

2 Economic Growth, Savings and Investments

2.1 Overview

Pakistan's economy witnessed a moderate recovery during FY07 with real GDP growth reaching the 7.0 percent target, as compared with 6.6 percent growth seen in FY06 (see **Figure 2.1**). This is the fourth successive year of sustained high growth in the economy, with the average annual growth accelerating to 7.0 percent during the FY03-07 period. The continued strong performance of the services sector made the major contribution to the FY07 outcome (see **Figure 2.2**). Growth in agriculture and industry also witnessed an improvement over the previous year.

One point of concern in the growth profile is the greater reliance on exceptional growth in key sub-sectors of the economy. For example, the 5.0 percent growth in agriculture during FY07 is entirely owed to a 7.6 percent increase in the major crops sub-sector (see **Table 2.1**). Similarly, the acceleration in industrial sector growth is largely attributed to a sharp jump in the construction sub-sector which grew by 17.2 percent in FY07 compared with 5.7 percent rise in the preceding year. In the same way, the strong growth in the services sector is a function of a surge in *finance & insurance* as well as the *social services* sub-sectors during FY07.

A disaggregation of aggregate demand presents a more encouraging scenario. Firstly, the growth in real private consumption remained stable, inching up from 3.3 percent during FY06 to 4.1 percent in FY07. Secondly (and more importantly) real gross fixed capital formation registered double digit growth for the third consecutive year, accelerating to 20.6 percent in FY07, due to higher FDI inflows and an acceleration in public investment on the back of a higher PSDP. As a result of the increase in public and private investment, the investment to GDP ratio rose to a record high 23.0 percent in FY07.

The rising trend in investment activity appears to reflect strong investor confidence in the economy and suggests the likelihood of improvements in infrastructure, production capacities and productivity. This would be expected to help sustain the economic growth momentum in the medium term, particularly if supported by continued reforms to improve governance.

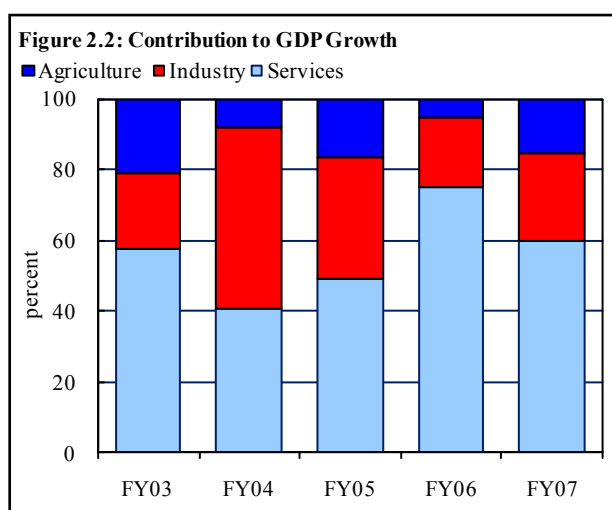
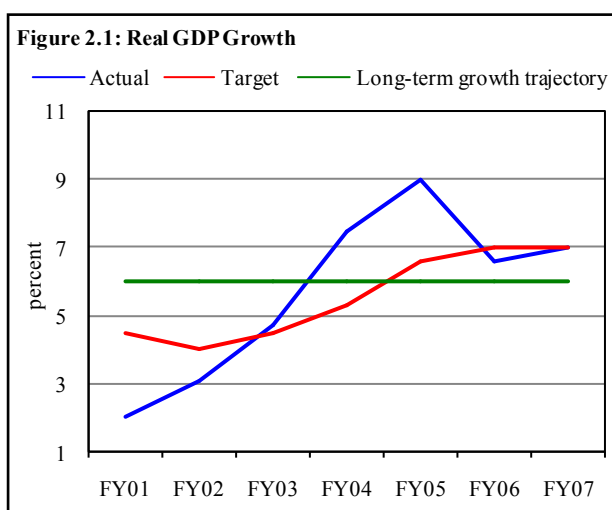


Table 2.1: Sector-Wise Growth Rates and Shares

percent; at constant prices of 1999-2000

	FY06	FY07		
	Growth rates	Growth targets	Growth rates	Percent share
Commodity producing sector	3.4	7.0	6.0	46.7
Agriculture	1.6	4.5	5.0	20.9
Crops	-3.0	3.8	6.0	10.0
Major crops	-4.1	4.3	7.6	7.6
Minor crops	0.4	2.3	1.1	2.4
Livestock	7.5	5.2	4.3	10.4
Fishing	20.5	4.0	4.2	0.3
Forestry	-43.7	3.5	-3.8	0.2
Industry	5.0	9.1	6.8	25.8
Manufacturing	10.0	11.0	8.4	19.1
Large-scale	10.7	13.0	8.8	13.6
Small-scale	8.3	7.4	8.1	4.2
Slaughtering	8.1	2.5	6.6	1.3
Mining and quarrying	4.6	3.8	5.6	2.6
Construction	5.7	7.0	17.2	2.3
Electricity & gas distribution.	-23.8	3.5	-15.2	1.8
Services sector	9.6	7.1	8.0	53.3
Wholesale & retail trade	8.7	8.8	7.1	19.1
Transport storage & comm.	6.9	6.0	5.8	10.3
Finance and insurance	33.0	12.0	18.2	5.6
Ownership of dwellings	3.5	3.5	3.5	2.7
Public admin. & defense	10.0	3.7	6.9	6.0
Community, social & personal services	6.3	5.6	8.5	9.6
Gross domestic product	6.6	7.0	7.0	100.0

Source: Pakistan Economic Survey 2006-07

2.2 Performance of Agriculture Sector

Agricultural growth witnessed a recovery in FY07. This was primarily due to a considerably improved performance of the cropping sub-sector, which overshadowed the impact of a moderation in the growth of the livestock sub-sector (see **Table 2.1**). The contribution of the remaining sub-sectors to overall agricultural growth was not material.

The rise in value addition by crops, in turn, centered essentially around three major crops, i.e. wheat, sugarcane and gram. All three recorded exceptionally strong growth during FY07, comfortably offsetting the impact of disappointing growth in two other important cash crops (cotton and rice). A striking feature in FY07 is that the yields obtained on almost all important major crops, were either at

Table 2.2: Gains in Yields of Major Crops
Kg per hectare

	FY07	10-year average (FY96-FY06)	Highest yield during last 10 years	Deviation from 10-year high (percent)	Deviation from 10-year average (percent)
Wheat	2,769	2,310	2,568 (FY05)	7.8	19.9
Rice	2,107	1,959	2,116 (FY06)	-0.4	7.6
Sugarcane	53,118	47,552	50,288 (FY98)	5.6	11.7
Maize	2,893	1,953	2,985 (FY06)	-3.1	48.1
Gram	785	589	793 (FY05)	-1.0	33.2
Cotton	712	605	760 (FY05)	-6.3	17.6

or near 10-year highs. In fact, the yields of all important major crops have been distinctly better in the last three years (see **Table 2.2**). A part of the improvement may simply reflect favorable weather conditions in these years, but it is probably no coincidence that growth in agri-credit began to regularly outstrip the annual (indicative) targets in the same period. The improved access to credit and supportive government policies (ensuring better seed availability, provision of subsidy on DAP fertilizers, incentives for exports of agri-commodities, etc.) seen in these years, probably helped this improvement in yields.

The growth of the livestock sub-sector in FY07 is one of the strongest in a decade (exceeded only by the exceptional FY06 growth). Moreover, consequent to robust demand, this sub-sector is attracting increasing investment in the production, processing, transportation and storage of dairy products. This augurs well for future growth prospects.

The outlook for the cropping sector seems positive for FY08, despite some damage due to rains and flooding in some regions. It is likely that the sugarcane harvest may touch new highs, the impact of which may be complemented by a possible recovery by the cotton crop. The production of rice is also likely to depict an improvement over the FY07 crop, with a weakness in IRRI production likely to be offset by a good basmati harvest. Similarly, while it is too early to forecast, the improvement in water availability, continued access to credit, quality seeds and fertilizer and pesticides is likely to allow farmers to increase wheat output in response to robust agri-commodity prices.

Table 2.3: Agriculture Sector Performance

	Unit	FY04	FY05	FY06	FY07 ^P	Growth rate	
						FY06	FY07
Agriculture value addition	billion Rs	964.9	1,027.4	1,043.6	1,095.7	1.6	5
<i>Of which</i>							
Major crops	billion Rs	327.1	385.1	369.2	397.3	-4.1	7.6
Minor crops	billion Rs	124.1	126.0	126.5	127.9	0.4	1.1
Livestock	billion Rs	473.8	484.9	521.4	543.7	7.5	4.3
Crops production							
Cotton	million bales	10.0	14.3	13.0	13.0	-9.1	0
Wheat	million tons	19.5	21.6	21.3	23.5	-1.4	10.3
Rice	million tons	4.8	5.0	5.5	5.4	10	-1.8
Sugarcane	million tons	53.4	47.2	44.7	54.9	-5.3	22.8
Non-crops							
Meat production	000 tons	2,185.0	2,238.0	2,419.0	2,578.0	8.1	6.6
Milk production	000 tons	28,624.0	29,438.0	31,294.0	33,230.0	6.3	6.2
Fish production	000 tons	567.0	574.0	597.0	611.0	4.0	2.3
Forest production	000 tons	819.0	576.0	404.0	366.0	-29.9	-9.4
Inputs							
Improved seed distribution	000 tons	179.0	210.0	223.0	285.0	6.1	27.8
Fertilizer off-take	million N/T	3.2	3.7	3.8	2.8	2.7	-26.3
Sale of tractors	Numbers	35,900.0	43,578.0	48,802.0	54,052.0	12	10.8
Credit availability							
Credit disbursement	billion Rs	73.6	108.7	137.5	168.8	26.5	22.8

P: Provisional

2.2.1 Crops

The aggregate value addition by major and minor crops witnessed a strong recovery in FY07, after having declined in the previous year (see **Table 2.3**). The improvement was led principally by the

robust harvests of three major crops, wheat, sugarcane and gram, it was complemented by a small improvement in the contribution by minor crops as well.

Major Crops

Traditionally only four of the ten major crops account for the bulk of the value-addition in the crops sub-sector of agriculture in Pakistan. These four crops (i.e., wheat, cotton, sugarcane and rice) account for approximately 80 percent of the total cultivated area and about a third of the total value addition in agriculture. Cotton, rice and sugarcane are principally produced in the *kharif* cropping season (April to September), while wheat is principally produced in the *rabi* cropping season (October to March).

The aggregate performance of the FY07 *kharif* season was disappointing as the rice and cotton harvests were hit by untimely rains and floods. These conditions were however well suited to the sugarcane crop, and since farmers were also encouraged by high prices in the previous years, the area under the crop increased at the cost of cotton. As a consequence, sugarcane production rose by 22.8 percent in FY07, offsetting part of the impact of relatively weak rice and cotton production.

The higher water availability as a result of better rains in the *kharif* season probably contributed significantly to the record wheat harvest in the following *rabi* season. The higher soil moisture, and expectations of better prices probably accounted for a rise in acreage, while improved supply of certified seed, a subsidy on DAP fertilizer, as well as favorable weather, all helped raising yields to a record high in FY07 (see **Box 2.1**). As a result, the FY07 wheat production touched a high of 23.5 million tons.

Box 2.1: Prospects for the Wheat Yield

Despite a gradual increase, the present yield is far below the potential yield (see **Figure 2.1.1**).¹ In perspective of the significantly higher yields of other countries, this potential level does not seem unrealistic. This is also evident from the remarkable increase in yield during FY07, which resulted in an improvement in the country's ranking amongst major wheat growing countries (see **Figure 2.1.2**).

In this backdrop, some important requirements are summarized below::

1. Increased availability of certified seeds is a key necessity.
2. Use of balanced mix of phosphate and nitrogen fertilizers by small farmers could make a real difference, since these small farmers has a dominating share in the aggregate harvest.
3. Implementation of low-cost land leveling technology and land management can reduce cost and help increase productivity.

Figure 2.1.1: Wheat Yield Gap

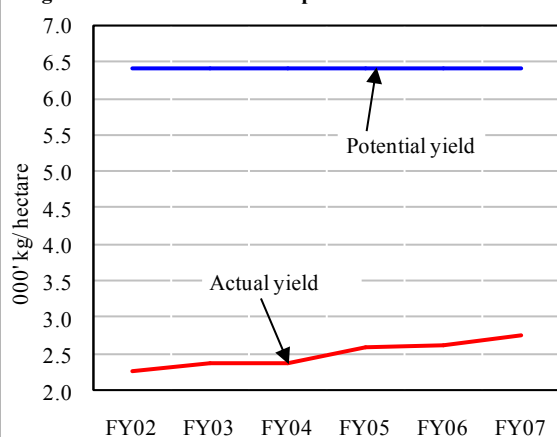
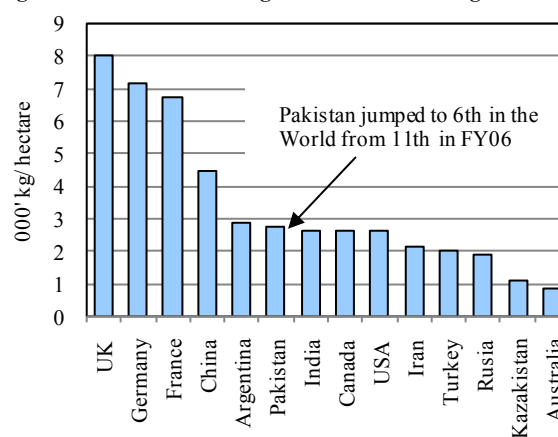


Figure 2.1.2: World Ranking in Wheat Yield during FY07



¹ Potential yield estimated by: Mellor, John W., (1996), "Accelerating Agriculture Growth – Is Irrigation Institutional Reform Necessary?", Pakistan Development Review, Vol. 35 : 4, Part I, Winter.

4. Effective control of weeds and insects is essential.
5. Despite significant increase in the availability of agri-credit, a number of small farmers are unable to avail this facility mainly due to inappropriate documentation (such as non-availability of Pass Books). This hinders the small farmers to invest in farm mechanization as well as implement optimum quantum and quality inputs.
6. Timely sowing is also an important factor as wheat yield started to decline after November 15 sowing. However, it has been observed that sowing continues even in January, which resulted in lower yield, and
7. Improved storage and transportation facilities are needed to minimize the post harvest losses.

The bumper wheat harvest was the single most important factor behind the resurgent growth in value-addition by the crops sub-sector during FY07. Moreover, given that wheat is most widely cropped grain in the country, the bumper harvest and good prices in the market probably contributed significantly to income growth for farmers in FY07. Another point to note is the continued importance of the cotton crop; while there was no growth in the value-addition by cotton during FY07, its share in the aggregate value-addition by crops remained a robust 23.6 percent.

Minor Crops

The value added by minor crops saw a negligible growth of 1.1 percent during FY07. This was only a little higher than the 0.4 percent rise seen in FY06, and lower than the FY07 target of 2.3 percent. While, improved availability of irrigation water, subsidy on non-urea fertilizers and significantly better prices of most of the minor crops helped in increasing the production of potato, masoor and mung, extended heavy rains damaged some of important minor crops such as onions, chillies and tomatoes during FY07 (see Table 2.4).

2.2.2 Agriculture Inputs

The role of agriculture inputs is very important in the performance of the crops sub-sector, therefore a detailed analysis of the key inputs would be instructive.

Agriculture Credit

In recent years, agriculture credit disbursement has increased substantially reflecting improvements in access (as commercial banks have aggressively expanded lending in the sector), and strong demand (as farmers were encouraged by strong commodity prices, supportive policies and favorable weather). As a result, for the last few years agri-credit disbursement targets were routinely surpassed (see Table 2.5). This was also seen in FY07, with disbursements rising by 22.8 percent YoY to exceed the annual target by 5.5 percentage points. The strong growth was achieved despite a significant decline of 15.8 percent in agri-credit by a major bank (HBL) due to restructuring, and a decline in the number of borrowers (probably due to improved farm incomes).

Table 2.4: Growth of Minor Crops
percent

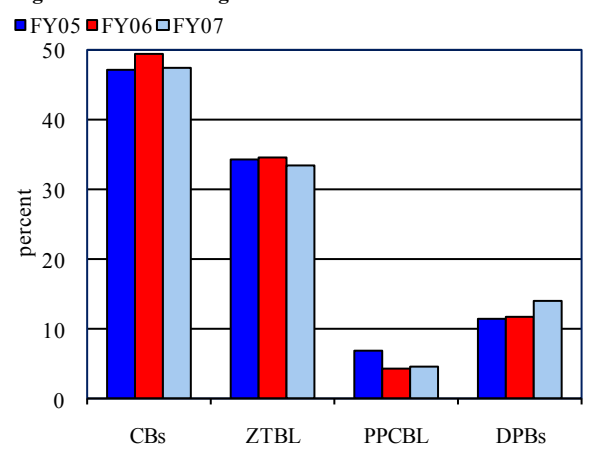
Crops	Area		Production	
	FY06	FY07	FY06	FY07
Masoor	-30.5	13.0	-30.9	17.9
Mung	-15.0	4.0	-12.4	21.6
Mash	-23.5	-4.6	-9.8	-3.6
Potato	6.2	12.4	-22.6	68.1
Onion	21.6	-16.5	16.5	-14.3
Chillies	68.2	-32.4	36.0	-49.6

Table 2.5: Credit Disbursement as percent of Target

Banks	FY05	FY06	FY07
CB's*	135.0	107.9	100.5
ZTBL	110.0	110.7	117.7
PPCBL	95.1	65.4	88.8
DPBs	248.1	106.8	104.2
Total	127.9	105.7	105.5

*: NBP, HBL, MCB, UBL, and ABL

Figure 2.3: Share in Agri-credit Market



While the share of the five largest commercial banks and ZTBL in total agri-credit disbursements declined during FY07 as a result of internal restructuring, the share of the relatively smaller players (PPCBL and DPBs) increased during the year (see **Figure 2.3**).

However, it should be noted that in contrast to the increasing agri-credit disbursement, the number of borrowers witnessed a decline for the second consecutive year in FY07. This meant that the average size of agri-loan increased and suggests that small farmers did not avail the financing facilities at the same pace as in previous years.

Purpose-wise Credit Disbursement

While, agri-credit for production purposes grew by a robust 29.0 percent during FY07 on top of the 31.0 percent growth in FY06, credit disbursements for developmental purposes saw a sharp decline of 12.0 percent during FY07 in contrast to a rise of 5.7 percent in the preceding year (see **Figure 2.4**). In particular, the share of tractor financing in total developmental loans witnessed a sharp decline in recent years (see **Figure 2.5**).

As a result, the share of production loans improved further from 84.8 percent in FY06 to 89.1 percent in FY07 (see **Figure 2.6**). However, the decline in development loans is probably a statistical artifact, since a part of these loans were classified under production loans on account of the revolving credit line facility.² This observation is well supported by the fact that despite a decline in developmental loans (and tractor financing), the sales of tractors (domestic and imported) increased significantly in FY07.

Agri-Financing for Fertilizer Purchase

The growth of agri-credit disbursement for the purchase of fertilizers slowed to 11.5 percent in FY07 compared with 40.0 percent rise seen in the previous year (see **Table 2.6**). The deceleration was recorded by all banks, except DPBs.

Figure 2.4: Purpose-wise Credit Disbursement - Growth

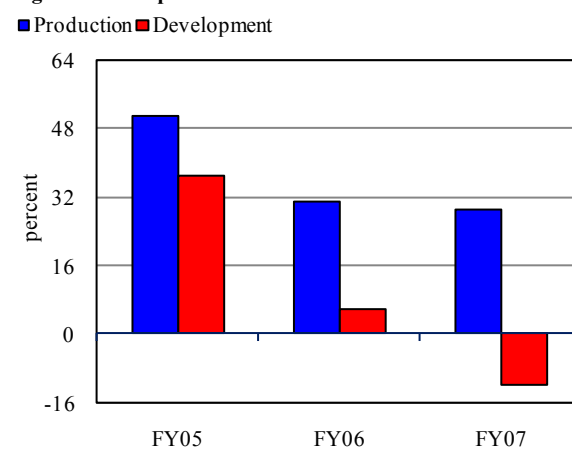


Figure 2.5: Share of Tractor Financing in Developmental Loans

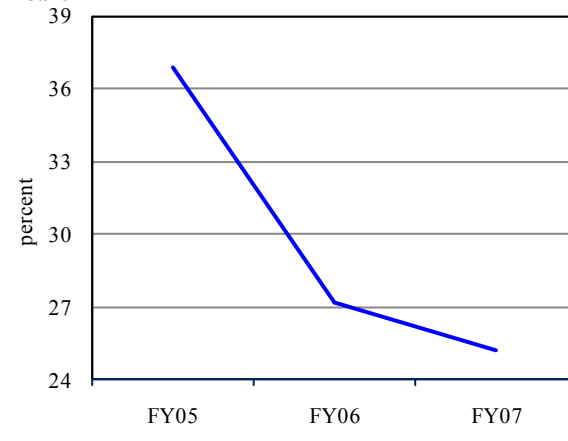
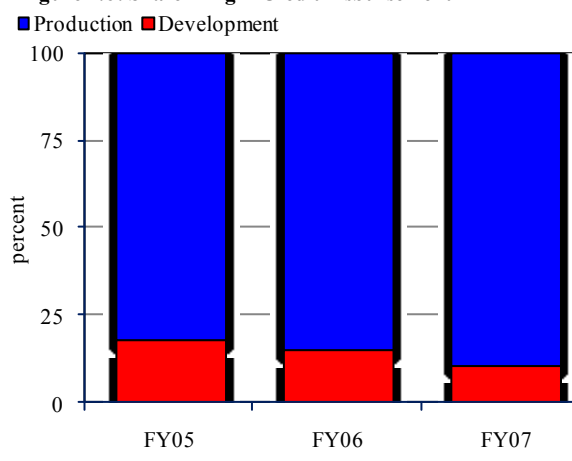


Figure 2.6: Share in Agri-Credit Disbursement



² Under this scheme, a credit limit has been sanctioned to the farmers and mark-up charged on the credit availed. This facility enables farmers to meet their financing requirements for production as well development purposes, but for reporting purposes is classified as a production loan.

A part of the explanation lies in the weakness in aggregate fertilizer sales in part of the year in anticipation of a subsidy (and supply bottlenecks in some periods). Also, farmers increased fertilizer purchases from their own resources, reflecting improved farm incomes and the rising cost of funding.

Irrigation Water

As a result of better monsoon and winter rains and heavy snowfall, aggregate water availability increased by 13.1 percent during FY07. In fact, for the first time in 8 years, *khari*f water availability finally exceeded the “normal levels”³.

Not only was the *rabi* rainfall slightly better than in the previous year (see **Figure 2.7**), the rains were also more timely, and as a result had a greater impact on the FY07 *rabi* crops. Specifically, *rabi* season received 11.6 percentage points’ higher rains in FY07 over the figures of last year.

Fertilizers

Despite a rise in DAP off-take on the back of a subsidy and access to institutional credit, aggregate fertilizer consumption declined by 7.4 percent in FY07, in contrast to a 4.5 percent increase seen in FY06 (see **Figure 2.8**). The decrease is mainly attributed to a fall in urea, which accounts for more than 74 percent of total off-take.

The recent decline in urea off-take is largely a substitution effect. Since DAP was much more expensive than urea, farmers did not use it as required, preferring to compensate through excessive urea usage instead. Thus, in order to persuade risk averse farmers of the benefits of a balanced fertilizer mix, the government announced a subsidy on DAP prices in November 2006, and began an aggressive media campaign to create awareness of the benefits from the balanced usage of nutrients.

Table 2.6: Agri-credit Disbursement for Fertilizers Purchase

million Rupee

Banks	FY04	FY05	FY06	FY07
CBs*	24,205	23,695	26,427	26,210
ZTBL	19,466	7,773	20,513	24,747
PPCBL	5,296	3,742	4,706	5,253
DPBs	4,668	4,182	3,511	5,265
Total	53,635	39,391	55,156	61,474
Growth (%)				
CBs*		-2.1	11.5	-0.8
ZTBL		-60.1	163.9	20.6
PPCBL		-29.3	25.8	11.6
DPBs		-10.4	-16.1	50.0
<i>Total</i>		-26.6	40.0	11.5

*: ABL, HBL, MCB, NBP and UBL

Figure 2.7: Rainfall Pattern

■ Kharif (Apr-Sep) ■ Rabi (Oct-Mar)

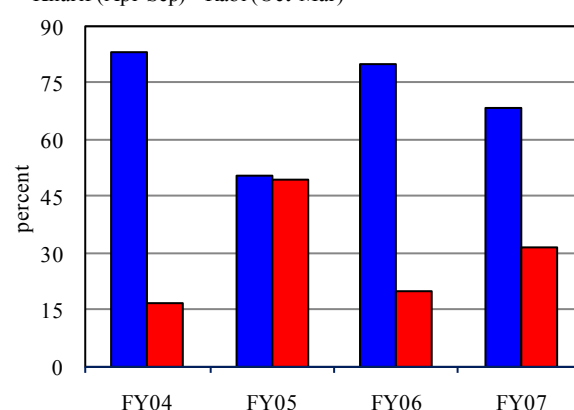
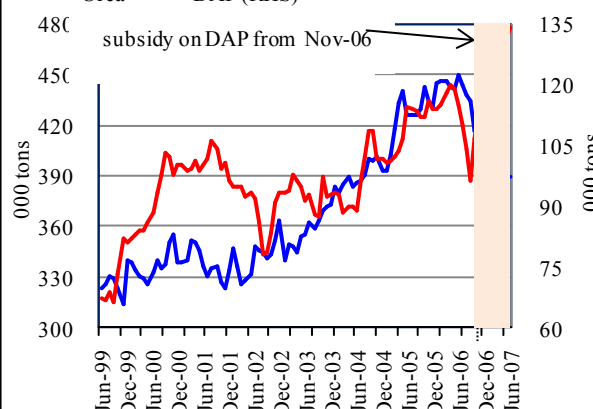


Figure 2.8: Fertilizer Off-take (12-month moving average)

— Urea — DAP (RHS)



³ As defined in the 1991 Water Accord, normal level refers to 103.5 MAF for the year with 67.1 MAF for *khari*f and 36.4 MAF for *rabi* seasons.

The subsidy resulted in a significant decline in the relative prices of DAP, and consequently its off-take witnessed a significant increase, while application of urea declined (see **Figure 2.9**). It may be noted that overall fertilizer off-take dropped significantly *prior* to the subsidy, as farmers delayed their purchase decisions amidst uncertainty over the subsidy announcement.

It is important to note that the impact of the initial subsidy on DAP was largely offset by a sharp jump in international prices of fertilizer (see **Figure 2.10**) amidst rising energy costs. In this backdrop, the government raised the subsidy from Rs 250 per 50 kg to Rs 400 in March 2007 and to Rs 470 in June 2007.

Seed Distribution

The availability of quality seed is essential to raise agricultural productivity and therefore several Federal and Provincial departments have been established in 1961 for the production, processing and distribution of certified seeds, but on average these have had limited success. Currently, the Federal Seed Certification & Registration Department regulates quality during the flow of seed from the (public and private) seed companies to the growers. It provides guidelines for all seed policies, seed projects, planning, import/export, inter provincial seed movements, seed standards and investment in the seed industry.

As Pakistan is still unable to meet its certified seed requirements, there is heavy reliance on imports. Although the private sector has been allowed to produce and distribute certified seeds but even these efforts are inadequate, with farmers raising serious concerns regarding mixture with undesired varieties and poor germination. This affects farmers' confidence and undermines efforts to promote the usage of improved seeds, especially to small farmers. To restore farmers' confidence in improved seed, efforts have to be made by the seed certification agencies to ensure that quality standards are maintained.

This said, a considerable gap exists in the total requirements and the availability of certified seeds in the country. In particular, a 78.5 percent gap in wheat and 96.7 percent gap for gram (see **Table 2.7**) indicate that there exists a great potential to enhance the yield of these important crops by increased usage of certified seeds.

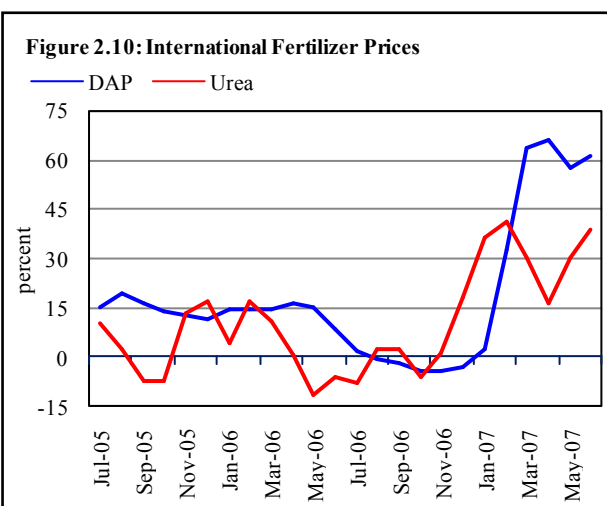
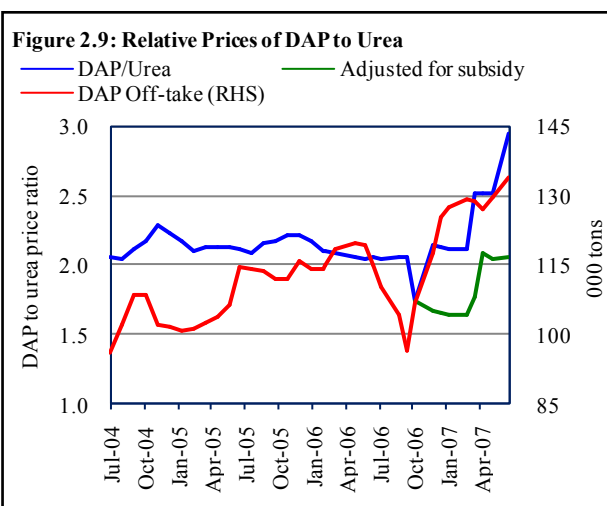


Table 2.7: Certified Seed Supply and Gap

Crops	Total seed required (000/tons)	Seed supplied (000/tons)		Certified seed gap in FY07 (percent)
		FY06	FY07 ^P	
Wheat	1053.3	169.9	226.0	78.5
Paddy	38.7	12.5	14.8	61.9
Maize	14.6	9.1	7.8	46.5
Cotton	76.8	29.1	34.2	55.5
Oilseed	1.6	1.7	1.3	18.9
Gram	23.6	0.6	0.8	96.7

P: Provisional

Source: Federal Seed Certification & Registration Department

2.2.3 Livestock

The value-addition in the livestock sub-sector grew by 4.3 percent in FY07. This is the second highest increase in the decade, exceeded by only the exceptional rise of 7.6 percent in FY06 (see **Table 2.8**).

Table 2.8: Livestock Population Growth
percent

Years	Buffalo	Cattle	Goat	Sheep
FY04	2.8	2.1	3.6	0.4
FY05	3.1	1.7	3.7	0.8
FY06	8.0	5.4	9.2	2.4
FY07	-3.9	16.1	-13.1	3.9

With growth in domestic supply of meat and milk is unable to meet the strong and growing demand, country imported a sufficient quantum of these products every year. Despite difficulties in raising livestock, emphasis should be given to (1) increase in infrastructure facilities, (2) improvement in breeding, health and growth of animals (3) better marketing facilities, (4) extended/easy approach to funds, and (5) improvement in law and order situation.

Further, in recent years, the livestock sector has been recognized as an important factor in enabling the growth and stability of income for rural households. Increased access to institutional credit, technical support from government, as well as initiatives of dairy farming at large scale by the private sector, are therefore welcome developments. The initiatives to increase supply are supported by the increasing popularity of packaged dairy products, which is improving the returns to the farmers as well. In addition, activities of this sector are increasingly reported in the formal sector. All these developments indicate that the contribution of the livestock sector could significantly increase in the years ahead.

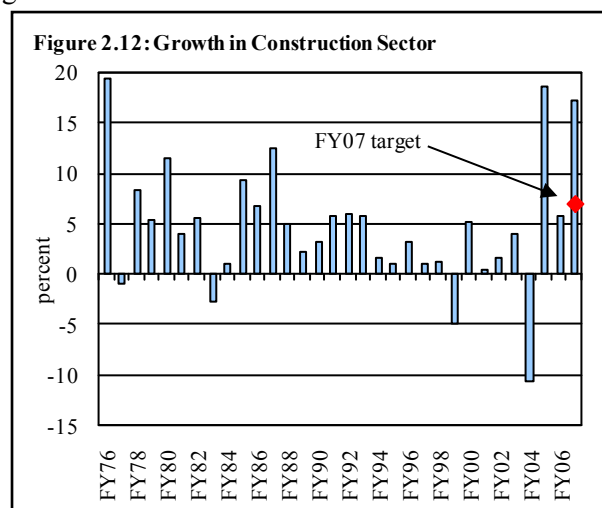
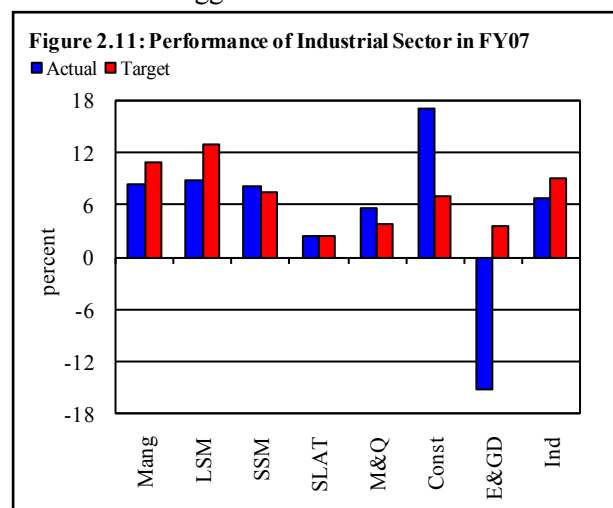
Table 2.9: Growth of Industrial Value Added
percent, at constant factor cost of 1999-2000

	FY04	FY05	FY06	FY07 ^P
Manufacturing	14.0	15.5	10.0	8.4
Large-scale #	18.1	19.9	10.7	8.8
Small scale & household \$	-20.0	7.5	8.3	8.1
Mining & quarrying	15.6	10.0	4.6	5.6
Construction	-10.7	18.6	5.7	17.2
Electricity & gas dist.	56.8	-5.7	-23.8	-15.2
Industry	16.3	12.1	5.0	6.8

Source: Economic Survey 2006-07; ^P provisional
 # LSM growth for full FY07 and FY06 is 8.4 percent and 9.2 percent respectively
 \$ **Box 2.2** present the salient feature of SME policy 2007

2.3 Industry

The industrial sector witnessed a moderate recovery during FY07, largely due to the strong growth in the *manufacturing*, and the *construction* sub-sectors, as well as the lower negative contribution from the *electricity and gas distribution* sub-sector (see **Table 2.9** and **Figure 2.11**). While large-scale manufacturing (LSM) witnessed a weaker performance in FY07 relative to the preceding year, it remained the biggest contributor to industrial sector growth.



2.3.1 Construction

Within the industrial sector, the highest growth was observed in the construction sub-sector during FY07, with value-addition rising by 17.2 percent. This was not only higher than the 7.0 percent target, but was also the second highest growth recorded by this sub-sector since FY76 (see **Figure 2.12**). The resurgence is mainly attributed to higher development expenditures by the government, increased foreign direct investment (FDI) in the construction sector and, record worker's remittances.

The sustained growth in construction sector is important from its strong backward linkages with a number of industries and employment generation. For example, with the increased construction activities, demand for cement, iron, electric fittings, timber & wood, color & chemical, marble, sanitary tiles, ceramics and related fittings also rises. In addition, construction also generates a range of employment opportunities from unskilled workers to architects.

Although the construction sector has only a 2.3 percent share in GDP, its share of the employed labor force was disproportionately large at 6.1 percent in FY07. Importantly, the employment elasticity of construction sector with respect to GDP has increased from 0.47 in 1960s to 0.87 percent in 1990s onward⁴ indicating that the economy is absorbing more construction-related workers than before. The higher demand for construction workers is also reflected in a continued double-digit rise in their wages since FY05 (see **Table 2.10**).

Table 2.10: Construction -Performance Indicators

	Unit	FY05	FY06	FY07
Value added by construction industry	billion rupees	98.2	103.8	121.6
Development expenditures	-do-	227.7	365.0	433.7
Gross fixed investment	-do-	13.2	19.4	24.1
Private credit for construction (flow)	-do-	13.1	10.6	13.0
Foreign direct investment *	million US\$	58.7	136.0	204.3
Workers' remittances	-do-	4,168.8	4,600.1	5,493.7
Wages of construction's workers	percent growth	11.7	18.2	11.1
Production of steel (Pak Steel)	000 tons	979.0	684.5	983.1
Import of iron & steel	000 tons	2,851.0	4,189.4	3,558.8
Import of construction & mining machinery	million rupees	8,339.9	11,383.9	13,471.5
Cement dispatches	000 tons	16,353.0	18,412.0	24,222.8

* It includes the FDI in construction, cement, metal, basic metal and ceramics groups.

2.3.2 Mining & Quarrying

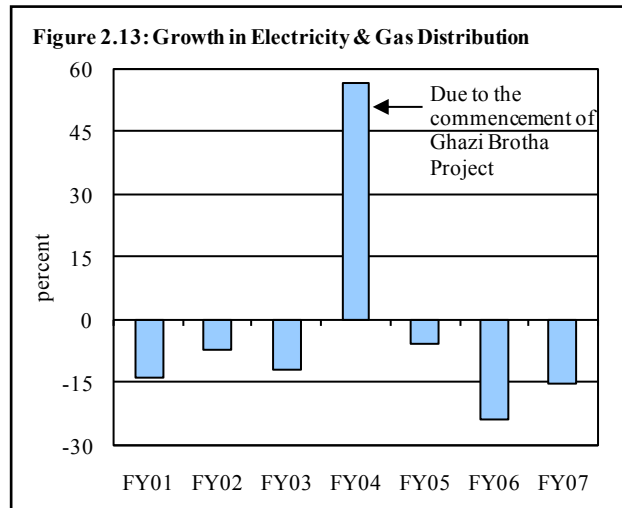
Provisional data suggests an acceleration in *mining & quarrying* sector with 5.6 percent YoY growth during FY07. The growth in this sector during FY07 was mainly attributed to higher production of limestone, dolomite, sulphur and chromites, which was partially offset by falls in the value addition of coal, marble, gypsum, rock salt, etc.

The above target growth by mining & quarrying sector is impressive given a poor law & order situation in Balochistan and Northern areas. This sector has tremendous potential to grow, and there is a need to improve infrastructure in mineral rich areas with security arrangements that would help attract foreign investment particularly in copper mining as well as in oil & gas exploration. In addition, continued rising international commodity prices amidst supply bottlenecks and strong demand suggests that the high growth potential of this underdeveloped sector.

⁴ Poverty Reduction Strategy Paper, PRSP Secretariat - Finance Division, Government of Pakistan, September 2005.

2.3.3 Electricity and Gas Distribution

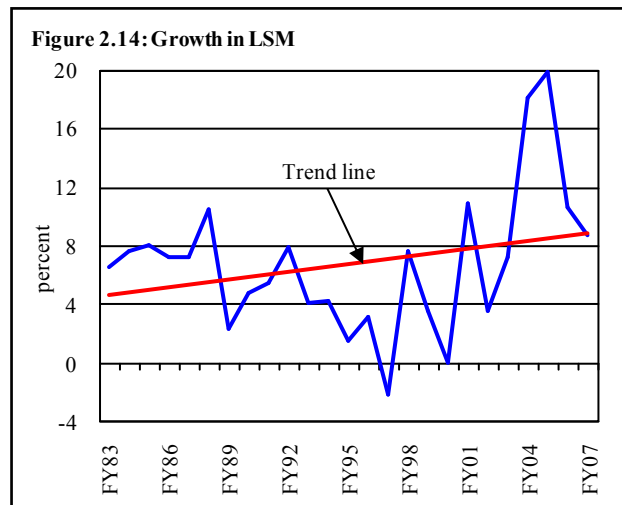
The electricity and gas distribution sub-sector continued to record losses in FY07 (see **Figure 2.13**), probably reflecting the increased cost of electricity generation as well as on-going distribution and transmission losses of the country's two electricity utilities. This impact was compounded in FY07 by the decline in the profitability of the larger gas distribution companies. Consequently, value addition by this sub-group was negative 15.2 percent in FY07 on top of a fall of 23.8 percent in the preceding year. Nonetheless, the lower drag due to the weaker negative contribution (relative to the previous year) was an important factor in the improvement in industrial growth in FY07.



2.3.4 Manufacturing

Both, large scale manufacturing (LSM) as well as small-scale manufacturing (SSM), remained significant contributors to GDP growth during FY07 despite a broad-based deceleration in the growth rates during the year (see **Figure 2.14** and **Figure 2.15** for LSM). This slower growth appears to reflect a broad moderation in external and domestic aggregate demand, as well as capacity and input constraints in some industries.

The value-addition in SSM includes that by SMEs, but since both sectors are primarily in the informal market, there is little information that can be used to assess annual developments. But given the importance of this sector towards employment generation and in supporting LSM, the sector received considerable policy attention. The government has recently announced its SME policy (see **Box 2.2**), and the SBP had earlier introduced separate prudential regulations to facilitate access to credit.



Box 2.2: SME Policy 2007: SME Led Economic Growth- Creating Jobs and Reducing Poverty

Federal Bureau of Statistics (FBS) had conducted Census of Establishments, which showed that there are about 3.2 million economic establishments in Pakistan. Of which, small and medium size endeavors (that employ upto 99 workers) represent around 90.0 percent of all private enterprises, providing employment to 78.0 percent of non-agriculture labor force. SMEs contributed more than thirty percent to GDP, twenty five percent in export receipts as well as thirty five percent in value addition by manufacturing sector. Given the importance of SMEs, the government of Pakistan announced the policy for the development of this sector. The salient features of SME Policy 2007 are:

- The government of Pakistan has adopted a single SME definition that is accepted by all public as well as private agencies to allow uniformity in designing support systems and incentives and also to monitor progress. SME definition is as follows:
 - Employment size upto 250.
 - Paid up capital upto Rs 25.0 million.
 - Annual sale upto Rs 250.0 million.
- The objective of SME Policy is to provide a policy framework with an implementation mechanism for achieving higher economic growth based on SME led private sector development.

- A business entity may be certified as an SME by a simple process to be exercised by SMEDA in partnership with other government agencies, chambers of commerce and industries. The process of certification is voluntary for those firms who choose to do so to benefit from the support mechanism and simplified regulatory regime.
- SME desks will be established at federal, provincial, banking and tax ombudsman offices for handling and addressing SME grievances. The complaint cell established at SBP may also facilitate redressal of SME complaints.
- A minimum quota will be fixed for SMEs for allocation of land in industrial estates and export processing zones. A concessional rate of land (at no profit no loss basis) will be charged from SMEs as compared to cost offered to large-scale enterprises.
- Genuine SME representatives are to be inducted in all federal monitoring and dispute resolution schemes with private sector participation.
- Regulatory regime for specialized sectors in provinces (such as mining) may be developed as per their specific requirements keeping in view their regional dynamics.
- Review of prudential regulations, periodically in line with the SME credit demand and supply data.
- Establishment of credit guarantees and credit insurance agencies to provide incentive and risk cover for bank, which comfortably provide the SME financing.
- Introduction of bankruptcy laws with dedicated and effective judicial process.
- Need Assessment Survey to identify major SME needs in HRD, technology up-gradation and marketing.
- Establishment of Institutes of Small and Medium Enterprise & Entrepreneurship Development (INSMED) in select business schools.
- Introduction of SME specific research projects supporting R7D and University-Industry liaison programs by Ministry of Science and Technology, Higher Education Commissions, Pakistan Software Export Board, Ministry of Information Technology and others.
- Encourage establishment of SME sector specific export marketing companies by providing matching grants in conducting international marketing research, developing marketing strategies, developing marketing material, packaging, branding, participating and conducting trade fairs and undertaking promotional and marketing activities.
- Establishment of SME quota in trade delegation supported by EPB.
- Support of financial institutions in designing and launching industry based program-lending schemes.
- Policy envisions increasing the share of manufacturing small enterprises from 5.5 percent to 7.0 percent.
- Reduce the number and density of regulations regarding SMEs, which will reduce the cost of doing business in SMEs.
- It set the target of increasing the share of SMEs in value added production to 40.0 percent.
- The 6.0 percent target is set for women ownership.

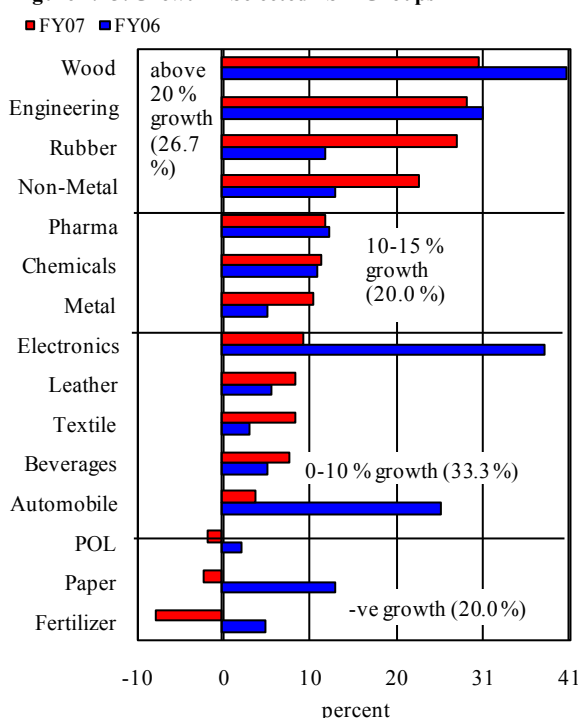
Developments in some key sectors of LSM are discussed below:

Textiles

The most significant contribution to the FY07 outcome was from the textiles sector, which staged a strong recovery, shrugging off the impact of a relatively disappointing domestic cotton harvest. The FY07 growth in textiles was the second highest since FY01 (see **Figure 2.16**), when the sector had benefitted from the removal of export quotas and a substantial increase in investments.

The textile industry faces considerable competitive pressures as a result of changing domestic and international factors. The former includes the high cost and low reliability of utility supplies (water, electricity, etc.) as well as administrative issues, inadequate availability of trainable labor, etc. Internationally the country's exports face stiff competition from low-cost

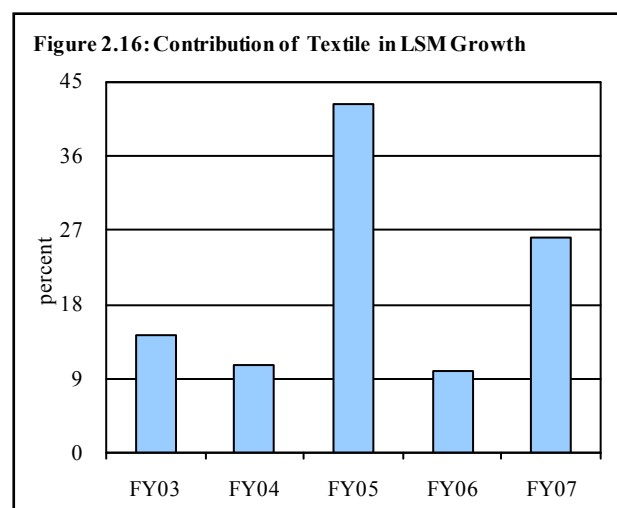
Figure 2.15: Growth in Selected LSM Groups



competitors such as China and Vietnam, resulting in narrowing margins. Thus, as margins in both domestic and international markets are coming under pressure, the textile industry needs substantial structural changes, if it is to continue growing, with a focus on:

1. Technological up-gradation at all production levels
2. Product diversification, as well as exploration of new markets
3. Improvement in the quality of products through better material, and design inputs, and
4. Establishment of large garment industries with modern facilities and management styles.

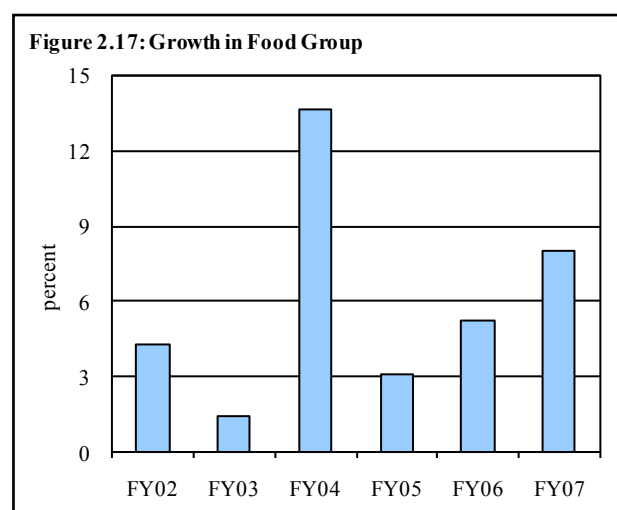
An active public-private sectors partnership is required to support the industry by establishing vocational training institutes, providing assistance in R&D related activities, and supply of reliable public utilities/ infrastructure. Moreover, government should also provide testing facilities to assure quality compliance. Synergies may also be obtained through international collaborations.



Food beverages & tobacco

Production in the *food, beverages & tobacco* sector also accelerated in FY07 (see **Figure 2.17**). Growth in the sector received a significant impetus from the robust sugarcane and wheat harvests (that underpinned the remarkable recovery in sugar industry and acceleration in wheat & grain milling), satisfactory performance of beverages industry and significant FDI inflows.

The growth in sugar output would have been even higher if a larger portion of the sugarcane crop had been processed by sugar mills. The sugarcane utilization of mills measured by the ratio of cane crushed to sugarcane production, increased to 73.8 percent in FY07 as compared with 67.4 percent during the last crushing season, the larger FY07 crop means that in absolute terms the tonnage of sugarcane not processed by the mills has increased. This possibly reflects the diversion of sugarcane towards the production of “gur” due to high prices of this commodity⁵ and the price disputes between sugarcane farmers and mills.



Cement

The cement industry was amongst the few bright spots in LSM in FY07. Production growth accelerated during the year, helped by the substantial capacity additions in recent years, a booming domestic construction industry, and strong export demand

⁵ Gur exports rose by 21.3 percent in FY07 as against a decline of 9.4 percent during the preceding year. Gur prices rose from Rs 34.8/kg in FY06 to Rs 37.9/kg during FY07.

Notably, cement exports recorded a robust growth of 111.8 percent in FY07 as against a decline of 3.8 percent in FY06 (see **Table 2.11**). This rising export is mainly due to strong construction activity in Afghanistan, Iraq and in the UAE, as well as the government decision to restore a duty drawback on cement export at the rate of Rs 25.08 per ton with effect from September 27, 2006⁶ and to exempt these exports from excise duty & sales tax.

It may be noted that the capacity additions in the cement industry during FY07 meant that at end-June 2007 the industry had excess capacity of about seven million tons. However, the industry prospects remain strong due to (1) the strong potential for exports to India which faces an acute shortage for at least next two years; and (2) domestic demand is expected to increase in the backdrop of increase in public sector development expenditure, as well as (3) continued strength in the housing construction industry.

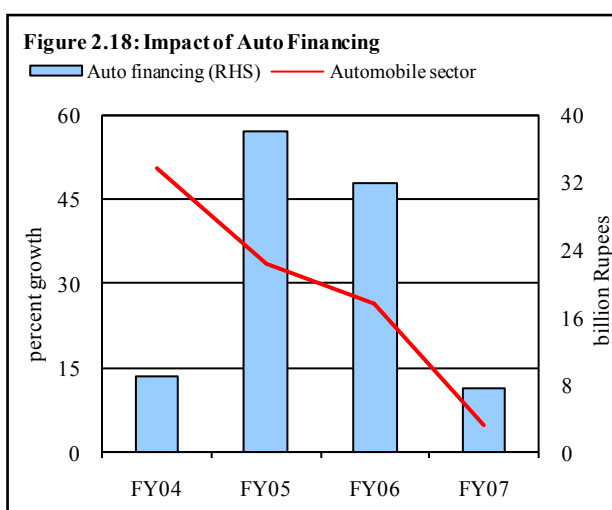
Table 2.11: Cement Dispatches Destination
000' tone

	Domestic	Foreign	Total
FY02	9,833	107	9,940
FY03	10,959	430	11,388
FY04	12,545	1,118	13,663
FY05	14,789	1,564	16,353
FY06	16,907	1,505	18,412
FY07	21,034	3,188	24,223

Automobile Industry

In contrast to a significant contribution from automobile sector in LSM growth in earlier years, the FY07 growth in this sector was a moderate 3.8 percent down from a healthy 25.8 percent growth in the preceding year (see **Figure 2.15**). A combination of demand side as well as supply side factors contributed to this slowdown in the growth of the automobile sub-sector during FY07.

The factors contributing to the softening demand for domestically produced vehicles include rising interest rate on consumer financing along with efforts of commercial banks to reduce credit risk (see **Figure 2.18**), availability of various imported vehicles in market at relatively lower prices, continued considerable delivery lags and premium on local manufactured vehicles.. The deceleration in demand particularly hurt growth in the local motorcycle industry where production capacity was increased significantly in recent years (see **Box 2.3**).



Box 2.3: Pakistan's Motorcycle Industry⁷

Motorcycle assembling in Pakistan started in 1964 when Atlas Group established a plant for assembly of Japanese brand Honda in Karachi. The number of motorcycle assemblers in Pakistan has now grown to 43, with their plants scattered in and around Karachi & Lahore. Out of these, only three viz., Honda, Yamaha and Suzuki, are Japanese brands while the rest are local brands using mainly Chinese technology. At present, the total production capacity is 1.31 million units for 70-175cc categories of motorcycles.

Despite the fact that only seven assemblers are members of Pakistan Automotive Manufacturers Association (PAMA – working since 1984), they have captured 75 percent share of total sales. Rest of the market is shared by local brands mainly of 70cc motorcycles. Interestingly, the market share of local brand assemblers is too small given that their production capacity is at par with PAMA member firms.

⁶ In FY06, the government had banned exports in order to contain a rise in domestic cement prices.

⁷ This analysis broadly draws from Competitiveness Support Fund's (CSF) study regarding motorcycle industry in Pakistan.

Motorcycle industry in Pakistan used to be protected from foreign competition during 1996-2005 under Deletion Policy. This policy allowed only the import of parts & components that were not indigenized yet and established gradual localization targets. But following the commitment under WTO, a Tariff Based System (TBS) is in place since 2005 to protect the industry with 90 percent duty on the import of Completely Built Units (CBU), 35 percent on Completely Knocked down (CKD) kit non localized parts and 50 percent on CKD localized parts.

The motorcycle industry has strong backward linkages with indigenous parts manufacturing industry. Most of the parts manufacturers are informal sector SMEs, numbering somewhere in between 1600-2000. The parts manufacturers are also protected under TBS with localized parts prior to 2004 having duty rate of 50 percent and non-localized parts 35 percent. But tariff policy does not impose duty on parts imported in CKD kit form. Further, non tariff protection is ; motorcycle assemblers can buy parts from local manufacturers or import directly but are not allowed to buy from commercial importers.

In the export market, Pakistan's major rivals are China, India, Thailand and Vietnam. All these competitors, not only have higher production capacity compared to Pakistan, they have also achieved higher levels of indigenization. Manufacturers are required to explore new markets for their products such as in Africa, Central Asia, Bangladesh and Sri Lanka etc. Currently only Atlas Honda has acquired export rights from Honda Japan for 70 & 125cc motorcycles while Dawood Yamaha has acquired export rights for Afghanistan only.

At present, the motorcycle industry is facing a challenge of stagnant domestic demand which is at around 770-775 thousand units, which is very low compared to the competitor countries such Thailand and Vietnam where the domestic demand is around 1.9 million units. This industry can receive significant boost in their demand if banks provide financing for the purchase of motorcycle. This is important as motorcycle industry needs a critical mass of production to realize gains resulting from economies of scale (translating in price decrease, quality & competitiveness maintenance).

2.4 Services

The FY07 growth target for the services sector had been set lower than the 9.6 percent growth recorded in FY06, taking into account the anticipated deceleration in some of the larger sub-sectors of the services group. While this expectation generally proved correct, the performance of two sub-sectors – finance, and social & community services – proved to be much better than forecast (see **Table 2.12**). Consequently, for yet another year, the services sector growth remained well above target (see **Figure 2.19**).

The sustained strong growth by the services sector for the last six successive years has contributed to a structural shift in the economy, the share of the services sector rose to a new high of 53.3 percent in GDP during FY07. Unfortunately, detailed disaggregated data related to services sector is not available, and information of some sub-sectors is based on old surveys, thus may have

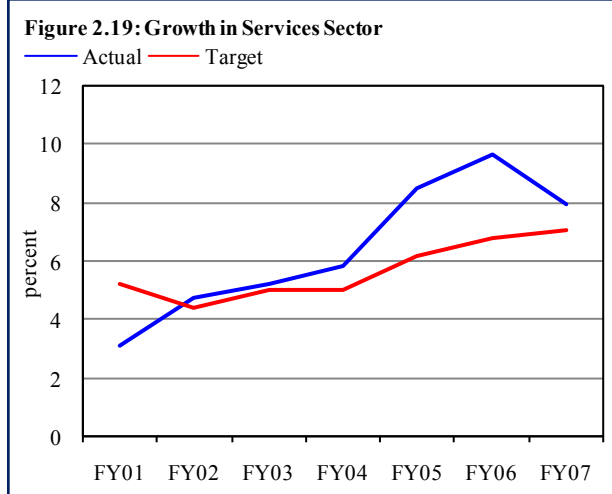


Table 2.12: Services Sector Targets vs. Actual Performance
percent

	FY05		FY06		FY07	
	Target	Actual	Target	Actual	Target	Actual
Services sector	6.2	8.5	6.8	9.6	7.1	8.0
Wholesale & retail trade	8.4	12.0	9.3	8.7	8.8	7.1
Transport storage & comm.	4.5	3.4	5.8	6.9	6.0	5.8
Finance and insurance	3.5	30.8	6.7	33.0	12.0	18.2
Ownership of dwellings	3.8	3.5	3.6	3.5	3.5	3.5
Public admin. & defense	6.5	0.6	3.5	10.0	3.7	6.9
Community, social & personal services	5.1	6.6	5.8	6.3	5.6	8.5

less relevance with current developments (see **Box 2.4**).

Box 2.4.: Data Issues in Services Sector

Services sector has proved its significance in economic growth during the past few years, with share of services sector reaching an all time high of 53.3 percent in FY07. Nonetheless, the data compilation process is not in line with the importance of the sector.

In contrast to the United Nations International Standard Industrial Classification (ISIC) Revision 4 for industrial classification outlines 15 categories for services sector data, data available in Pakistan for six sub-sectors namely, *wholesale & retail trade, transport storage & communication, finance & insurance, ownership of dwellings, public administration & defense and community & social services*. Since, international data reporting requirements include following these classifications (ISIC Revision 4 was approved in 2005 and is under implementation phase), Pakistan needs to reclassify the services sector for more disaggregated data collection and reporting.

Moreover, data reported across most of the categories is not compiled from source through surveys and value-added is estimated. For some sectors (e.g. *ownership of dwellings*), it is based on ratios/ growth rates compiled in a survey carried out in the re-basing year i.e. 1999-2000. While for others, data from some indirect source is extrapolated to get estimates of services sub-sectors, e.g. value added by road transport (with 70 percent share in *transport, storage and communication*) is calculated by applying a ratio calculated in 1996-97 survey to the number of vehicles on road during the year.

Although due to complex nature of services industry, data compilation from source is not possible each year, however using ratios calculated almost a decade ago, is unlikely to present a true picture of the developments. Hence, there is a need to streamline the data collection by carrying out in-field surveys more frequently..

Since individual services sub-sectors differ markedly and require diverse statistical procedures, improving services data by reclassifying the sectors and conducting regular surveys for updated information requires serious commitment. It should also be noted that the under ISIC Revision 4, number of sub-sector increased (see **Table 1**), it implies that the statistical agencies would require additional resources to perform this task effectively.

Table 1: Services Sector Under International Standard Industrial Classification (ISIC) Revision 4 (draft)

- Wholesale and retail trade; repair of motor vehicles and motorcycles
- Transportation and storage
- Accommodation and food service activities (Hotels & restaurants)
- Information and communication
- Financial and insurance activities
- Real estate activities
- Professional, scientific and technical activities
- Administrative and support service activities
- Public administration and defense; compulsory social security
- Education
- Human health and social work activities
- Arts, entertainment and recreation
- Other service activities
- Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use
- Activities of extraterritorial organizations and bodies.

A disaggregated analysis of the services sector reveals that the structural changes are evident within the services sector as well. The share of *finance & insurance* and *wholesale & retail trade* sub-sectors increased in the overall services sector. The *finance & insurance* sub-sector, in particular, has witnessed very strong double-digit growth rates during the last three years. Similarly, the *wholesale & retail trade* sub-sector improved its leading position in the services sector in recent years mainly due to increasing openness of the economy.⁸ This sector facilitates the transactions of the goods and services in the economy; it is the leading sector in urban areas in terms of employment generation.

⁸ External trade to GDP ratio increased from 25.8 percent in FY00 to 32.7 percent in FY07, after peaked at 35.2 percent in FY06.

2.4.1 Finance and Insurance

The growth momentum of the *finance and insurance* sub-sector continued into FY07. This owed mainly to a robust performance of the banking industry, although the insurance sector also did well. The sustained growth in the *finance & insurance* sector during recent years meant that its share in GDP has gradually increased from 3.1 percent in FY01 to 5.6 percent by FY07.

In recent years, the banking sector, in particular, has benefitted from significantly from the first generation financial sector reforms and the privatization of the large public sector institutions. As a result, profitability of the banking industry has seen significant growth in the last four years, including FY07. However, as in FY06, the dominant contribution to the strong value addition by the sector in FY07 was from SBP profits.

2.4.2 Wholesale and Retail Trade

Wholesale and retail trade sub-sector covers the trading activities in the economy, and value added in this sector reflects the margins taken by the traders for transactions of domestically produced and imported products, in the wholesale and retail markets. Services rendered by hotels and restaurants are also a component of this sub-sector. The wholesale & retail trade is the largest component of the services sector, contributing on average approximately one-third of the value addition in the services sector during the preceding four years.

The FY07 growth for this sub-sector has been estimated at 7.1 percent – the lowest growth rate in this sub-sector since FY03. The slowdown not only reflects the sharp deceleration in imports growth during the year, but also the impact of a deceleration in LSM growth during FY07. It is important to note that this sector is transforming towards modernization with the entry of large multinational chain stores. These new entrants are likely to bring new culture, management techniques and inventory systems, which would help the domestic trade sector to upgrade itself in the same lines.

2.4.3 Transport, Storage and Communication

As with *wholesale & retail trade*, growth in *transport, storage and communication* sub-sector also missed the target of 6.0 percent for FY07, but by a smaller margin. Value addition in the sub-sector increased by 5.8 percent during FY07, compared to the 6.9 percent in the preceding year, but even this is the second highest growth in this sub-sector since FY98.

The relative slowdown in the *transport & communication* sub-sector principally stemmed from a decline in three sub-sectors namely, *port and shipping*, *airlines* and *pipelines*, as well as decelerating growth in three other areas, namely, *communication*, *roads transport* and *storage* sub-sectors. The decline in airlines is a reflection of weaker performance of PIA during FY07, the fall in value-addition by the *pipelines* sub-sector is attributed to unrest in Baluchistan province, and negative contribution by *port & shipping* is principally driven from fall in port activities compared to the previous year. Encouragingly, *railway*

posted a healthy increase of 23.8 percent in its value addition during FY07 over an already high 12.0 percent growth achieved in FY06 (see **Table 2.13**). Significantly, the investment in *transport, storage and communication* sector grew strongly in FY07, attracting 25.3 percent of total investment in Pakistan. This was mostly concentrated in the telecommunications sub-sector.

Table 2.13: Transport, Storage & Communication Sector (Jul-Mar 07)

	% Share in value addition	Growth in percent	
Sub -sectors.	FY07	FY06	FY07
Pak railway	1.1	12.0	23.8
Port and shipping	2.6	11.2	-1.2
Airlines	4.0	-5.2	-9.8
Pipelines	0.6	-15.2	-7.4
Communication	16.0	6.3	5.7
Road transport	72.3	7.9	6.9
Storage	3.2	8.5	6.7
Transport, storage & communication		6.9	5.8

Source: Federal Bureau of statistics

Transport

In Pakistan, the transport sector includes *road & railway networks, ports & shipping, airlines and pipelines*. Provisional data for Jul-Mar FY07 indicates that the *transport* sub-sector registered 5.7 percent growth. It may be noted that the inefficiencies in terms of long waiting, high travelling time and delays in goods delivery renders high costs of doing business. More importantly, these inefficiencies make domestic firms less competitive in foreign markets where timely deliveries are required.

Road transport provides about 90 percent of the country's transport needs. Poor infrastructure as well as low investment in truck fleet and stiff price competition has led to deterioration in quality of services. During FY07, growth in the road transport sector decelerated to 6.9 percent from 7.9 percent in the preceding year.

In contrast, performance of railways was better during FY07, which is evident in the 23.8 percent growth in value addition during FY07⁹ compared with 12.0 percent growth in FY06. It may be noted that the share of railway in overall transport sector has declined over the years, which reflects a substitution between rail services to road services mainly due to inefficiencies in railways operations. The inefficiencies are especially evident in the aged infrastructure and poor business practices. There is a need to revamp Pakistan Railways operations on commercial basis under an autonomous corporation.

Table 2.14: Cargo Handling-Growth
percent

	FY05	FY06	FY07
Port Qasim			
Imports	41.5	10.1	11.0
Exports	20.6	14.5	19.0
<i>Total</i>	<i>36.2</i>	<i>11.1</i>	<i>12.8</i>
KPT			
Imports	1.7	15.5	-9.8
Exports	7.1	2.5	10.3
<i>Total</i>	<i>2.9</i>	<i>12.5</i>	<i>-5.6</i>
Total (Port Qasim + KPT)			
Imports	15.6	13.2	-1.2
Exports	12.4	7.6	14.2
<i>Total</i>	<i>14.9</i>	<i>11.9</i>	<i>2.2</i>

Similar to railways, the share of airlines has remained very low in the transport sector at around 5 percent. This reflects lack of true competition in the market as well as lack of efforts to run the market on commercial lines. Efforts are needed to boost the competition in the market. FY07 value addition by the air transport sector witnessed a 9.8 percent fall, mainly reflecting the poor performance of the national airlines, PIA, where profitability was hit mainly by high energy costs.

Shipping and Port Activities

A slowdown in imports and exports is also evident in port activities during FY07. The major cause of this deceleration is a decline of 9.8 percent in imports related cargo handling at KPT during FY07 (see **Table 2.14**).¹⁰ This is not surprising given a visibly lower growth in imports during FY07 relative to FY06. However, the reported jump in export related cargo at both, KPT and Port Qasim, is a little surprising, given the sharp drop in the growth of Pakistan's exports during FY07.

Communication

Value addition in communications sub-sector registered 5.7 percent rise in FY07, dropped from 6.3 percent during FY06. The slowdown in growth of value addition is attributable to saturation in the *telecom* sector and deceleration in *postal & courier* services (see **Table 2.15**).

⁹ Gross earnings of the sole entity "Pakistan Railways" rose by 12.7 percent against a mere 0.9 percent rise observed in the preceding year.

¹⁰ Despite the increase in cargo handling for imports at Port Qasim, the overall cargo for imports saw a decline during FY07 due to the fact that the total cargo handling at KPT is almost double that of Port Qasim. Thus, the effect of the decline in imports at KPT has overshadowed the increase of the import through Port Qasim.

The telecom sub-sector has benefited from the liberalization and government incentives, and showed a strong growth in recent years. Keeping in view the role of sector in job creation, this expansion seems very encouraging. For FY07, value addition by the sector has witnessed 4.8 percent growth. Importantly, despite a decline in the charges of telecom services, revenue growth remained impressive due to increased demand (see **Figure 2.20**).

Cellular services in particular are growing strongly, amidst declining tariffs due to intense competition. For FY07, number of cellular subscribers increased to 65.6 million from 36.7 million in FY06. Also, cellular teledensity¹¹ in the country improved to 41.51 in FY07 up from 26.7 in the previous year.

Other segments of telecom sector have exhibited a mix picture in FY07 with a fall in fixed line subscribers, and a marginal rise in wireless local loop subscribers (see **Box 2.5**).¹² On the other hand, internet subscribers¹³ have increased tremendously during FY07 mainly due to (1) reduction in prices of PCs and laptops, as well as (2) a fall in internet charges and availability of cheap internet cards. In addition, liberalization policies of the government have positive impacts on the growth of electronic media in Pakistan. According to PEMRA report 2003-06, electronic media is earning annual advertisement revenue of around Rs 3 billion, while cable TV revenue amounts to almost Rs 5 billion. The total receipts of PEMRA amounted to Rs 626 million in FY06 up from Rs 138 million in FY05. Major component of these receipts is originating from cable TV and FM radio services (see **Figure 2.21**).

2.5 National Savings

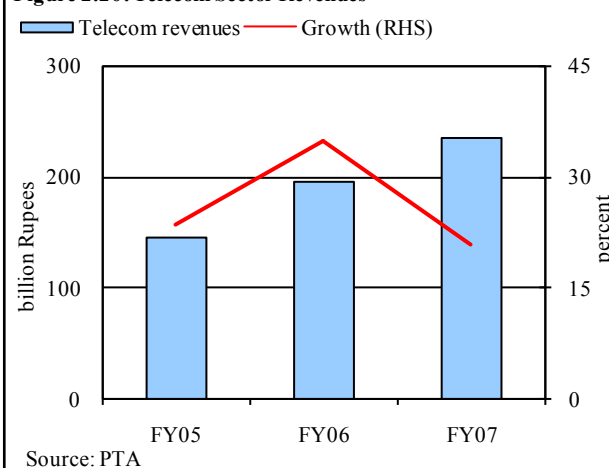
During FY07, national savings rose sharply by 19.8 percent, raising its share in GDP to 18.0 percent - the highest in the last four years (see **Figure 2.22**). The improvement in national savings is driven by

Table 2.15: Communication Sector Indicators (Jul-Mar)
numbers

	FY05	FY06	FY07
Post Offices	12107	12411	12,339
Telephones	5052	5174	5,200
Internet connected cities	1900	2339	2,444
PCOs	217,597	236,166	353,194
Mobile phones	10,542,641	27,344,938	55,600,211

Source: Economic Survey of Pakistan 2006-07

Figure 2.20: Telecom Sector Revenues



Box 2.5: WLL Services

Wireless local loop services were started in Pakistan in 2004 as a new segment of telecom sector with the basic aim to provide telecom accessibility to remote areas of Pakistan. Initially 17 companies were licensed to operate in 14 regions of Pakistan, out of which only 4 companies are operational so far. These four companies namely Telecard, World Call, Great Bear and PTCL have shown expansion with their subscriber base reaching above 1.9 million in 2006-07. Sluggish growth in wireless local loop services is primarily due to (1) non-availability of required investment from the operators, (2) lack of effective marketing from the market players and (3) higher tariffs being charged

Although this telecom segment is expanding over time, its penetration in rural areas needs special focus especially the higher tariffs being charged are not in conformity with its purpose to cater to rural population which falls in lower income group of the country.

Source: PTA website

¹¹ Teledensity is defined as “the number of landline telephones in use for every 100 individuals living within the country.”

¹² Wireless local loop is the use of a wireless communications link as a connection for delivering plain old telephone services (POTS) and broadband Internet to telecommunications customers.

¹³ Number of DSL subscribers reached 32.2 thousand in March 2007, up from 26.6 thousand in June 2006.

a 21.4 percent rise in domestic savings (21.4 percent) as well as a 7.2 percent increase in *net factor income from abroad*.

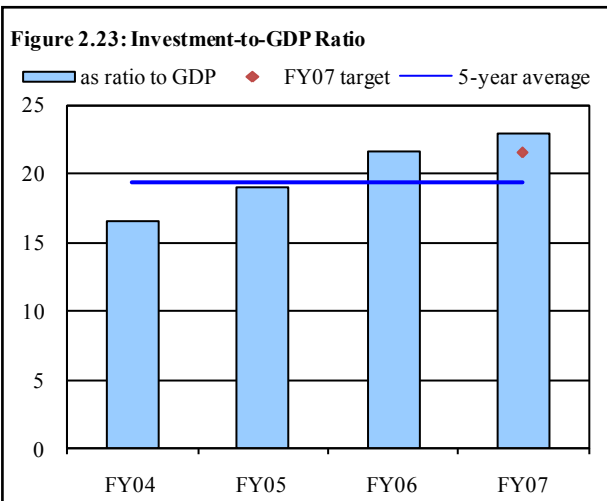
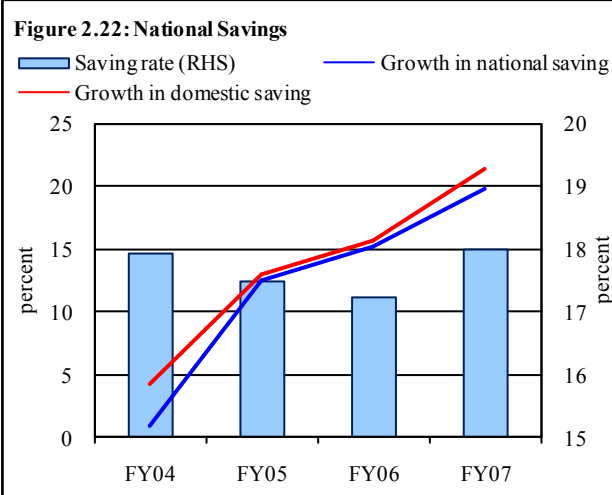
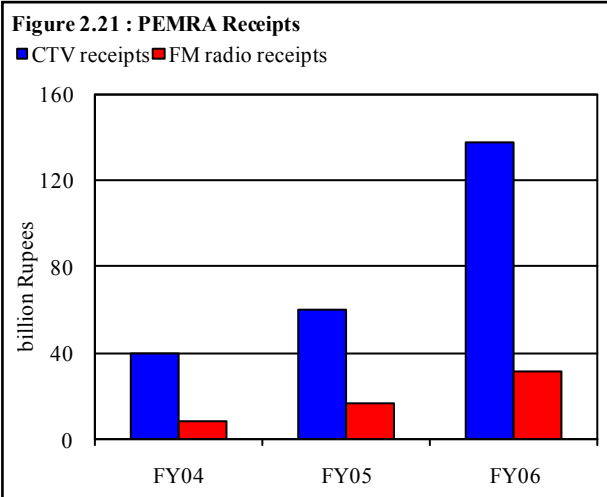
It should be noted that despite a rise in FY07, Pakistan's savings to GDP ratio remains quite low relative to other emerging economies. To maintain the growth momentum, there is a need of investment flows in the economy without putting pressures on external balances; this is only possible by a rise in savings in the economy. The main causes of low savings in Pakistan are: low per capita income, lack of proper saving infrastructure (particularly in small towns and rural areas), overall spendthrift attitude of the people, and high dependency ratio. At the same time, loss-making public commercial enterprises and a large fiscal deficit are sources of drag on public savings. Moreover, a significant part of household saving in Pakistan remains in informal instruments, e.g., business committee system, gold and silver holding.

To increase the savings rate, it is necessary to expand the network of banks, microfinance institutions, and postal savings to the far flung areas with simple procedure and friendly atmosphere for small depositors. In addition, savings schemes for school/college students could also help inculcate savings behavior from an early age.

2.6 Investments

The sustained high pace of growth in the economy is also reflected in a record level of investment during FY07, with the investment to GDP ratio rising to a record high of 23 percent (see **Figure 2.23**). This impressive performance is a result of sustained growth in the economy, continued strength of domestic demand, a sharp rise in foreign direct investment (FDI)¹⁴ amidst easy international liquidity in favor of emerging market economies as well as a healthy increase in the public sector development program (PSDP).

In particular, public sector investment in infrastructure is resulted in higher private investment in recent years (see **Figure 2.24**).



¹⁴ For details see **Section 7.3.2**.

Another striking feature was the unprecedented level of FDI (US\$ 5.1 billion) in the economy. The major sectors which accounted for the bulk of FDI are *communication, oil & gas exploration, tobacco & cigarettes, construction and trade* (for details see **Chapter 7**).

2.7 Saving-Investment Gap

Despite a significant rise in national savings during FY07, saving-investment (S-I) gap widened further from 4.5 percent of GDP during FY06 to 5.0 percent of GDP in FY07, the highest level since FY97. The deterioration entirely stemmed from public sector dis-savings. In contrast, despite strong growth in private investment, the savings-investment gap for the private sector declined (see **Figure 2.25**).

Table 2.16 shows that the savings to GDP ratio Pakistan remained low compared with the regional economies. While the low saving-investment gap in 1990 and 2000 was principally a result of the subdued investment in the economy, as investment needs of the economy emerged, this gap also widened in 2006.

Sustaining a high investment rate is a pre-requisite to retaining the growth momentum of the economy and it should also be remembered that while any country can afford large saving-investment gap, this is not desirable in long-run, due to its negative impacts on macroeconomic stability. The large saving-investment gap results in accumulation of external debt and put additional burden on country's balance of payments in terms of mounting debt-servicing. As a result, country seeks more external debt to service its debt obligation and falls into a debt trap. In this

Table 2.24: Real Fixed Investment as percent of GDP

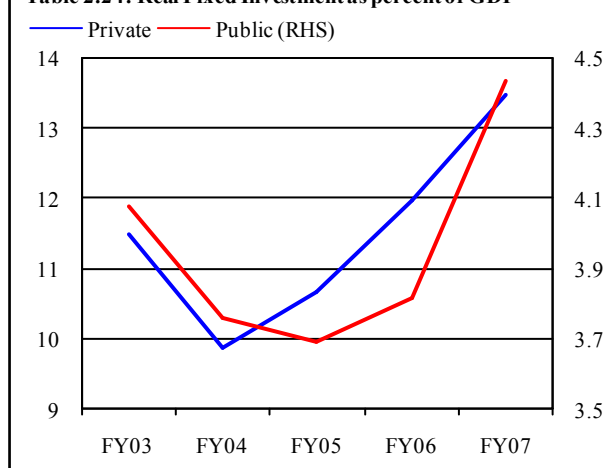


Figure 2.25: Saving-Investment Gap

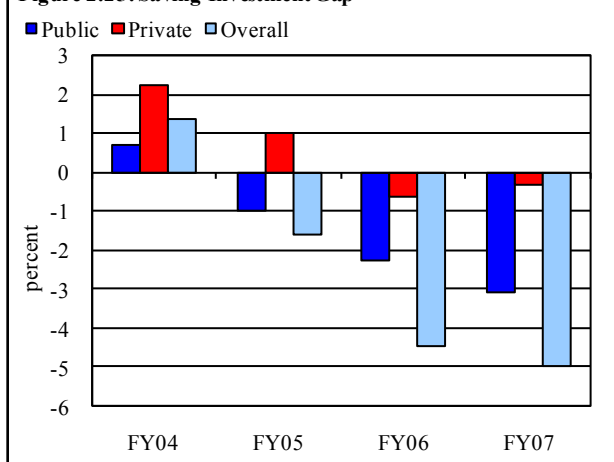


Table 2.16: Domestic Saving, Capital Formation, and Resource Gap
percent of GDP

Country	Gross domestic saving			Gross capital formation			Resource gap		
	1990	2000	2006	1990	2000	2006	1990	2000	2006
China	35.2	38.0	47.3	36.1	35.1	44.9	-0.9	2.9	2.4
South Korea	37.3	33.9	31.7	37.5	31.0	29.8	-0.2	2.9	1.9
Indonesia	32.3	31.8	28.7	30.7	22.2	24.6	1.5	9.6	4.1
Malaysia	34.4	46.1	43.0	32.4	26.9	20.7	2.0	19.2	22.3
Philippines	18.7	17.3	18.3	24.2	21.2	14.3	-5.5	-3.9	3.9
Singapore	44.0	46.9	50.5	37.1	33.3	18.8	6.9	13.6	31.7
Thailand	34.3	30.4	29.5	41.4	22.8	31.5	-7.1	7.5	-2.0
Bangladesh	12.9	17.9	20.3	17.1	23.0	25.0	-4.2	-5.1	-4.7
India	22.8	23.7	32.4	26.0	24.3	33.8	-3.2	-0.6	-1.3
Sri Lanka	13.2	17.5	17.0	21.2	28.1	28.4	-8.0	-10.6	-11.4
Pakistan	13.5	16.0	13.7	18.9	17.2	21.8	-5.5	-1.2	-8.1

Sources: Asian Development Bank - Key Indicators 2007 (www.adb.org/statistics)

situation, exchange rate depreciates, domestic interest rates increase, and fiscal deficit rises, these imbalances, most of the time, result in sustained high inflation and low economic growth.