capita Food Consumption and Availability

kgs. per annum

	Consumption[1]	Availability		
		FY00	FY01	% change
Wheat	124.4	140.9	140.5	-0.3
Rice	15.7	20.8	20.2	-2.8
Sugar	18.2	26.5	27.0	1.9
Pulses	9.1	6.7	6.6	-1.1
Meat	8.9	14.2	14.3	0.5
Fish	1.9	5.5	4.7	-14.2
Edible oil	11.0	11.1	11.2	0.8
Milk (liters)	89.6	82.4	82.5	0.1
Eggs (No.)	18	44.0	45.0	2.3

[1] Consumption is based on Household Integrated Economic Survey, 1993-94 by Federal Bureau of Statistics.

Sources: Planning and Development Division, GOP.

2.2.7 Support Price Policy

Under the price support program, GOP makes the changes in procurement/support prices of wheat, rice, sugarcane, oilseeds, potatoes, onions, gram, and cotton on the basis of recommendations by the Agricultural Prices Commission (APCOM). These prices are revised keeping in view factors like changes in international prices, domestic prices of agricultural inputs, the overall pressure on food prices and specific promotion priorities of the government.

During the year, support prices for the different varieties of rice were increased on September 21, 2000, and Pakistan Agriculture Storage and Supplies Corporation (PASSCO) was asked to buy rice from growers. Support prices were revised upward to avert the false crises created by traders, who wised to push prices down by limiting their demand in the markets. In September 2000, the average price of rice basmati at different grain markets was 11.3 percent below the prevailing price in the same month last year.

On June 8, 2001, the ECC approved a support price for cotton (phutti) at Rs 780 per 40-kg for the crop that would be marketed in FY02 (September to December). The support price of phutti was fixed at Rs 725 per 40-kg during the course of this year, and TCP was nominated to act the second buyer. However, since market prices were very attractive (in the range of Rs 750 to Rs 1,050 per 40 kg), farmers were able to realize prices between Rs 850 to Rs 950 without having to sell to the government agent. Given the strategic importance of this crop, the government has decided that all necessary steps would be taken to ensure that the market mechanism kept prices attractive enough for growers. If needed, TCP will intervene during FY02 as the second buyer in the market at the revised support price.

In case of sugarcane, there has been no increase in support prices since FY98. This made the cash crop comparatively less profitable than other crops. On the other hand, the support price for rice, wheat and oilseeds were revised at least twice since FY98, thereby undermining the profitability of sugarcane. This direct hit led to a 21 percent decline in the production of sugarcane in the last two years. During FY01, it had become difficult for sugarmills to acquire sugarcane at the designated support prices, as growers refused to supply sugarcane on these prices; this forced the majority of

mills to shutdown their operations during the first half of December. Eventually, market forces were able to shift prices in favor of growers, without any direct intervention by the government. During the crushing season in FY01, the market prices of sugarcane were on average 40 percent higher than support prices. Thus the determination of sugarcane price will no longer depend upon support price, which the government had discontinued to prescribe.

The increase in support prices of wheat and cotton (during FY00) was well received. Market prices of wheat during the third quarter of this year remained around the fixed procurement price of Rs 300 per 40 kg, but fell with the arrival of new crop in April/June 2001. Similarly, the market price of phutti during FY01, also settled above the minimum support price fixed at Rs 725 per 40 kg.

As shown by past experience, support prices bring stability in the market when simultaneously supported by other measures that impact market prices. For example, in the earlier part of the peak season of food-grains and cotton marketing, traders and commission agents indulge in speculative trading in these commodities. This pattern and the frequency of such trading plays a leading role in determining market prices. Hence, effective implementation of support prices is far more difficult when it conflicts with the interests of one or more stakeholders in the market.

The reasons for the successful implementation of support prices for wheat and cotton (in terms of the desired stabilization in market prices) during the year are listed below:

- A sizeable amount of the total produce of wheat during FY00 (more than 40 percent) was actually purchased by procurement agencies around the country. This created a sense of comfort in the market this year.

- Prior to the increase in support price of wheat in November 1999 (to Rs 750 per 100 kilogram), market prices were considerably higher than the earlier support price that was announced in FY97 (at Rs 600 per 100 kilograms). It is therefore not surprising that the market was very much receptive to this increase since the support price was even higher than the prevailing market price of Rs 720 per 100 kilograms in October 1999.

- The crop size of wheat preceding FY00 was generally less than domestic requirements (consumption and the required buffer stock) with the result that a sizeable volume of wheat was imported during the period FY 97 to FY99. Within this context, the supply increase witnessed last year has calmed the market and increased the credibility of the support price regime.

- The import price of wheat (C&F including other incidental charges) was higher than the earlier support price, which means that it was rational for the government to actually procure wheat at the designated procurement price.

In terms of cotton, it was the 37 percent increase in the international price of cotton during calendar year 2000, that supported the market's perception that the support price would create the required stability in the commodity markets. More generally, as the simultaneous occurrence of the above factors each year is unlikely, the fall back comfort for all growers is that the government is ready to purchase a sizeable quantity of the produce at the designated support prices.

Contrary to last year, the support price of wheat was not effective during the peak-harvesting season this year (i.e. May and June). Apparently, the main reason for this failure was the sharp decline in the quantity of wheat procurement by the government during FY01. Of the total wheat production of 19.0 million tones, the government only procured 4.0 million tonnes, which is less than half the quantity procured last year (8.4 million tones). This went against the sentiments of the market, where

growers (who are not always aware of broader issues relating to government constraints) were expecting procurement volumes to be at FY00's levels. Furthermore, market traders were not able to pay for the additional quantity of crop that was left in the market. The resulting panic selling of wheat in May 2001, pushed wholesale prices to almost Rs 600 per 100 kilograms.

This falling trend started in April 2001, but during the peak selling season (May to July), market prices actually were below the government's procurement price. In the wholesale grain markets in ten major cities, the average prices declined by almost 18 percent in July over its level in March 2001. At important stations like Lahore, Gujranwala, Sukkar and Sahiwal, price declines were more severe: looking at the change in price between March and July, these cities posted declines of 21.0 percent, 22.7 percent, 34.1 percent and 28.1 percent, respectively.

To strengthen the financial position of market participants and encourage private sector participation in wheat trade, SBP issued instructions on June 27, 2001 that banks should provide more financing for the purchase of wheat. Specific steps taken include:

1. *Lowering of proportionate equity finance for bank lending*: To finance the purchase of wheat as raw material for manufacturing and processing, the equity margin requirement for borrowing was reduced from 25 percent to 10 percent; the margin for financing traders was also brought down from 35 per cent to 15 percent.

2. *Financing procurement of wheat by flourmills:* Banks were encouraged to finance the procurement of wheat by flourmills from any source in Pakistan, without any restrictions based on the installed capacity of the flourmill.

3. *Pledge of wheat stock*: All borrowing for the procurement of wheat could pledge the produce as collateral.

These policy changes have helped the markets resulting in higher purchasers of wheat by traders. Just within a period of ten day after the announcement of this policy (June 27), 90 applications were received of which 71 applicants were given total financing of Rs 326 million.

2.2.8 Credit to Agriculture Sector

Disbursement of credit to agriculture for seasonal inputs, implements like tractors, tubewells, harvesters, etc. and for development of new agriculture land, is mostly availed from the five major domestic banks (ABL, HBL, MCB, NBP, UBL) and specialized banks (ADBP and FBC). Other commercial banks, which have a limited exposure to the rural sector in terms of branch network and lack of knowledge, tend to avoid extending loans to this sector.

Disbursements

A record Rs 44.0 billion was disbursed to the agriculture sector during FY01, compared to Rs 39.7 billion last year (see **Table 2.6**).[4] ADBP shared 62.7 percent of total disbursement followed by 27.4 percent and 9.9 percent, respectively by the commercial banks and FBC. Of the total amount, 67.9 percent was disbursed to farmers with subsistence holdings of land, 27.2 percent among farmers with economic holdings and 4.9 percent among large farmers.[5]

[4] However, it is important to realize that in net terms, there was a contraction in the last two years (Rs 4.4 billion during FY01 and Rs 3.9 billion during FY00).

[5] Subsistence holding means upto 32 acres (1 acre = 0.405 hectares) of land in Balochistan, 16 acres in Sindh and 12.5 acres in NWFP; Economic holding means upto 64 acres in Sindh and Balochistan and 50 acres in Punjab and NWFP.

Agricultural credit, in terms of disbursement and recovery, is highly seasonal. It is availed by farmers twice a year for two major cropping seasons (i.e. kharif from April to September, and rabi from October to March). Generally, higher volumes of credit are disbursed in the kharif season compared to rabi. This is because cotton, rice, and sugarcane are kharif crops.

To deal with drought-affected farmers, in July 2000, ADBP started a micro credit scheme aimed at encouraging the rural poor to engage in commercially rewarding activities. Under the scheme, a maximum of Rs 25,000 may be advanced both against personal surety and tangible security. Financing under this program covers 136 loanable items, and funding is available for 18 months at 16 percent annual rate of return. During its first year of operation, a sum of Rs 149.6 million was disbursed amongst 6,430 borrowers. The encouraging factor is the fact that loan recovery during FY01 stood at 90 percent. Furthermore, ADBP also helped farmers cope with the water shortage by providing a record Rs 1.6 billion for financing tubewells during the year. This amount was availed for the installation of 8,991 tubewells compared to Rs 830 million disbursed last year for installing 4,375 tubewells.

All participating commercial banks (except UBL) exceeded their individual credit targets during FY01. In the case of UBL that only disbursed 22.5 percent of its target, the primary reasons were the closure of branches and the reduction of trained staff.

Table 2.6: Credit to Agriculture Sector
billion Rupees

	Disbursement			Recovery		
	FY00	FY01	% change	FY00	FY01	% change
ADBP	**24.4**	**27.6**	**13.0**	**29.7**	**31.9**	**7.2**
Commercial banks	**9.3**	**12.1**	**29.5**	**8.7**	**10.9**	**25.3**
ABL	1.2	1.4	21.9	1.1	1.2	17.0
HBL	3.8	3.8	0.1	3.3	3.1	-5.6
MCB	0.6	2.3	286.0	0.5	1.8	268.3
NBP	3.5	4.0	15.4	3.6	4.4	21.3
UBL	0.2	0.5	113.7	0.2	0.3	57.8
FBC	**6.0**	**4.4**	**-26.6**	**5.1**	**5.6**	**8.2**
Total	**39.7**	**44.0**	**11.0**	**43.6**	**48.4**	**10.9**

Source: Agricultural Credit Department, SBP

Recovery

In overall terms, recovery at Rs 48.4 billion during FY01, improved by 10.9 percent over last year (see **Table 2.6**). This was on account of a strong recovery drive launched by the financial institutions at their own initiative, and the on-going accountability drive in the country. Following SBP's decision to discontinue the provision of concessionary credit to ADBP and FBC, both these institutions put extra efforts on recovery to be able to maintain the same volume of gross lending. On account of this, ADBP was able to collection of Rs 31.9 billion during FY01, compared to Rs 29.7 billion last year. The recovered amount would have been higher if this drive was not deferred in drought-hit areas. ADBP rescheduled a number of loans to farmers in calamity-hit areas throughout the country. In effect, looking at the provincial recovery targets, ADBP was only able to recover 21 percent of its target for Balochistan, 62 percent for Sindh, 63 percent for NWFP and 75 percent for Punjab.

Credit Expansion Measures

During the year in question, SBP has expanded the scope and coverage of agriculture credit to make it more attractive for commercial banks. Some important measures are mentioned below:

- The entire value chain of agriculture; from inputs, production, storage, marketing, transport, processing to distribution, has become eligible under the agriculture credit scheme.

- Owing to a policy shift to minimize distortions in the financial system, SBP has discontinued all concessionary credit facilities to ADBP and FBC since October 2000. Now all fresh credit lines to ADBP (including any future refinancing of cooperative banks) are to be priced at the minimum average rate on T-bills. The prime objective of this measure is to force these institutions to improve their lending and recovery operations. Other allied objective are: (1) it should encourage other financial institutions to lend their funds to ADBP, (2) the market based cost of funding will force agricultural lending rates to be aligned with commercial lending rates, and (3) in the long-run, greater competition amongst banks in terms of lending to agriculture should bring down lending rates.

- In the past, commercial banks were not allowed to lend outside their narrow territorial area that was specified by SBP. In certain cases, this provided banks with an excuse not to lend. The removal of this rule should enable commercial banks to lend on purely commercial basis. More importantly, this will also give farmers the option to choose the bank of their choice.

- In order to improve credit flows to farmers, SBP has allowed them the facility of revolving credit, which means even if farmers are unable to adjust their previous loans fully, they can still avail fresh credit. Earlier, banks were only allowed to sanction credit on revolving basis for three year, and only to farmers who repaid their previous loan fully and on time. It is hoped that will help improve farmers' ability to meet their credit needs. Also, it has been decided that banks will not ask for *fresh* documents at the time of each renewal.

- The limit on credit against personal securities has also been raised from Rs 50,000 to Rs 100,000. This should help those farmers with limited access to collateral.

- Finally, in order to facilitate commercial banks meeting their mandatory targets, they are now allowed to count their equity stake in corporate farms as part of their lending. They can also include lending to micro credit institutions, recognized NGOs and rural supports organizations. Most importantly, however, commercial banks can also use their lending to ADBP as part of their mandatory targets.

Apart from these measures, SBP has also revised the methodology used for estimating agricultural credit needs by provinces. This methodology also includes the revised list of eligible items for disbursement of agricultural credit. More than 45 items or activities have been added to this list.

2.3 Industry

Contrary to the decline of 0.1 percent last year, the industrial sector recovered with 4.2 percent growth in FY01. This recovery was led by the manufacturing sector, which dominates industrial activities with around 69.4 percent share. Had growth in the remaining three sub-sectors i.e. *mining & quarrying*, *construction* and *electricity & gas distribution* not declined during the year, the pace of industrial recovery would have been much higher (see **Table 2.7**).

Table 2.7: Sectoral Growth of Industrial Value Added
at constant factor cost of 1980-81

	Growth rates		Sectoral shares	
	FY00	FY01	FY0(	FY01
Manufacturing	1.4	7.0	67.5	69.4
Large-scale	-0.2	7.8	47.1	48.8
Small-scale	5.3	5.3	20.4	20.6
Mining & quarrying	6.1	-0.4	1.9	1.8
Construction	5.2	-0.4	14.(	13.4
Electricity & gas dist.	-9.8	-3.1	16.(	15.4
Industry	**-0.1**	**4.2**	**10(**	**100**

Source: Economic Survey 2000-01

2.3.1 Large-scale Manufacturing (LSM)[6]

Large-scale manufacturing staged a strong recovery with 8.4 percent growth during FY01 against a 0.1 percent decline last year (see **Table 2.8 & 2.9**). This was driven by a sharp turn around in food, beverages and tobacco, which had been showing negative growth in production during the last two years. More specifically, the production of sugar, cigarettes, vegetable ghee and cooking oil increased significantly during the year, against sharp declines last year. This is also evident from the fact that excluding these four items, LSM grew by only 6.7 percent during FY01 as compared to 8.4 percent last year.

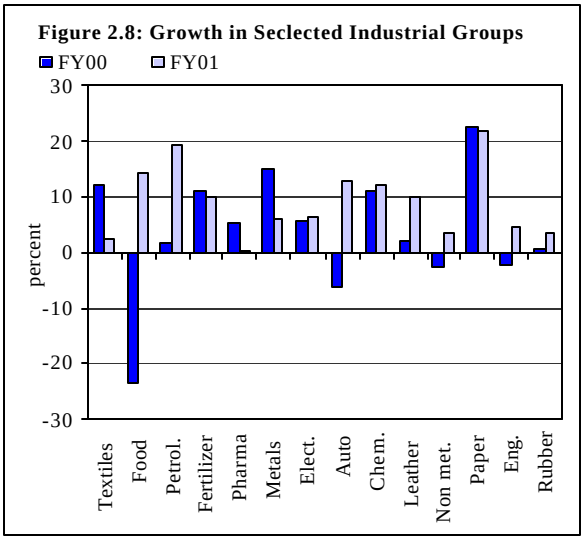
Table 2.8: Summary of Growth Rates
percent

	FY00	FY01
Overall	-0.1	8.4
Excluding sugar	6.8	7.5
Trimmed	4.8	7.7

Source: Federal Bureau of Statistics

While analyzing the performance of LSM, it is important to flag some data limitations. In particular, the weights used for calculating growth, were worked out on the basis of 'Census of Manufacturing Industries' (CMI) conducted in 1980-81 ? twenty years back. Though, various Censuses have been conducted since then, the weights have never been updated. Needless to mention, these weights no longer represent current industrial composition due to marked shifts in their structure over this period. In fact, weights calculated for the selected items on the basis of most recent CMI (which was conducted in FY96) show significant change in the share of those industries over FY81. For example, the share of *textiles* showed an increase of 3.2 percentage points in FY96. Similarly, *food, beverages & tobacco* showed a rise of 2.0 percentage points and *cement* 4.1 percentage points. Although, the use of new weights may not necessarily result into a higher growth rate, it will at least depict the true picture.

Figure 2.8: Growth in Seclected Industrial Groups



[6] This analysis is based on the latest provisional twelve-month data on 96 items of large-scale manufacturing. Therefore, the overall and group wise growth figures will not tally with figures given in **Tables 2.1** & **2.7**, which have been calculated on the basis of nine months' (July to March) provisional data.

The growth in LSM this year is also broad based; for the first time in seven years, all industrial groups recorded positive growth. Furthermore, nine out of fourteen groups, showed improvement over last years' performance (see **Figure 2.8**). Industries like *food, beverages & tobacco*, *petroleum products*, *automobile*, *chemicals*, *leather products* and *paper & board* have performed very well during the year. In terms of the distribution of growth by individual items, though the number of industries showing positive growth this year is similar to last year, their combined weight differs significantly (see **Table 2.10**).[7] The trimmed growth, calculated to assess how broadly the economic growth was realized, also reveals that this growth is not skewed towards a few items.[8]

Having said this, the growth in LSM is tilted towards consumer goods, which is shown by higher imports of raw material for consumer goods than capital goods during the year (see **Table 9.10,**

Table 2.9: Production of Selected Large-scale Manufacturing Items

Items	Weights	Percentage change		Items	Weights	Percentage change	
		FY00	FY01			FY00	FY01
Textile	**19.069**	**12.27**	**2.32**	**Electronics**	**2.976**	**5.68**	**6.41**
Cotton yarn	8.85	8.82	2.50	Electric transformers	0.577	-12.48	-20.81
Cotton cloth	4.881	15.55	11.59	Storage batteries	0.451	1.90	-0.14
Cotton ginned	3.893	27.77	-4.52	TV sets	0.363	-5.16	-19.93
Other five items	1.445	2.39	2.11	Air conditioners	0.12	327.02	47.71
Food, beverages & tobacco	**17.336**	**-23.60**	**14.00**	Refrigerators	0.015	13.13	28.76
Sugar	8.630	-31.59	14.81	Other six items	1.45	9.32	7.86
Vegetable ghee	3.004	-15.49	18.05	**Automobile**	**2.413**	**-5.94**	**12.65**
Cigarettes	2.505	-7.29	24.02	Trucks	0.698	-11.58	-2.56
Tea belnded	1.785	-7.27	-15.65	Tractors	0.593	31.50	-7.49
Beverages	0.964	5.30	8.98	LCVs	0.369	-17.61	4.64
Cooking oil	0.448	-9.31	16.17	Cars & jeeps	0.309	-16.31	22.26
Petroleum products	**7.824**	**1.71**	**19.17**	Motor cycles	0.249	1.84	24.22
Fertilizer	**5.871**	**11.23**	**9.98**	Buses	0.13	27.91	-11.34
Nitrogenous	5.441	7.22	5.42	Diesel engines	0.065	28.10	2.04
Phosphatic	0.430	139.77	75.46	**Chemicals**	**2.335**	**10.99**	**12.18**
Pharmaceuticals	**5.798**	**5.40**	**0.37**	Caustic soda	0.621	17.33	2.98
Tablets	2.705	1.60	-3.90	Soda ash	0.32	2.64	-11.32
Syrup	1.602	6.37	1.47	Other six items	1.394	7.94	30.33
Injections	0.466	3.52	-2.09	**Non metallic minerals**	**1.915**	**-2.86**	**3.36**
Capsules	0.228	-2.70	-2.14	Cement	1.846	-2.77	3.87
Other five items	0.471	18.81	12.02	Glass sheets	0.069	-5.32	-9.76
Metal industries	**3.317**	**14.81**	**6.02**	**Paper & board**	**1.359**	**22.59**	**21.99**
Pig iron	1.477	11.86	-3.19	**Engineering items**	**0.691**	**-2.22**	**4.60**
Coke	1.319	12.58	8.25	Bicycles	0.348	5.97	6.64
Billets	0.311	25.88	20.48	Metal containers	0.153	-1.91	11.67
Safety razor blades	0.109	-9.20	30.85	Sewing machines	0.052	-6.94	-2.52
H.R coils/plates/sheets	0.074	13.94	-9.81	Power looms	0.051	-65.53	-45.06
C.R coils/plates/sheets	0.013	6.65	-12.12	Other five items	0.087	-16.63	-35.37
Leather products	**2.333**	**1.92**	**10.05**	**Rubber products**	**0.452**	**0.83**	**3.54**

Source: Federal Bureau of Statistics

[7] During FY00, 65 industries having a weight of 50.048 showed positive growth against 64 industries with weight of 57.833 in FY01.

[8] This refers to LSM growth excluding five outliers each for best and worst performing sub-sectors. Given the lumpy categorization, trimmed growth in FY01 excludes the following: petroleum products, sugar, cigarettes, cotton cloth, and vegetable ghee (top performers) and T.V sets, tablets, electric transformers, cotton ginned, and tea blended (poor performers). In terms of FY00, the top outliers were cotton ginned, cotton yarn, cotton cloth, phosphatic and nitrogenous fertilizers: while bottom outliers included trucks, tea blended, cigarettes, vegetable ghee and sugar.

Chapter 9). On the basis of an increase in domestic demand, the output of consumption-oriented industries like food and consumer durables (cars, refrigerators, air conditioners etc.) increased sharply during FY01. The following presents a group wise analysis of the developments during the year:

Textiles (weight in total LSM: 19.069)
Growth rate in FY01 = 2.3 percent; FY00 = 12.3 percent.
The lower growth posted by textiles was mainly due to a 4.5 percent decline in the size of the cotton crop and the increase in domestic prices during FY01 (see **Figure 2.9**). While the overall performance is largely determined by the size of the crop, its impact varies across various sub-sectors. It is evident from **Figure 2.10**, that the size of the crop has the greatest impact on low value addition activities (ginning), and this relationship tapers as one moves up the value addition chain. This is to be expected since higher value addition can rely on imported inputs, while carry over stocks from past crops can also be used.

FY01 provides a good example; the negative growth in crop size is because of the bumper crop from last year, which explains the sharp reversal in output growth shown by the ginning sector. Spinning followed this trend, with moderate growth of 2.5 percent in FY01. Weaving however was able to post strong growth in the last three years, ending FY01 with 11.6 percent growth. Given the fact that weaving is high on the value addition ladder and relatively insulated from the size of the cotton crop, the need to shift towards higher value addition is obvious if the textile sector is to remain the backbone of Pakistan's manufacturing sector.

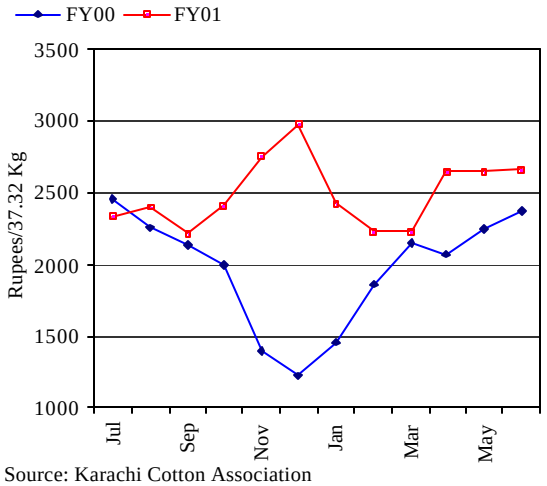
Other factors responsible for the slowdown in textiles (particularly spinning) include the withdrawal of export refinance subsidy and higher cotton prices. In order to encourage higher value addition, the export refinance facility that could be availed for the export of cotton yarn and grey cloth, was withdrawn with immediate effect from 1st July 2000.

Table 2.10: Distribution of Growth of 96 Items

Range of growth rates	FY00		FY01	
	No of items	Weight	No of items	Weight
Growth Rates = -15	10	12.533	8	3.094
-15 < Growth rates = -10	5	1.733	7	0.938
-10 < Growth rates = -5	10	5.934	3	0.736
-5 < Growth rates = 0	6	3.441	14	11.088
0 < growth rates = 5	23	14.152	15	16.790
5 < Growth rates = 10	12	18.272	10	8.217
10 < Growth rates = 15	8	3.969	4	13.682
Growth Rates = 15	22	13.655	35	19.144
Total	**96**	**73.689**	**96**	**73.689**

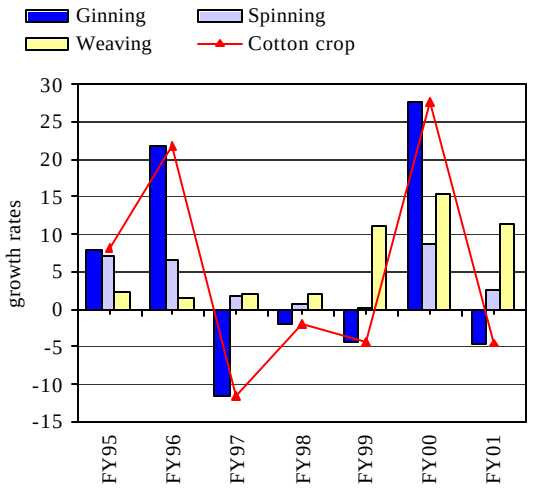
Source: Federal Bureau of Statistics

Figure 2.9: Lint Cotton Prices



Source: Karachi Cotton Association

Figure 2.10: Cotton Crop and Textiles



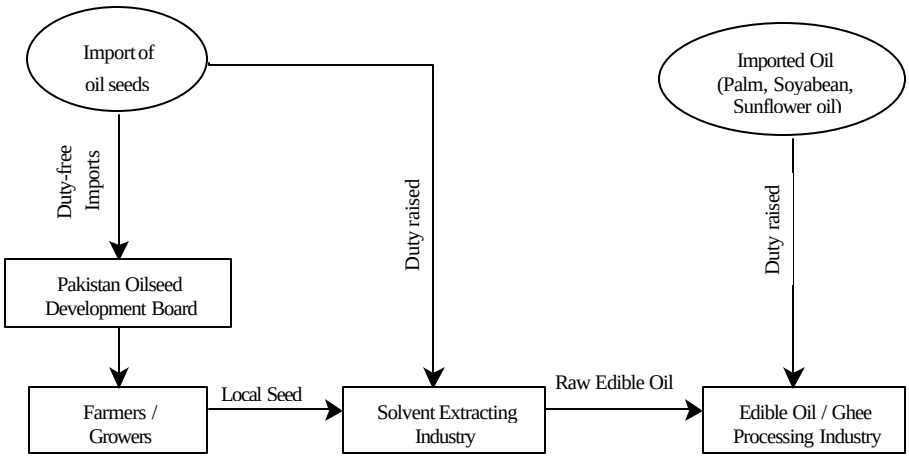
Furthermore, during the entire year, cotton prices remained higher than last year. This is particularly noticeable for the peak season of September-January, when prices were rising in sharp contrast to the falling trend last year (see **Figure 2.9**).

Food, beverages & tobacco (weight in total LSM: 17.336)
Growth rate in FY01 = 14.0 percent; FY00 = -23.6 percent.
The sharp reversal in this group is on account of a low base effect as the largest items (sugar, vegetable ghee and cigarettes) witnessed sharp declines in production last year.

Sugar (weight in total LSM: 8.630)
Growth rate in FY01 = 14.8 percent; FY00 = -31.6 percent.
The sharp recovery was mainly attributable to the processing of imported raw sugar. As the largest item in LSM, major changes in the production of sugar have a considerable impact on the Quantum Index of Manufacturing (QIM). With a fall in the size of the sugarcane crop this year and the delayed crushing of sugarcane, the government allowed raw sugar imports to ease domestic prices and to ensure that production activity was not affected. As a result, around 0.5 million tons of imported raw sugar was processed that enabled the domestic industry to reverse the previous year's trend.

Vegetable ghee and cooking oil (weight in total LSM: 3.452)
Growth rate (vegetable ghee): FY01 = 18.1 percent; FY00 -15.5 percent;
Growth rate (cooking oil): FY01 = 16.2 percent; FY00 = -9.3 percent.
The increase in production of vegetable ghee and cooking oil is the result of the surge in import of palm oil following the fall in international prices during FY01.[9] Out of a total domestic requirement of around 1.9 million tons of vegetable ghee and cooking oil, 30 percent is produced using local oil seeds (cottonseed, rapeseed, etc), while the remaining is met through processing of imported oilseeds and edible oil (palm oil, soyabean, sunflower oil etc.).

In order to reduce dependence on imported oil and seeds, an Oil Productivity Enhancement Scheme was launched during FY97. Under this program, the government encouraged domestic cultivation of oilseeds by allowing for duty free import of seed varieties. At the same time, however, import of



[9] Malaysian palm oil prices fell to US$ 193 per ton in February 2001, from its peak of US$ 343 in April last year.

seeds for crushing and import of raw edible oil were discouraged (see **chart** given above).[10] Although, the duty structure on these imports have not changed during FY01, the slump in international palm oil prices encouraged imports, and effectively undermined the government's efforts to enhance self-reliance in edible oil. However, over the past 4 to 5 years since the scheme was launched, the domestic response has not been strong.

Cigarettes (weight in total LSM: 2.505)
Growth rate in FY01 = 24.0 percent; FY00 = -7.3 percent.
This increase in production was mainly due to higher demand (both in domestic and international markets) during the last couple of years. The impetus is coming from the reduction in prices and improved marketing strategies put into place by the largest tobacco companies.[11] By reducing the prices of their low-end brands, the largest companies (Pakistan Tobacco Company and Lakson Tobacco Company) regained their market shares that had been lost to small and unregistered manufacturers. The exit of unregistered manufacturers has also manifested in higher production, since these producers are largely undocumented. Hence, with a greater share of registered brands in the market, overall production showed a higher increase. Furthermore, enhanced production of tobacco leaf over the last few years has supported this higher growth during FY01.

Petroleum products (weight in total LSM: 7.824)
Growth rate in FY01 = 19.2 percent; FY00 = 1.7 percent.
A significant increase in the production of petroleum products during FY01 is mainly on account of a new oil refinery that enhanced overall refining capacity in the country.[12] However, the underlying demand was driven by the need to shore up power generation following the slow down of hydel power generation on account of the drought. This is substantiated by larger quantitative imports of crude oil. Strong demand for car and motorcycles also provided a boost to this industry.

Fertilizer (weight in total LSM: 5.871)
Growth rate in FY01 = 10.0 percent; FY00 = 11.2 percent.
Higher growth in the fertilizer industry during the last two years is the result of a new fertilizer plant that started production in the later half of FY00 (Fauji Jordan). This is the first plant established for the production of phosphatic fertilizer, and is capable of meeting around 37 percent of the total phosphatic requirements of the country. Production of nitrogenous fertilizer, however, slowed down during FY01, as two plants (Pak Arab and Engro) remained closed for a brief period on account of repair and maintenance.

Pharmaceuticals (weight in total LSM: 5.798)
Growth rate in FY01 = 0.4 percent; FY00 = 5.4 percent.
An increase in the cost of production on account of the Rupee deprecation, coupled with an insufficient retail price increase, resulted in lower growth in pharmaceuticals during FY01. The domestic industry is vulnerable to changes in the value of the Rupee since imported raw materials in both medicinal products and packaging account for a large share of total costs.[13] Besides, this

[10] In June 1999, the custom duty on the import of palm oil was raised from Rs 4,800 per ton to Rs 10,800 per ton. Similarly, custom duty on the import of soyabean oil was raised from Rs 3,800 per ton to Rs 9,050 per ton. On the other hand, import of oil seeds for cultivation purposes was allowed duty free, while imports for crushing purposes were subjected to a higher duty of Rs 1,200 per ton.

[11] Tobacco companies launched various prize schemes that were advertised extensively through the electronic and print media.

[12] With an installed capacity of 4.5 million tons, PARCO started production from September 2000. In fact, this increase in refining capacity even allowed for higher export of petroleum products during FY01 compared to last year.

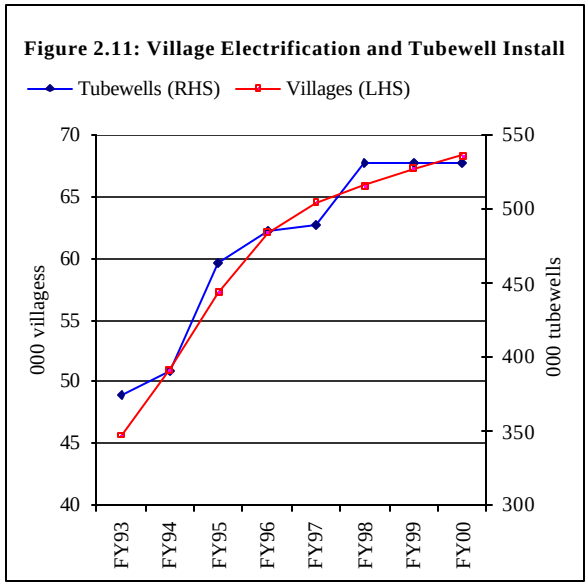
[13] Pharmaceutical products are divided into two groups: controlled (life saving) and decontrolled (other categories). Retail price increases are determined with the help of a formula given in Health Ministry's Notification No. SRO 1038(I)/94. This grouping was announced in FY94, but has not been implemented in true spirit; the government strictly regulates both groups,

industry has had to bear an additional cost in the form of a 2.25 percent sales tax (non-adjustable) on all inputs.

Metal industries (weight in total LSM: 3.317)
Growth rate in FY01 = 6.0 percent; FY00 = 14.8 percent.
Decline in the production of pig iron, hot rolled (H.R.) and cold rolled coils (C.R.), held back overall growth of this sector during FY01. This slowdown was due to Pakistan Steel's low production plan for the current year. During FY01, Pakistan Steel rationalized its annual production keeping in view market requirements and available stock of raw materials. Accordingly, most resources were utilized in the production of thinner gauges of C.R. and Galvanized products, which are technically difficult to produce and entail more time. Furthermore, the non-availability of essential spares (specifically working rolls) and the poor condition of reheating furnaces, resulted in lower capacity utilization and production. Since the reheating capacity of the aging furnace has deteriorated, repairing and overhauling resulted in momentary closure of one of the furnaces during FY01. In this regard, the ongoing BMR program for Pakistan Steel is expected to solve such problems in the near future.

Electronics (weight in total LSM: 2.976)
Growth rate in FY01 = 6.4 percent; FY00 = 5.7 percent.
The electronics industry continued its robust growth this year. The major contributors are discussed below:

Air conditioners and refrigerators (weight in total LSM: 0.135)
Air conditioners: growth rate in FY01 = 47.7 percent; FY00 = 327.0 percent.
Refrigerators: growth rate in FY01 = 28.8 percent; FY00 = 13.1 percent.
Higher production of air conditioners and refrigerators in the last two years is the result of enhanced demand and lower smuggling. The introduction of leasing facilities for the purchase of home appliances and other durables has fueled purchases of air conditioners and refrigerators. Furthermore, in FY99, the government reduced custom duty and sales tax on the import of raw materials (primary and sub-components) while it increased duties on completely built up (CBUs), especially in the case of air conditioners. This enhanced production during FY00 and FY01.[14]



Transformers (weight in total LSM: 0.577)
Growth rate in FY01 = -20.8 percent; in FY00 = -12.5 percent.
The demand and resulting production of transformers is directly linked with transmission and distribution of electricity in the country, which remained subdued during the year mainly due to the weak financial position of Wapda & KESC, and lower electricity generation in the

with an allowance for slightly higher prices of decontrolled medicines. After a period of three years, prices of controlled and decontrolled medicines were raised on 19th June 2000, by 8 percent and 10 percent, respectively.

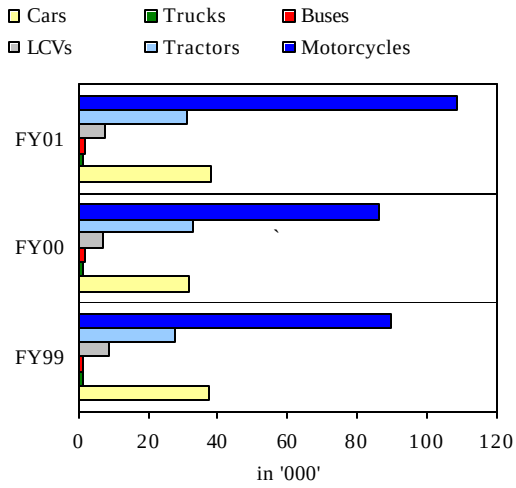
[14] In 1999, custom duty on the import of raw materials, sub-components, and components was reduced from 10, 15 and 25 percent respectively to 5, 10 and 10 percent, respectively. On the other hand, custom duty on the import of Completely Built Up (CBUs), especially air conditioners, was increased from 25 percent to 35 percent.

wake of water shortages in the country. On the other hand, the installation of tubewells for irrigation did add to the demand for transformers.[15] Despite the drought, it has been observed that village electrification and tubewell installations have shown almost stagnant growth (see **Figure 2.11**). It may be noted that more ADBP financing for tubewells during FY01 is likely to generate demand for transformers in the coming year.

Automobile (weight in total LSM: 2.413)
Growth rate in FY01 = 12.7 percent; in FY00 = -5.9 percent.

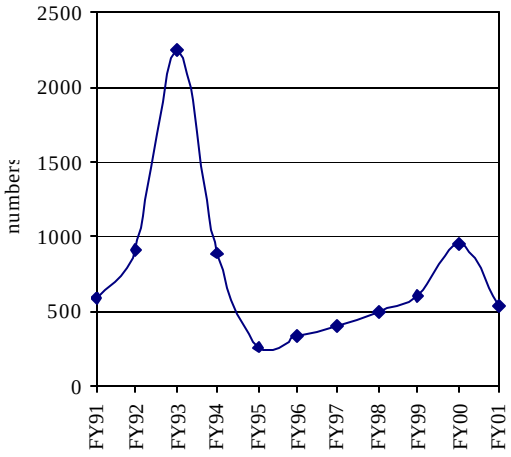
During the year, the automobile sector bounced back mainly on account of sharp increases in demand, especially for motorcycles, LCVs and compact size cars. The past couple of years have witnessed a marked shift in the leasing sector's focus towards consumer durables, particularly for the purchase of motor vehicles. Almost all manufacturers have entered into agreements with local/foreign banks as well as leasing companies to finance their products. Hence, with active participation of commercial banks, the popularity of purchase through lease has grown in the middle-income segment of the population, especially for motorcycles and four-wheelers (see **Figure 2.12**). In view of this growing demand, two new car assembly plants were established during FY01, while existing plants have increased their capacity utilization.[16]

Figure 2.12: Sale of Automobile



Source: Pakistan Automotive Manufacturers

Figure 2.13: Import of Buses



Source: Pakistan Economic Survey

On the other hand, production of trucks and buses has been hit by a slowdown in demand. A disruption in informal financing arrangements (which is important for these vehicles) following the documentation drive, may have contributed to the lower sale of trucks. In this connection, anecdotal evidence suggests that truck smuggling via Afghanistan has also hit the domestic industry. In the case of buses, the premature demise of the Urban Transport Scheme, initially started in Punjab to be followed in other provinces, has severely impacted the sale of buses. In addition, due to rising cost of production, domestic manufacturers are finding it difficult to compete with imported buses. This is substantiated by increase in imports over the last few years (see **Figure 2.13**). As far as the decline in the production

[15] A transformer accompanies each tube-well that is installed.

[16] Dewan Farooque Motors Limited and Raja Group of Industries established one plant that started production in the latter half of the current financial year. Most of the units that started production during FY00 almost doubled their capacity utilization during FY01.

of tractors is concerned, this was due to weak demand caused by lower ADBP financing and the withdrawal of subsidized financing provided by Punjab.

Chemicals (weight in total LSM: 2.335)
Growth rate in FY01 = 12.2 percent; FY00 = 11.0 percent.
Despite a slowdown in the manufacturing of caustic soda and the slump in production of soda ash, growth in chemicals was driven by the production of paints.[17] While the construction sector remained subdued during the year, strong demand by the automobile sector created favourable conditions for growth in the production of paints.

Production of soda ash declined sharply by 11.3 percent during FY01, mainly due to the closure of Sindh Alkalis Limited (SAL), the second largest soda ash producer in the country. The acute shortage of liquidity forced SAL to default on its utility bills, resulting in the disconnection of gas supply, which compelled management to shut down operations in May 2000. Furthermore, the old plant was in dire need of overhauling and repair, requiring heavy funding that was not available. Though another soda ash plant (Olympia Chemicals) had been established late last year, the initial stages of production did not allow it to fill the gap created by the closure of SAL.

As the basic raw material in the production of caustic soda, the sharp decline in the production of soda ash during the year, had spill over effects on caustic soda. Furthermore, the textile sector, which is the major user of caustic soda, also experienced a slowdown in during the year.

Leather Products (weight in total LSM: 2.333)
Growth rate in FY01 = 10.1 percent; FY00 = 1.9 percent.
The outbreak of *foot and mouth* disease in Europe in 1999, particularly in the UK, proved a blessing in disguise for Pakistan's leather industry. Higher export orders led to an increase in output of leather sheets during the year. As complementary outputs, leather products like shoes and small leather items have also increased. This can also be seen from higher export of leather and leather products during FY01 compared to last year.

Non-metallic Mineral Products (weight in total LSM: 1.915)
Growth rate in FY01 = 3.4 percent; FY00 = -2.9 percent.

Cement (weight in total LSM: 1.846)
Growth rate in FY01 = 3.9 percent; FY00 = -2.8 percent.
Amidst a supply/demand imbalance resulting from a build up of excess capacity in the cement industry, production increased this year. This is the second time since FY96 that installed capacity and production witnessed strong growth despite sluggish demand in the country. Rising costs on account of an exorbitant increase in the price of furnace oil has been the main cost constraint in the production of cement over the last few years.[18] However, during FY01, furnace oil prices declined marginally from last year's peak. Furthermore, many units have started converting their operations to coal, which is cost effective.

The other major reason for an increase in production this year, is the nationwide cartel collapsed following the breach in agreement when four units based in NWFP continued to avail GST exemptions in September 2000. In order to capitalize on this, these four units attempted to increase their market shares by cutting their retail prices. Since other units followed suite, this culminated in

[17] During FY01, production of liquid and solid paints and varnishes increased by 60 and 48 percent respectively.
[18] Cost of furnace oil constitutes around 35 percent of total cost of goods sold.

falling market prices. Furthermore, Dandot Cement Company Limited, which was closed for last few years, was revived in February 2001.

Glass Sheet (weight in total LSM: 0.069)
Growth rate in FY01 = -9.8 percent; FY00 = -5.3 percent.
This decline was mainly due to lower demand, slump in the production of soda ash[19] and closure of Gunj Glass Works (Hasanabdal).[20] Sluggish growth in the housing sector, which is the major domestic user of sheet glass, led to depressed demand during the year. Although, the automobile sector might have created a potential market for glass sheets, the glass industry is not yet capable of producing *laminated* glass that is used in vehicles.

Paper & paperboard (weight in total LSM: 1.359)
Growth rate in FY01 = 22.0 percent; FY00 = 22.6 percent.
Production of paper & paperboard has been showing strong growth for the last couple of years on the basis of better availability of raw materials and higher demand. The major inputs used by this sector include straw (chaff), river grass (kahi), cotton waste, bagass, pulpwood and waste paper. Above average production of cotton, wheat and rice in the last couple of years, has created sufficient supply of by-products that are used as inputs by this sector. The waste paper collection network, which is another source of raw material, has also been expanding in Pakistan over the last few years. Furthermore, Packages Limited and Century Paper Mills Limited enhanced their production capacities by expanding existing plants and by establishing new paper plants during FY00. The increase in production is supported by an expansion in packaging demand related to higher industrial output and rising number of newspapers during the last couple of years.

Engineering items (weight in total LSM: 0.691)
Growth rate in FY01 = 4.6 percent; FY00 = -2.2 percent.

Power looms (weight in total LSM: 0.051)
Growth rate in FY01 = -45.1 percent; FY00 = -65.5 percent.
Production of power looms has been showing significant declines for the last couple of years, as more efficient and high tech looms (like shuttle less and water jet looms) are replacing the outdated equipment. The increase in importation of old textile machinery suggests that industrialists prefer this to locally manufactured machinery.[21] This can also be supported by the declining use of LMM financing during the last two years.

Tyres & tubes (weight in total LSM: 0.452)
Growth rate in FY01 = 3.5 percent; FY00 = 0.8 percent.
The strong performance by this sector was mainly driven by the buoyant growth in automobiles. Although, domestic production of tyres & tubes increased during FY01, it still lags behind the production rates posted by the automobile sector. Furthermore, imports of tyres & tubes have been declining since FY98. This suggests that despite cuts in import duties to 15 percent and strict monitoring of the Pak-Afghan border during the year, smuggled items are hurting the domestic industry.

[19] Soda ash is one of the basic raw materials used in the production of glass sheets and constitutes 80 percent of the total cost of raw materials consumed.
[20] Gunj Glass Works is presently undergoing BMR and expansion process. This represents about 27 percent of the total installed capacity of glass sheet industry.
[21] There is a requirement that textile machinery older than 5 years cannot be imported into Pakistan.

2.3.2 Mining & Quarrying and Electricity Generation

[Share in overall Industry: 1.8 percent; Growth: -0.4 percent (FY01) and 6.1 percent (FY00)]
Value addition by *mining & quarrying* declined during FY01, compared to sound growth in the previous year. Major declines were recorded in the production of china clay, silica sand and chromites during the year (in the face of dismal performance of downstream industries which offset positive growth in other mineral items (see **Table 2.11**). The major industries that use these minerals include ceramics, glass and the chemical industry (especially soda ash).

Unfortunately, the largest producer of ceramics in the country (Federal Chemicals and Ceramics Corporation) closed down its operations during the year, while the performance of other users also remained depressed (discussed in previous sections – glass and chemicals).

Extraction of crude oil, natural gas, coal, limestone and gypsum, however, showed positive growth during FY01. As far as production of crude oil and natural gas is concerned, concerted government efforts to develop the oil & gas sector succeeded in attracting a higher inflow of foreign investment during FY01. As a result, 36 new wells were drilled during the year, against 27 in the previous year.

Table 2.11: Mining and Quarrying

		Growth Rates	
		FY00	FY01
1	Coal	-6.3	3.3
2	Crude oil	-49.0	3.4
3	Natural gas	10.8	7.0
4	Lime stone	1.3	13.3
5	Rock salt	14.1	2.7
6	China clay	-6.0	-26.6
7	Gypsum	46.7	2.5
8	Silica sand	5.7	-7.2
9	Chromites	39.5	-36.8

Source: Federal Bureau of Statistics

Growth in electricity generation declined primarily due to lower hydel power generation on account of the prolonged dry spell in the country. This overshadowed the increase in installed capacity when Chashma Power Plant (Chasnupp) came into operation in April 2001.

2.3.3 Construction

[Share in overall Industry is 13.4 percent; Growth in FY01:-0.4 percent; and in FY00: 5.2 percent]
Constrained development spending, slack construction activities and rising building material prices, are the major factors for the fall in value addition by construction during FY01. At a micro level, two major developments took place this year that hindered house building and commercial construction. First, the House Building Finance Corporation (HBFC) suspended disbursement of loans to housing companies in the second half of FY01, on account of the delayed legislation process for Islamization of different modes of financing. Secondly, the Karachi Building Control Authority (KBCA) formulated by-laws regarding the evaluation and approval of building projects, which has increased the cost of construction projects.

2.3.4 Electricity and Gas Distribution

[Share in overall Industry: 15.4 percent; Growth: -3.1 percent (FY01) and –9.8 percent (FY00)]
Although value addition by electricity and gas distribution fell by 3.1 percent during FY01, this still shows an improvement over the 9.8 percent decline last year. While the retail distribution of natural gas increased on account of more CNG stations during the year, transmission and distribution of electricity suffered due to the fall in electricity generation and poor financial conditions of Pakistan's public utilities.

2.3.5 Public Sector Enterprises (PSEs)[22]

[Growth in production value in FY01: 2.9 percent; and in FY00: 4.3 percent]

Contrary to last year, production and net sales of public sector industries (other than Pakistan steel Mills Corporation PSMC), improved during FY01 (see **Table 2.12**). This resurgence is mainly supported by improved performance of National Fertilizer Corporation (NFC) and Pakistan Automobile Corporation (PACO). Increase in fertilizer prices and higher production pushed up value growth in NFC; while strong growth in automobile demand, provided a boost to the production and net sales of PACO. On the other hand, production of the State Cement Corporation (SCCP) and State Engineering Corporation (SECP) declined during FY01, mainly due to closure of some units.

Table 2.12: Performance of Selected Public Sector Industries

billion Rupees

	Production value		Percentage change	
	FY00	FY01	FY00	FY01
National Fertilizer Corporation	3.5	3.9	12.3	88.3
Pak Automobile Corporation	0.2	0.3	15.4	6.5
State Cement Corporation	0.6	0.4	-25.5	-5.5
State Engineering Corporation	1.3	1.3	-1.5	20.5
Sub-total	5.6	5.9	3.8	5.4
Pakistan Steel	7.4	7.5	4.6	1.0
Gross total	13.0	13.4	4.3	2.9

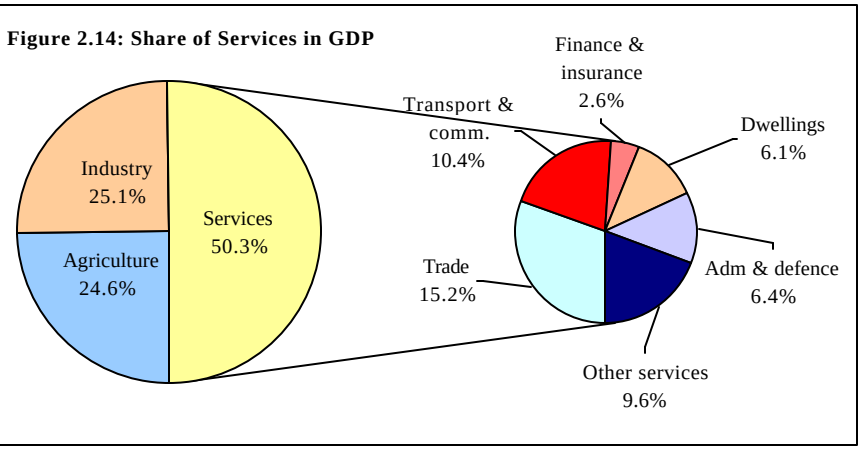
Source: Expert Advisory Cell, Ministry of Industries and Production

Despite a slow down in growth during FY01, production and net sales of Pakistan Steel increased. This increase is mainly attributable to improved management, rightsizing and increase in prices during the year. These measures have allowed Pakistan Steel to show positive profits against heavy losses suffered last year.

2.4 Services

Services sector grew by 4.4 percent during FY01 compared to 4.8 percent last year. Over a period of four decades, steady growth in services averaged more than 6 percent during the 1960s to 1980s, and 4.6 percent during the 1990s, pulled up its share in GDP from 38.4 percent in FY70 to 50.3 percent in FY01 (see **Figure 2.14**). On the other hand, commodity producing sector could not sustain such a steady growth rate and during the recent decade, it remained below one percent in three different years. Value added by services usually move in tandem with commodity producing sector due to forward linkages. The fact that commodity producing sector did not display as steady a growth as services during the 1990s, suggests the increasing importance (and independence) of services like

Figure 2.14: Share of Services in GDP



[22] During FY01, out of 40 units under Ministry of Industries & Production, only 15 were operative while the rest remained closed. The Federal Chemicals & Ceramics Corporation (FCCCL) reported nil production during FY01, whereas, the State Petroleum Refining & Petro-chemical Corporation (PERAC) has been handed over to Ministry of Petroleum and was not involved in production activity during FY01.

education and health offered by the private sector.

During FY01, *wholesale and retail trade* and *transport, storage & communications* grew by 3.8 percent and 4.1 percent, respectively (see **Table 2.1**). Better performance of these sub-sectors compared to a meager growth of 0.8 percent in commodity producing sectors, was the upshot of their backward linkage to the growth in commodity producing sector observed in FY00, when that grew by 3.0 percent. A large part of the record production of wheat (at 21.1 million tones) realized during the last two months of FY00, was traded in FY01, thus contributing to the growth of above two sub-sectors in FY01.

Historically, *transport, storage & communication* and *wholesale and retail trade* (with a share of more than half of services) were more volatile because of their strong linkages with commodity producing sectors. Year to year changes in *finance and insurance* were also very high, due to the process of financial sector reforms witnessed in the 1990s. *Ownership of dwellings* and *other services* with a sizeable share of almost 31.3 percent have been estimated on survey based stipulated growth of 5.3 percent and 6.5 percent respectively since late 1980s. Despite lack of regular data on these two, growth by these sub sectors had mitigated the volatility of other sectors and smooth out the estimated growth of overall services sector.

2.4.1 Wholesale and Retail Trade

The value added in *wholesale and retail trade* is measured by the total value of trade, adjusted for inventory changes, cost of inputs and under reporting. Trade margins were estimated on the basis of Survey of Distributive Trade & Services 1984-85. Growth in this sector during FY01 increased by 3.8 per cent compared to 2.9 per cent of last year. The developments in this sub-sector are closely attached to the level of domestic production, consumption and import of consumer and capital goods. Within commodities, wholesale traders earn the highest trade margin, i.e. about 40 percent on manufactured products that enters into the market for onward transactions. The higher contribution shown by manufacturing and imported goods also mitigated the impact of the agricultural slowdown, in wholesale & retail markets.

2.4.2 Transport, Storage and Communication

Transport, storage and communication is mainly composed of road, marine, air transport and communication. During FY01, against a target of 5.5 percent and growth of 3.6 percent last year, value added in this sector grew by 4.1 percent. Though major shortfall was observed in the operating surplus of railway and national shipping, the increase in value addition by air transport, NLC, Karachi Port, Karachi Container and Pakistan Post Office, compensated for the losses suffered by other sister organizations. KPT cargo handling of exports and imports reached a level of 5,918 thousands tones and 20,063 thousand tones, showing an improvement of 5.4 and 10.5 percent, respectively, during FY01 **(**see **Table 2.13**). At the same time the growth of *transport, storage and communication* was also driven by the higher rate of expansion witnessed in telecommunications, telephone, internet, computer software and other related services. The total number of telephones increased to 3.9 million, internet connections to 1.3 million and public call offices to 66,968 during the year. During FY01, the telecommunication sub sector was boosted by the introduction of new service like U-Phone (a mobile phone service) and the introduction of Calling cards by PTCL. Interestingly, Pakistan Post Office (which is part of this sector) has also done well and improved its operating performance by earning a profit of Rs 198 million against a loss of Rs 275 million incurred last year.

2.4.3 Finance and Insurance

Finance and insurance comprises four sub sectors (SBP, scheduled & non-scheduled banks, DFIs and insurance companies). Generally the performance of this sector depends upon the behavior of

commodity producing sector, investment trend and distribution activity in the documented economy. Finance and insurance registered weaker growth of 2.3 percent in FY01 compared to 8.2 percent recorded last year. No doubt the slower growth of GDP dampened the performance of this sector, but its activities both in terms of deposits mobilization, investment income and others, have depicted an improvement over last year. The deceleration in growth might also be seen in the context of merger and acquisition as well as the closure of a number of bank branches during the year because of the restructuring process and slower depreciation.

Table 2.13: Cargo Handling at Karachi Port

	FY96	FY97	FY98	FY99	FY00	FY01
Imports						
Dry general cargo	4475	4357	4215	4520	4952	5241
Dry bulk cargo	1693	2536	1352	1764	1559	2255
Total dry cargo	6167	6893	5567	6284	6510	7496
Liquid bulk cargo	12552	11470	11547	12034	11639	12567
Sub total (000 tones)	18719	18362	17114	18318	18149	20063
Exports						
Dry general cargo	2930	2802	2659	1678	2162	2580
Dry bulk cargo	806	1196	1317	1932	1574	1840
Total dry cargo	3736	3998	3976	3609	3736	4419
Liquid bulk cargo	1126	1115	1594	2125	1876	1499
Sub total (000 tones)	4862	5113	5570	5735	5612	5918
Total imports & exports						
Dry general cargo	7405	7159	6874	6198	7114	7821
Dry bulk cargo	2499	3732	2669	3696	3133	4095
Total dry cargo	9903	10891	9543	9893	10246	11916
Liquid bulk cargo	13678	12585	13141	14160	13515	14066
Sub total (000 tones)	23581	23476	22685	24053	23761	25982
Container handling						
No. of import TEU[1]	278	278	259	277	315	338
No. of export TEU	272	278	246	251	300	314
Sub total (000 No.)	551	555	505	527	615	652
Ship handling						
Container ships	787	721	646	750	768	739
Bulk cargo ships	120	220	146	135	126	189
Gen. cargo ships	426	392	340	294	277	231
Oil tankers	413	381	392	446	416	405
Sub total (in No.)	1746	1714	1524	1625	1587	1564

[1] TEU= Twenty feet equivalent unit

Note: Total and sub total may not tally for separate rounding off.

Source: Karachi Port Trust

2.4.4 Public Administration and Defense

Value added by this sub sector is based on budgetary figures relating to wages and salaries of government employees. During FY01, *public administration and defense* recorded slower growth of 3.0 percent compared with 7.0 percent last year. The subdued growth can be attributed to the wage component of government employees, which have been constrained mainly on account of the fiscal stringency during the year.

2.4.5 Ownership of Dwellings and Other Sub-Sectors

As mentioned above, growth estimates of these sub-sectors are based on survey results from the mid-1980s, which are assumed to be replicated every year. The value added by *ownership of dwellings* is based on the assessment of rent accruing from self occupied and rented dwellings. In case of *other*

services, the income arising from persons engaged in private education, medical, household and community services, are taken into account

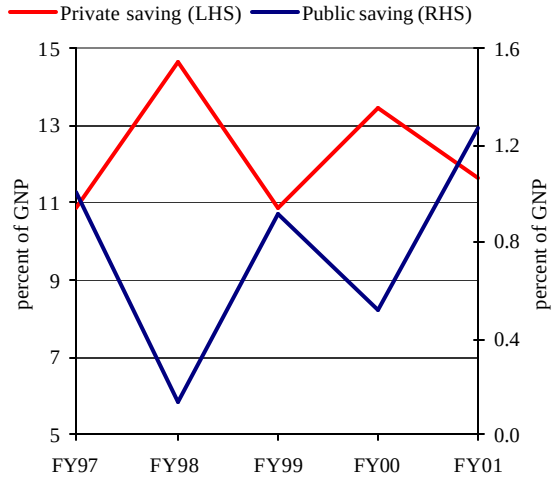
The survey that forms the basis for calculating of value addition in these sub-sectors, has become outdated because a number of new economic activities (setting up private schools, establishing clinics, health centers, community centers and running of NGO's) have become very active of late. Keeping in view the contribution of ownership of dwellings and other services in GDP (15.7 percent) as well as in services (31.3 percent), there is an urgent need to update data to capture a more realistic picture of these activities.

2.5 Savings

National savings at current market prices recorded a marginal increase of 0.8 percent to Rs 441.09 billion during the year compared with a rise of 27.3 percent in the preceding year. Consequently, the savings to GNP ratio fell to 12.9 percent in FY01 from 13.9 percent last year (see **Table .2.14)**. According to the UN System of National Accounts, savings is a balancing item that arises as a residual of disposable income, which is not used in final consumption. However, the existing system of National Accounts of Pakistan, estimates national savings through the investment approach.

Under the investment approach, savings is derived by taking estimated actual investment and deducting the part financed by external resources, usually labeled as foreign savings. Hence, under this approach, the trend in national savings is determined by investment activity and inflows of foreign savings. Given the nature of this approach, it would be difficult to identify the true underlying determinants of savings with much certainty. Furthermore, the estimates of national savings are susceptible to errors that occur in the estimation of investment and foreign savings.[23] However, that does not mean that the estimate is not useful. In principle, it should be the same if computed using the expenditure approach, which is the residual of gross national income, after excluding private and government consumption. Private consumption is also estimated residually from gross national income, after deducting government consumption and total investment. In short, due to limitations of the existing estimation methods, only a tentative analysis of underlying factors of national savings is possible, rather than an incisive and detailed causative analysis.[24]

Figure 2.15: Public and Private Saving



2.5.1 Public Savings (Government and Enterprise)

During FY01, public savings showed exceptionally high growth of 337.7 percent as against a decline of 65.5 last year. Its ratio to GNP increased from 0.3 percent last year to 1.2 percent in FY01 (see **Figure 2.15**). This boost in public savings can be attributed to two main factors: (1) higher revenues

[23] Estimation method is discussed in detail in " Economic Survey 1984-85", Appendix, pp 55-59.
[24] A detailed exposition of savings is contained in "Savings in Pakistan-Practice and Policy" (1981-96), by Dr. Andrew T. Hook, 1997, SBP.

and a lower budget deficit, and (2) improved governance of public sector enterprises. During the year, the federal government was able to curtail its debt servicing expenditure by Rs 21 billion in comparison with FY00. Expenditure on public sector development program (PSDP) was also Rs 18.3 billion less than the targeted amount of Rs 120.4 billion. On the revenue side, efforts to increase tax receipts were largely successful, with an increase of Rs 45.9 billion over FY00. Although, there was a marginal decline in non-tax revenues, PSE, declared higher dividends this year; improved governance of these institutions contributed to this. These institutions have shown a gross profit of Rs 1.3 billion against a loss of Rs 0.2 billion in FY00. Among them the National Fertilizer Corporation of Pakistan, Pakistan Steel Mills and Pakistan Automobile Corporation, have shown profits of Rs 1341.9 million, Rs 553.2 million and Rs 55 million respectively. The turn around of Pakistan Steel this year was primarily due to 86 percent capacity utilization and record sales of Rs 17.5 billion coupled with better management. The overall improved profitability of publics sector enterprises is on account of two main factors: (1) reducing losses through restructuring and better governance, and (2) improving production by streamlining procedures as well as better marketing.

Table 2.14: Investment and Savings

at current prices

	Growth rates				
	FY97	**FY98**	**FY99**	**FY00[R]**	**FY01[P]**
1. Gross total investment	8.0	9.0	-3.6	8.6	2.5
2. Gross fixed investment	7.7	1.5	1.6	8.7	1.8
Public sector	-5.3	-14.8	25.8	2.9	4.6
Private sector	19.5	13.3	-11.4	13.2	-0.1
3. Net external resource inflow	-2.9	-45.0	38.7	-47.9	15.5
4. National savings	14.8	37.1	-12.4	27.3	0.8
Public savings	-22.8	-85.8	679.3	-65.5	337.7
General government	-26.2	77.2	96.5	-2075.1	35.7
Others	-4.8	-6.3	-36.4	42.9	49.8
Private savings	19.8	48.5	-18.5	35.1	-6.5
Household	19.8	48.5	-18.5	35.1	-6.5
Corporate	19.8	48.2	-18.3	35.1	-6.5
5. Net factor income from abroad	-314.2	-22.8	3.5	-53.1	-18.8
6. Domestic savings	23.1	35.8	-11.6	29.7	2.7
	As percent of GNP				
1. Gross total investment	18.1	17.9	15.7	15.8	14.9
2. Gross fixed investment	16.5	15.2	14.1	14.2	13.3
Public sector	6.9	5.3	6.1	5.8	5.6
Private sector	9.6	9.9	7.9	8.4	7.7
3. Net external resource inflow	6.2	3.1	3.9	1.9	2.0
4. National savings	11.9	14.8	11.8	13.9	12.9
Public savings	1.0	0.1	0.9	0.3	1.2
General government	-1.0	-1.5	0.0	-1.0	-0.6
Others	2.0	1.7	1.0	1.3	1.8
Private savings	10.9	14.7	10.9	13.7	11.7
Household	9.6	12.9	9.6	12.0	10.4
Corporate	1.3	1.7	1.3	1.6	1.4
5. Net factor income from abroad	-1.2	-1.4	-1.2	-1.7	-1.9
	As percent of GDP				
1. Domestic savings	13.0	16.0	12.9	15.4	14.5
	As percent of gross total investment				
1. Net external resource inflow	34.3	17.3	24.9	11.9	13.4
2. National savings	65.7	82.7	75.1	88.1	86.6

R=Revised, P=Provisional

Source Federal Bureau of Statistics, Planning and Development Division, GOP

2.5.2 Private Savings

While public savings showed an improvement, private savings declined during FY01. Private savings, which consists of households and corporate savings, recorded a decline of 6.5 percent over FY00. Lower GDP growth and increased consumption of durables by the private sector, may have caused this decline. Production of durables like refrigerators, motorcycles and cars increased on the basis of this higher demand, which was financed by leasing companies (**section 6.5**). Moreover, import of consumer goods recorded an increase, reflecting high domestic absorption. Also, downward changes in National Saving Schemes (NSS) rates has also contributed to this decline; only Rs 36.7 billion was invested in NSS during the FY01, as compared to RS 96.5 billion in FY00.

Corporate Savings

During FY01, corporate savings declined by 6.5 percent in FY01 in contrast to an increase of 35.1 percent in the preceding year. Corporate savings are derived using the factor income payment approach, which is based on depreciation and retained earnings. Corporate savings is calculated either from balance sheets as the change in net assets, or from its income accounts as the excess of current income over current expenditures. Decline in corporate savings may be attributed to high cotton prices in 1H-FY01, leading to squeezed profit margins in the textiles sector.

2.6 Investment

Investment activities slow down considerably during FY01. Total investment at current prices, grew by only 2.5 percent compared with 8.6 percent in FY00. The *Annual Plan* envisaged total investment of Rs 545.5 billion, while the current estimate is Rs 509.3 billion, which is 7.1 percent short of the target. An additional investment of only 12.5 billion took place in FY01, with the result that the total fixed investment to GNP ratio declined to 14.9 percent in FY01 from 15.8 percent last year. This does not augur well for the economy as investment plays a key role in the growth potential of a country.

Gross fixed investment, which is the major part of gross total investment, grew by a meager 1.8 percent during FY01. Sectoral break up indicates that the deceleration in investment was mainly on account of a marginal decline in private investment from Rs 262.2 billion in FY00 to Rs 261.9 billion this year. Although public investment grew by 4.6 percent in FY01 compared with 2.9 percent last year, it could not stimulate the pace of overall investment. Lack of infrastructure development projects in the recent past seemed to have diluted the "crowding-in" aspects of public investment.

The downturn in private sector gross fixed investment can be attributed to a host of factors including the continuing effect of the tax survey, lower GDP growth, depreciation of Rupee and an end to the abnormal profits in textiles.[25] More specifically, the weakening Rupees had a direct bearing on the import unit value index of machinery, which went up by 12.6 percent in FY01. Also, lending rates, were higher this year, up from 12.9 percent in FY00 to 14 percent. Moreover, the excess capacity available in industries like cement, sugar and electricity, in the face of sluggish demand, has acted as impediment towards any new investment by private sector.

[25] Due to higher domestic cotton prices in FY01

2.6.1 Real Fixed Investment

Real fixed investment, which is computed after allowing for depreciation of existing capital and the effect of inflation, grew by 0.2 percent in FY01 compared with 3.6 percent during FY00 (see **Table 2.15**).[26] Its sectoral break up indicates that public sector investment has grown by 5.1 in FY01, compared with 1.6 percent last year. On the other hand, private sector investment experienced negative growth of 3.5 percent in contrast to 5.1 percent last year. Investment in mining & quarrying, electricity & gas distribution and trade sectors, have shown an improvement compared with massive decline observed in the remaining sectors this year. The sectoral shifts in investment between manufacturing and services during the last few years, probably reflects a decline in returns, on capital in large-scale manufacturing and construction, relative to investment in *transport, storage and communication* and *mining & quarrying* (see **Figure 2.16**). Details on the sectoral investment are discussed in the following paragraphs.

Figure 2.16: Sectoral Shift in Investment

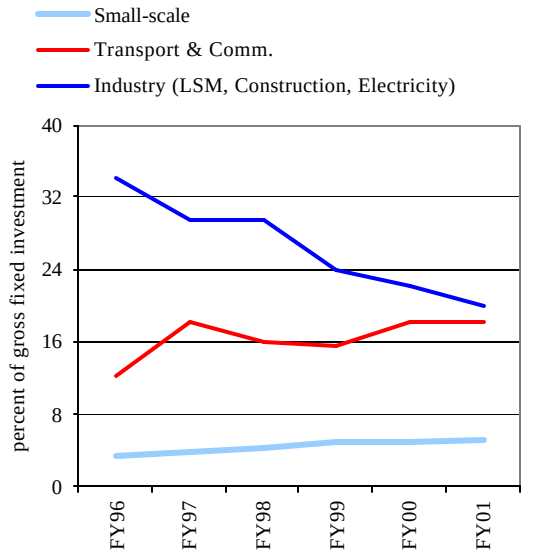


Table 2.15: Growth of Real Fixed Investment

at constant prices of 1980-81

Sectors	Total fixed investment		Public fixed investment		Private fixed investment	
	FY00[R]	FY01[I]	FY00[R]	FY01[P]	FY00[R]	FY01[I]
Agriculture	8.5	-6.0	-45.0	128.0	19.3	-18.6
Mining and quarrying	-20.8	8.0	-31.4	28.1	-14.7	-1.3
Manufacturing	-0.5	-12.5	-33.1	-57.8	14.4	-0.5
Large-scale	-0.1	-21.2	-33.1	-57.8	27.0	-5.4
Small-scale	-1.2	7.3	-	-	-1.2	7.3
Construction	-4.8	-10.9	-38.3	55.4	6.7	-24.0
Electricity and gas distribution	-9.0	3.9	16.3	7.3	-55.8	-12.5
Transport, storage and communication	22.7	-0.6	24.6	-1.1	19.5	0.1
Wholesale and retail trade	11.8	12.5	-	-	11.8	12.5
Finance & insurance	3.2	-0.5	-9.4	4.9	3.7	-0.6
Services	3.2	-0.6	-15.9	7.3	5.7	-1.4
General government	0.8	13.5	0.8	13.5	-	-
Total	**3.6**	**0.2**	**1.6**	**5.1**	**5.1**	**-3.5**

R = Revised, P = Provisional.

Source: Federal Bureau of Statistics

Agriculture

Investment in agriculture includes tractors, tube wells, harvesters, cultivators, tools and machinery for dairy, fishing & forestry, as well as, construction and maintenance of culverts, canals, distributaries,

[26] Provisional estimates

watercourses, and machinery needed for salinity control and land reclamation. Private investment is concentrated in machinery, implements and small projects, while public investment is mainly in infrastructure projects. During FY01, real investment in agriculture declined by 6.0 percent as against an increase of 8.5 percent last year, which can be attributed to a major shortfall of 18.6 percent in private investment. Main financier for private investment is Agriculture Development Bank of Pakistan (ADBP), which provided Rs 5.1 billion for the purchase of tractors, Rs 1.6 billion for the installation of tubewells and Rs 0.15 billion as micro credit for various small projects.

This downturn in private investment is largely on account of the removal of subsidized credit by the Punjab government on purchase of tractors, rising diesel prices and fall in agriculture income due to drought. Also, rising electricity costs for tubewells due to change in WAPDA's policy towards metered consumption of electricity (as opposed to a flat rate), may have depressed investment in this sector. Contrary to private sector investment, the public sector recorded strong growth of 128.0 percent, primarily because the government has undertaken a number of water resources development projects during this year. These include the remodeling of canals, distributaries, minors, watercourse renovations and flood protection.

Mining & quarrying

Mining and quarrying provides coal, natural gas, crude oil, marble, limestone and rock salt. Investment in this sector is estimated through the expenditure approach and broadly covers expenditures on construction work, site development, the purchase of equipment for mining & quarrying and digging/exploration machinery. To meet the objective of substituting imported petroleum with indigenous production, the government announced an Offshore and Onshore Petroleum Policy 2000, during FY01. Consequently, investment in mining & quarrying experienced a growth of 8.0 percent in contrast to the decline of 20.8 in the preceding year. Both public and private sectors played an active role. The role of the public sector is visible from its investment that increased by 28.1 percent in contrast to negative growth of 31.4 percent during FY00. During the year, exploration activities increased by 33.3 percent over last year.

Manufacturing

Under the existing system of National Accounts, estimates of gross fixed investment in large scale manufacturing (LSM) cover balancing, modernization and replacement (BMR) in existing units and development of new units. Information on gross fixed investment in these two areas is estimated by the Federal Bureau of Statistics (FBS) on the basis of data collected from industrial units, credit for industrial investment by financial institutions as well as contribution by sponsors (new units cover established units that are not yet in production). During FY01, real investment in manufacturing remained thin mainly because of the decline observed in public sector investment; negative growth of 57.8 percent, indicates that the government is minimizing its role in commercial activities and is determined to go ahead with the privatization of public sector enterprises. Similarly, private real fixed investment declined marginally by 0.5 percent compared with an increase of 14.4 percent in the preceding year. This slowdown in private sector investment can be attributed to the slowdown in the textile sector and the exchange rate depreciation that caused an increase in price of imported capital goods.

Transport, storage and communication

During FY01, this sector recorded negative growth of 0.6 percent compared with a robust growth of 22.7 percent in the preceding year. Both public and private investment fell. The decline is more severe in the case of public sector investment, which recorded negative growth of 1.1 percent, as against positive growth of 24.6 percent last year. Similarly, private sector investment decelerated from 19.5 percent in FY00 to only 0.1 percent in FY01. Private, investment in *transport, storage and*

communication is estimated with the commodity flow approach. The import of transport machinery and equipments, as well as the value of domestic production (trucks, buses, trailers and LCVs) adjusted for export, are taken into account. During the year, import of trucks and buses declined by 51.8 percent and 64.5 percent respectively, indicating lower private investment in transport. It is generally the case that informal financing plays a key role in private investment in transport, which would have been undermined by the tax survey and accountability drive. Although, private sector participation is being encouraged specially in communication, airlines, shipping, roads and highways, the impact of these measures may take sometime before these are realized.

The fall in public sector investment in *transport, storage and communication* stems mainly from the lower PSDP allocation for NHA, and non-budgetary corporations like PTCL, PIAC, CAA and PNSC. The import of transport equipment (railway, aircraft, tugs and floating structure) also declined from $ 71.0 million in FY00 to $ 40.6 million this year.

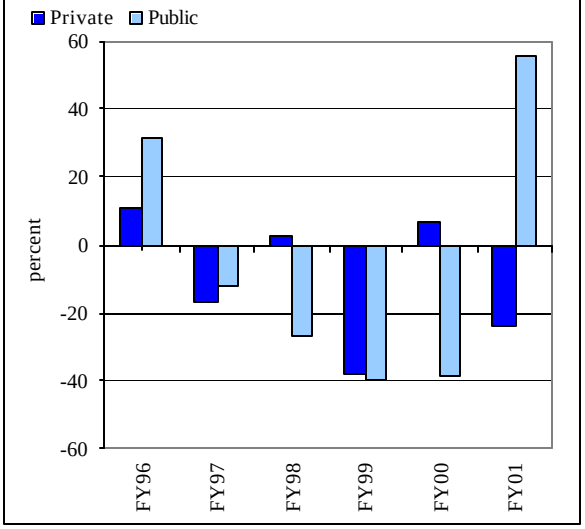
Electricity and gas distribution

Investment in this sector is mainly undertaken for generation of electricity, its distribution network, and for the purification, transmission and distribution of natural gas. During FY01, real investment in electricity and gas distribution increased by 3.9 percent, compared with negative growth of 9.0 percent in FY00, as expected, this is mainly on account of public sector investment (total installed generation capacity of electricity increased by 6.0 percent). Similarly, on the distribution side, transmission lines have also been extended, while the number of consumers increased by 6.9 percent during the year. On the other hand, investment by the private sector declined by 12.5 percent, which is still an improvement over last year's negative growth of 55.8 percent. This downward trend is mainly on account of lower investment by independent power producers (IPPs).

Construction

Investment in construction mainly includes expenditure on land improvement, construction of residential and non-residential buildings, highways, bridges etc. Total investment in construction posted negative growth of 10.9 percent, but break up reveals that public sector investment increased by 55.4 percent during the year (see **Figure 2.17**).

Figure 2.17: Public & Pvt Investment in Construction



The rise in public sector investment is mainly attributed to an increase in the number of housing units, schemes for drinking water and sanitations work. The decline in private sector investment in construction, was on account of various factors including the slowdown in financing by House Building Finance Corporation (HBFC), lower import of construction machinery and tightening of regulations imposed by the Karachi Building Control Authority.

2.6.2 Foreign Investment

Although, the government is making efforts to persuade foreign investors to invest in Pakistan, efforts have remained unsuccessful. During FY01 total foreign investment declined by US $361.4 million

from US $ 543.4 million in the preceding year. In terms of portfolio investment, there was an outflow of $140.4 million compared with inflow of US $ 73.5 million. The heavy outflow of portfolio investment is mainly on account of a foreign fund that closed its operation in Pakistan. Although, direct foreign investment also showed an absolute decline of US $147.5 million over last year, its sectoral break up indicates that some sectors still remain attractive to foreign investors (see **Table 2.16**).

Table 2.16: Foreign Private Direct Investment (Net)

million US $

	FY98	FY99	FY00	FY01	Absolute change	
					FY00	FY01
Food, beverages and tobacco	19.1	7.4	49.9	45.1	42.5	-4.8
Textiles	27.3	1.7	4.4	4.6	2.7	0.2
Chemicals, pharmaceuticals & fertilizers	72.1	54.1	119.9	26.3	65.8	-93.6
Petro chemicals and petroleum Refinery.	1.6	38.8	12.0	8.7	-26.8	-3.3
Cement	3.0	2.0	0.1	15.2	-1.9	15.1
Machinery	11.4	14.6	4.6	2.5	-10.0	-2.1
Electronics	2.7	1.2	2.3	2.8	1.1	0.5
Power	239.5	131.4	67.4	40.3	-64	-27.1
Construction	21.5	13.9	21.1	12.5	7.2	-8.6
Trade, transport, storage and communication	20.1	38.8	38.6	96.5	-0.2	57.9
Financial business	20.4	24.4	29.6	-34.9	5.2	-64.5
Mining &quarrying-and Oil &Gas	99.1	112.8	79.7	84.7	-33.1	5.0
Others	63.5	31.2	40.3	18.1	9.1	-22.2
Total	**601.3**	**472.3**	**469.9**	**322.4**	**-2.4**	**-147.5**

Mining & quarrying and oil & gas continued to be the preferred area for foreign investment in Pakistan. During FY01, mining and quarrying attracted US $ 84.7 million foreign direct investment (FDI) as compared to US $ 79.7 million last year. Union Texas Pakistan, Lasmo Oil, Premier Exploration Pak, GECO Prakla Int. Ltd., Ocean Pakistan Ltd, Shell Developers & Offshore Pak and Orient Petroleum, were the leading companies in this sub sector. The increasing flow of foreign investment in the field of *mining & quarrying and oil & gas* is driven by the policy measures taken by the government. This provided an impetus to exploration of oil and gas, which was largely ignored in the past. With the revival of Saindak copper project and further exploration of Lakhra coal reserves, the chances of attracting more foreign investment are brighter.

Trade, transport, storage and communication also fetched US $ 96.5 million FDI, compared with US $ 38.6 million in FY00. The improvement is to be seen in the context of fiscal relief given in the Federal Budget and follow-up steps for the promotion of information technology and software development in the country. The subsequent unveiling of the IT policy and IT exhibitions were held to attract foreign investors. Policy measures initiated during FY01, mainly included duty-free imports of computer hardware and accessories, reduction of duties on software exports, tax incentives to IT institutions, drastic reductions in Internet tariff for *ISPs* etc. *Textiles, electronics and construction* have also shown an improvement in attracting FDI during the year.

However, foreign investment in some sectors declined. In power it stood at $ 40.3 million in FY01 compared to US $ 67.4 million during last year. The breakup in power reveals a large share by Liberty Power, Uch Power Ltd., Ghazi Brotha Hydro Power and Rousch (Pakistan) Power Ltd. The slowdown of foreign investment in power was mainly on two accounts: (1) saturation of foreign investment following the power policy of 1994 and (2) given the problems in the past, IPPs are engaged in consolidating their operations rather than expanding.

The inflow of foreign investment in *chemicals, pharmaceuticals and fertilizer*, also declined to US $ 26.3 million during FY01 compared with US $ 119.9 million last year. During the previous year, the considerable inflow to this sector was primarily on account of the commissioning of ICI's PTA plant that attracted about 38 percent of total FDI.

Notwithstanding significant deregulation followed by various incentives and efforts of the government, Pakistan is still trying to pave the way for further inflow of foreign investment. Historically, the USA, UK and Japan are the largest source of FDI in Pakistan. However, this had declined over the year on account of various reasons. Certain exogenous factors may also be responsible; merger and acquisition amongst multi national corporations, recession in US economy, lack of progress on privatization and the lackluster performance of stock exchanges in the country during FY01.