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To be recognized in the market place by Institutionalizing a merit & performance culture, Creating a powerful & distinctive brand identity, Achieving top-tier financial performance, and Adopting & living out our core values.

ECONOMIC BULLETIN

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Contents

Editor's Corner

Dear Readers,

The trade talks held in Hong Kong, December 13-18, were shaped by the development agenda set at Doha in 2001; agriculture, non-agriculture market access (NAMA), services, WTO rules on anti-dumping, subsidies, regional trade agreements, trade facilitation and development issues, and scepticism about the survival of the WTO even before the talks began. Prior to the start, World Bank President Paul Wolfowitz had said the stakes for the poor and for the world economy are too big to allow the Doha Round to fail. The trade related issues discussed were critical for both the developing and the developed nations. It was recognized that the global trading system was unequal and unfair for most of the world, particularly in agriculture where high barriers to trade, the elimination of export subsidies, the principle of greater reductions of higher tariffs and deeper cuts in larger subsidies were the main issues which needed resolution. As these were crucial to the world's poor, about 1.2 billion people, they dominated the talks in the hope that the full modalities in respect of agriculture and NAMA would be agreed upon. The talks managed to avoid a collapse, and attained a modest development package which averted a crisis. However, there is still a long up-hill journey to achieve an equitable world trading system which responds to the aspirations of the under-developed world and its people.

Inequities in the world trading system have placed the developing countries at a disadvantage, as liberalisation has progressed at different paces for different countries and in different sectors reflecting previous trade rounds. Developing countries would only gain if global markets open to more people, either through multilateral or regional trade negotiations, and the prospect of new "aid for trade" regime emerging to help the poorest countries invest in infrastructure and institutions. All of these are germane for equitable participation in the global marketplace.

Subsidies that the rich states provide to their farmers makes them highly unpopular with poor country farmers. They find it hard to compete against unjustified subsidised prices. These huge subsidies far outweigh the aid given to developing countries. While rich countries pledge to reduce the size of their farm support, but so far little has changed. The world's 30 rich countries gave $305 billion as subsidies to support their non-agricultural industries, and doled out a pittance, only $50.6 billion, as development assistance to poor countries in 2000.

Both the US and EU subsidise their farmers. Direct assistance to US cotton producers reached $3.3 billion, while the European Union's support was $979 million in 2003. While this benefits the farmers in these two regions, they harm poor, small farmers in the rest of the world. Cotton is a major commodity for a number of poor African and Central American countries contributing upto 40 percent of merchandise exports and 5 – 10 percent of GDP.

Under strong pressures from most WTO members, the European Union agreed to set 2013 as the final deadline for phasing out all export subsidies. The EU had the greatest difficulty on this issue, and the agreement was reached at the last minute. Members would be meeting next year to complete 'full modalities' in agriculture and non-agricultural market access by the new deadline they have set themselves, 30 April 2006.

For cotton, there has been an agreement to eliminate export subsidies by end of 2006, a relief for cotton producing developing countries. In addition, cotton exports from least developed countries will be allowed into developed countries without duty or quotas from the start of the period for implementing the new agricultural agreement. The four African countries, who were keen to arrive at an agreement on cotton were Bali, Burkina Faso, Chad and Mali. They had argued that they were losing $400 million a year because of unfair cotton subsidies. African cotton growing countries charge that the price and income supports endanger the livelihoods of some 15 million subsistence farmers living on less than a $ a day. As subsidies depress world cotton prices by 10-20 percent, it depresses the income of thousands of poor farmers in West Africa, Central and South Asia and other poor countries. In West Africa alone, where cotton is a major cash crop for many small farmers, annual income losses for cotton growers surpass $150 million annually.

The demand of cotton growers drew the support from more than 100 other developing countries. US negotiations had initially resisted giving up the subsidies, saying cotton should not be considered separately from overall farm trade issues and deal must be done as part of comprehensive agricultural settlement. Some other issues will be discussed in 2006. These includes among others, NAMA, where tariffs will be cut by a Swiss formula, with differential coefficients for developed and developing countries; on market access for agricultural products, import duties will be cut after grouping them into four bands etc.

Hong Kong gave birth to the placement of developing country interests at the heart of the negotiations and their views are being heard.

Ayesha Mahmud

Trade and Poverty Reduction

Extreme poverty has fallen

Poverty is perhaps one of the greatest challenge the countries of the world, especially the developing countries where more than one person in five subsists on less than a $ a day face today. Since 1990, extreme poverty in developing countries has fallen from 28 percent to 21 percent. Population meanwhile has grown to 6 billion people, where 1.1 billion people live in extreme poverty. The majority of these poor live in South Asia and Sub-Saharan Africa.

Inequality between rich and poor nations

Statistics show the inequality between the rich countries where fewer than one child in 100 does not reach its fifth birthday, and the poorest countries where as many as a fifth of children do not. And while in rich countries fewer than 5 percent of all children under 5 are malnourished, in poor countries as many as 50 percent are.

Millennium Development Goals

Faced with poverty and inequality, the international community has set itself several goals, based on discussions at various United Nations conferences in the 1990s. These international development goals, most for 2015, include, reducing income poverty and human deprivation in many dimensions. The first target of the Millennium Development Goal (MDG) is to halve between 1990 and 2015, the proportion of people living on less than a $ a day and halve, between 1990 and 2015, the proportion of people who suffer from hunger.

This and the other goals; ensure universal primary education; eliminate gender disparity in primary and secondary education; reduce infant and child mortality by two-thirds; reduce maternal mortality by three quarters; ensure universal access to reproductive health services; and implement national strategies for sustainable development in every country by 2015 so as the reverse the loss of environmental resources, will have to be achieved in a world whose population will grow by some 2 billion people in the next 20 years with the majority of that increase taking place in developing countries.

5 point agenda to achieve MDGs

Global Monitoring Report 2005, produced jointly by the World Bank and IMF has identified a five point agenda for accelerating progress towards the MDGs. There are: -

§ Anchor efforts to achieve the MDGs in country led development strategies.

§ Improve the environment for stronger, private sector led economic growth.

§ Scale up human development services.

§ Dismantle barriers to trade.

§ Substantially increase the level and effectiveness of aid.

Let us look at what the Report has to say about removing barriers to trade as a tool to help achieve the MDGs. "Multilateral, reciprocal, nondiscriminatory trade liberalization offers the best approach for supporting development. Rapid conclusion of an ambitious Doha Round is therefore of great importance."

In this context the points highlighted include among others; transforming agricultural trade policies in OECD countries, reducing the trade restricting effects of non tariff measures, and safeguarding and expanding the scope for developing countries to contest services markets.

Trade liberalization to be accompanied by other policies

Trade restrictions in developing countries would have to be further liberalized to realize the full potential of trade for development. While trade is the engine of growth, but it needs to be complemented by many other policies. Any changes that are initiated would be within the broader context of development and poverty reduction strategies. The given argument for trade liberalization is that total gains exceed total losses — especially over time — and that gainers can compensate losers while still improving their welfare. An ambitious Doha Round would generate substantial gains, providing a basis for transferring additional resources to low income countries to enhance trade capacity.

Successful Doha outcome — significant liberalization commitments, by both developed and developing countries, accompanied by a commitment to convert a part of the gain into increased aid to the poorest countries would enhance their trade capacity and send a signal that political will exists to leverage trade to help achieve the MDGs.

Trade has assumed significance as countries of the world come closer. There is evidence available in literature which shows that countries that have intensified their links with the global economy through trade and investment have usually grown more rapidly and have consequently experienced larger reductions in poverty. Many developing countries however, have lagged behind because of their own inadequate policies, infrastructure and by the protectionist policies adopted by the rich countries that restrict low income countries exports.

It is here that WTO policies can play a central part, so that it is more supportive of development, especially in the poorest countries and for poor people across the developing world.

In a World Bank publication, *Poverty and the WTO: Impacts of the Doha Development Agenda*, the first chapter, Poverty Impacts of a WTO Agreement: Synthesis & Overview by Thomas W. Hertel & L. Alan Winters reports on the findings from a major international research project investigating the poverty impacts of a potential Doha Development Agenda (DDA).

Main findings of the Report

Some of the main findings are:

§ The liberalization targets under the DDA have to be quite ambitious if the round is to have a measurable impact on world markets and hence poverty.

§ Assuming an ambitious DDA, the near-term poverty impacts are found to be mixed; some countries experience small poverty rises and others more substantial poverty declines. On balance, poverty is reduced under this DDA, and this reduction is more pronounced in the longer run.

§ Allowing minimal tariff cuts for just a small percentage of special and sensitive products virtually eliminates the global poverty reduction due to the DDA.

§ Deeper cuts in developing country tariffs would make the DDA more poverty-friendly.

§ Key determinants of the national poverty impacts include the incomplete transmission of world prices to rural households, barriers to the mobility of workers between sectors of the economy, and the incidence of national tax instruments used to replace lost tariff revenue.

§ To generate significant poverty reductions in the near term, complementary domestic reforms are required to enable households to take advantage of new market opportunities made available through the DDA.

§ Sustained long-term poverty reductions depend on stimulating economic growth. Here, the impact of the DDA (and trade policy more generally) on productivity is critical. To fully realize their growth potential, trade reforms need to be far reaching, addressing barriers to services trade and investment in addition to merchandise tariffs.

Increased manufactures exports

The chapter states, "international trade is arguably the most direct economic means by which rich countries influence poor countries. Exports of manufactures by developing countries have increased rapidly over the last 30 years, due in part to falling tariffs in the Organisation for Economic Co-operation and Development (OECD) countries as well as in developing countries, declining transport costs, increased specialization, and sustained economic growth. Manufactures accounted for just 25 percent of developing country exports in 1965, and this share tripled to nearly 75 percent over the next three decades, while agriculture's share o developing country exports has fallen from 50 percent to under 10 percent. Increased manufactures trade has benefited many developing countries, helping them make the transition out of agriculture and lifting many out of poverty.

Some of the poorest developing countries, however, have gained relatively little from increased manufactures trade. Market access for their most competitive manufactured exports (apparel) remains highly restricted, as it does for their key source of employment and exports, farming, and the problem with agricultural exports is exacerbated by the massive government subsidies provided to farmers in OECD countries. When poverty within the poorest countries is considered, developed countries' agricultural policies become even more central. A majority of the poor are concentrated in rural areas, where agriculture is usually the main source of economic activity (World Bank 2004), and in the poorest developing countries, large shares of households (including most of the very poorest) depend on self-employment in agriculture for virtually all of their income. Together, these facts highlight the potential influence that multilateral trade policies can have on poverty in developing countries.

Agricultural policies in rich countries are central to poverty

Various conferences sponsored by the WTO at periodic intervals have not made much headway, because of the question of rich countries' agricultural support and its impact on poverty in developing countries. The Doha negotiations are now emphasizing the need to better understand the linkages between trade policies — particularly in rich countries and poverty in the developing world. Poverty reduction is now widely accepted as a central focus for development efforts.

The issue of trade and developing country poverty is the focus of much research activity for the last several years. The mentioned book offers a comprehensive analysis of the national poverty impacts of specific policy reforms proposed under the auspices of the WTO.

One of the chapters in the book talks extensively about cuts in tariffs and market access to give development stimulus. It is not just agriculture and non agricultural market access, in the Doha Development Agenda the other issues for example, are trade facilitation, service liberalization and rules on antidumping and regionalism. It seeks to answer what impact would significant cuts in agricultural and non-agricultural protection have on poverty.

At the WTO meeting in Hong Kong recently the trade deal agreed upon moved the process of trade negotiations forward, as it agreed to end one type of agricultural subsidies, export subsidies by 2013. For cotton the elimination is accelerated to the end of 2006. In addition, cotton exports from least developed countries will be allowed into developed countries without duty or quotas from the start of the period for implementing the new agriculture agreement. Cotton farmers in West Africa will benefit.

Household impact of trade reform

Another chapter from the same book studies the issue of household level impacts of the price changes ensuing from trade reforms. It has studied the impact of trade reform on cotton producers in Zambia, where the share of household income generated by cotton production is the critical factor. It has shown the largest poverty reduction benefits appear to arise when subsistence households switch to cotton production in the wake of increased demand for exports. All else constant, subsistence producers could boost their incomes by nearly 20 percent if they switched to cotton production.

"When combined with improved extension services and higher cotton prices, the switch from subsistence production to cotton could boost incomes of some of the poorest households in Zambia by nearly one-third. In sum, while trade reform alone is not sufficient to raise a large number of poor out of poverty in Zambia, but when the market opportunities presented by trade reforms are combined with complementary domestic reforms, significant headway in the fight against poverty is possible."

Global trade reforms do not simply alter one single commodity price rather they affect all prices in the economy, including wages. The study has discussed how agricultural trade reform would benefit Brazil.

However the real question is, which households within Brazil will benefit? Many believe that all of the benefits will go to large farmers, thereby worsening the income distribution in Brazil. The research argues that, when one takes account of the additional employment generated by the expansion of agriculture and related industries in many of the poorer states of Brazil, the largest gainers are actually the households that are most heavily reliant on low-skill labour.

The paper, *'Trade Growth and Poverty'* by Aart Kraay and David Dollar, supports the view that globalisation leads to faster growth and poverty reduction in poor countries. The authors have identified a group of countries that are participating more in globalisation. China, India and several other countries are a part of this group, so well over half the population of the developing world lives in these globalizing economies. Their growth rates accelerated between the 1970s and the1980s and again between the 1980s and the 1990s. The authors examined the effects of trade on the poor. They find little systematic evidence of a relationship between changes in trade volumes and changes in the income share of the poorest or between changes in trade volumes and changes in household income inequality.

Economic growth helps increase incomes

They conclude, therefore, that the increase in growth rates that accompanies expanded trade translates on average into proportionate increases in incomes of the poor. Absolute poverty in the globalizing developing countries has fallen sharply in the past 20 years. The evidence from individual cases and from cross-country analysis supports the view that globalisation leads to faster growth and poverty reduction in poor countries.

The above study includes besides India other countries of South Asia. For the region as a whole, the period 1985-2000 saw significantly higher per capita GDP growth performance. The effect on reduction in poverty in India was dramatic, implying that growth is the principal driver of poverty reduction.

A report of the World Bank, *'Trade Policies in South Asia; An Overview'*, September 2004, states; "For the South Asian developing countries, well endowed with labor, trade openness is expected to stimulate production and expansion of labor-intensive exports, thus generating employment, raising wages, and thereby reducing poverty. But the linkage between greater trade openness and poverty reduction need not be direct, but rather through the positive impact of trade expansion on growth performance — a correlation that has been established in extensive empirical research. Cross-country studies on the relationship between growth performance and poverty reduction lead to the conclusion that there exists a close correspondence between growth of per capita income and growth of incomes of the poor, though not all growth is necessarily pro-poor.

Correlation exists between economic growth and poverty reduction

More importantly, trade openness is a necessary, not a sufficient condition for rapid growth. Trade policy reforms generally need to be accompanied by complementary measures for ensuring macroeconomic stability and efficient financial intermediation, improving infrastructure services, removing burdensome regulations and in these and other ways, improving the investment climate for private enterprises. "

A UNDP paper, *'Trade Liberalisation, Macroeconomic Performance and Poverty Reduction: The Asian Experience'*, April 2005 has examined the impact of trade liberalization on macroeconomic performance. Cross country data has been analysed, to answer certain major questions, which includes among others, how trade liberalisation works to the advantage or disadvantage of the poor. How important is export growth for poverty reduction.

The paper while analyzing the affects of trade liberalisation, says "no conclusive evidence exist on the direct impact of trade liberalisation on poverty reduction. Though the evidence is somewhat mixed, it leans towards the conclusion that there is no systematic relationship between trade variable and the income of the poorest, beyond the effect of trade on overall growth.

"The accompanying table gives the rate of export growth, economic growth and poverty reduction in sample countries. We distinguish

Box

Trade, Growth and Poverty: A Selective Survey

Andrew Berg and Anne Krueger - IMF Working Paper, February 2003

The above mentioned paper has surveyed recent literature about trade policy and poverty to ask how important trade policy is for poverty reduction. It has analysed the effects of openness on poverty in two components; the effects of openness on average income growth, and the effect on distribution for a given growth rate. The paper has also raised two main questions: is trade openness an important determinant of growth, and is the growth that is associated with trade liberalization particularly pro-or-anti-poor?

We give below excerpts from the paper and see the conclusion they have arrived at.

We focus on the links between trade and growth because changes in average per capita income are the main determinant of changes in poverty. In the past 20 years, the share of extremely poor people in the world (those living on less than two 1985 dollars per day) has fallen sharply, from 38 percent in 1978 to 19 percent in 1998. Because of population growth, the absolute numbers of poor have declined less, though the reduction in the number of poor from 1.4 billion to 1 billion is probably unprecedented. These changes in poverty are almost entirely attributable to growth itself, not changes in the world income distribution. More generally, there is no systematic relationship between growth and changes in income distribution. Thus, the income of the poor tends to grow proportionally with mean per capita growth.

This suggest that our focus on growth as the core of a poverty-reduction strategy is well-founded. Changes in income distribution could still be important sources of changes in poverty within countries, however, even if they tended to “average out” across countries. Moreover, if faster growth were associated with worsening income distribution, then there would be a limit on how much improvement in poverty we could expect from growth alone. In fact, neither concern turns out to challenge the primacy of growth in driving poverty reduction.

Even though in general changes in poverty are mostly due to changes in average incomes, it might be that the growth that is due to trade liberalization is different from growth in general. That is, it is possible that trade liberalization generates a sort of growth that is particularly anti-(or pro-)poor. There are strong reasons to suppose that trade liberalization will benefit the poor at least as much as it benefits the average person. If, nonetheless, trade liberalization worsens the income distribution enough, then it is possible that it is not after all good for poverty reduction, despite its positive overall growth effects.

Most empirical analyses of openness look directly at policy measures that restrict trade, such as tariffs, non-tariff barriers, and so on. Severe problems arise in the analysis of each of these measures. It is not clear how to aggregate across goods to arrive at a meaningful overall measure. A higher tariff (or tariff-equivalent) on commodity A may have lower welfare costs than a lower tariff on commodity B; the same tariff rate may have different effects in different countries; issues arise in comparing different tariff structures regarding the dispersion of tariff rates, and so on. Simple averaging does not capture the relative importance of different categories of goods, while using actual trade weights gives too little weight to high-tariff categories, precisely because the tariff has discouraged trade in that good.

The literature on trade and growth is almost as vast as that on growth itself, since openness is a part of much recent theory and most empirical work. Disagreements and contradictions abound. We can, however, extract several principles that are both plausible and well established. Overall, and perhaps not surprisingly, we find that, while there are deep problems with the measurement of openness, and while establishing causality from openness to growth is difficult, the weight of the evidence, from a variety of sources, is strong to the effect that openness is an important element explaining growth performance.

There is some evidence of absolute convergence, at least for sufficiently similar regions within countries and, less clearly, for countries that are integrated through trade. That is, poor countries or regions tend to grow faster than rich regions if they are sufficiently integrated with each other. This suggests that poor countries will grow, and reduce poverty, if they are sufficiently open.

Among regions that are sufficiently open to each other in all senses and with sufficiently similar overall policy environments, poorer ones tend to grow faster than average.

Case studies have also tended to show benefits from trade liberalization. Clearly, opening to trade does not guarantee faster growth. But one striking conclusion from the last 20 years of experience is that there are no examples of recent take-off countries that have not opened to an important extent as part of the reform process.

Individual case studies inevitably present a varied picture. Country experiences differ radically and trade is only part of the story. Disentangling the various factors is difficult. In our view, though, a common thread across most successful cases of ‘take-off’ is a significant degree of trade liberalization, even if this is not obviously decisive in each case and even if it is not sufficient.

Perhaps the central finding from the large cross-country studies of trade liberalization in the 1970s and 1980s was the highly distortionary nature of the import substituting regimes being considered; these proved to be much greater than the simple average tariff rates would suggest. These studies emphasized the ways in which inward-oriented trade policies reinforced poor macroeconomic and exchange rate policies. In their careful study of the differences between inward-and outward-oriented regimes in practice, these analyses can be contrasted with many recent discussions of the merits of openness, which are impoverished through a lack of a concrete counterfactual.

There are strong reasons to suppose that trade liberalization will benefit the poor at least as much as the average person. Trade liberalization tends to reduce monopoly rents and the value of connections to bureaucratic and political power. In developing countries, it may be expected to increase the relative wage of low-skilled workers. Liberalization of agriculture may increase (relatively low) rural incomes. On the other hand, trade liberalization might also worsen the income distribution, for example by encouraging the adoption of skill-biased technical change in response to increased foreign competition.

If trade liberalization worsens the income distribution enough, particularly by making the poor poorer, then it is possible that it is not after all good for poverty reduction, despite its positive overall growth effects. We have seen that this seems unlikely based on the weak general relationship between growth and inequality. But perhaps trade-based-growth is different.

Though the evidence is somewhat mixed, it leans strongly towards the conclusion that there is no systematic relationship between openness and the income of the poorest, beyond the effect of openness on overall growth.

On the question of whether the poor benefit more or less than others, no clear pattern emerges from the numerous studies of individual liberalization episodes. This is not surprising, as any particular liberalization will change relative prices and incentives throughout the economy. A few generalizations can nonetheless be extracted from these studies. Poor consumers tend to benefit from trade liberalization as do other consumers. Liberalization of agricultural trade typically has the strongest effects on the poor, since in most countries most poor are engaged in small-scale agriculture. In general, trade protection usually induces an anti-agricultural bias, so liberalization should help; the poorest among small farmers may, though, be relatively ill placed to benefit.

We have examined a large amount of evidence about the effect of openness on growth and poverty. Much of this evidence is vulnerable to the criticism that the effect of openness has not been isolated from the effects of many other reforms that were often implemented at the same time. In the case studies and before-after comparisons, for example, effects of liberalization of trade are hard to disentangle from the effects of macroeconomic stabilization, internal price liberalization, changes in the foreign exchange system and the exchange rate, liberalization of the capital account, the introduction or elimination of social safety net programs, and a host of other measures.

This correlation of openness with other elements of reform is indeed a difficult econometric problem. We do not consider it to be a problem from the point of view of the design of reform programs, however. First, trade is a particularly important component of reform. Second, trade openness has important positive spillovers on other aspects of reform so that, on the whole, the correlation of trade with other pro-reform policies speaks to the advantages of making openness a primary part of the reform package. Finally, there is little evidence that there are other reforms that must precede an effective trade reform, though there are many reforms that are complementary.

There are a variety of reasons why trade openness might promote other sorts of reforms. Openness provides powerful channels for feedback on the effect of various policies on productivity and growth. For example, competition with foreign firms can expose inefficient industrial policies. Trade raises visibility of failure in other areas. Trade raises the marginal product of other reforms, in that better infrastructure, telephones, roads, and ports translate into better performance of the export sector and, less visibly, this raises productivity for domestic goods as well. Trade liberalization may change the political reform dynamic by creating constituencies for further reform.

We have surveyed the literature and extracted three main propositions about the trade policy and poverty: (1) poverty reduction is mainly about growth in average per capita income; (2) trade openness is an important determinant of growth; (3) the growth that is associated with trade liberalization is as pro-poor as growth in general.

On the first proposition, there is ample evidence that the main cause of changes in absolute poverty is changes in average per capita income. Long-run trends reinforce the point that the relationship between poverty and openness is dominated by growth. First, within-country inequality has been relatively stable and not a source of much of the change in overall global inequality.

By concluding that openness tends to increase growth, we suggest that if poor countries opened more, poverty would fall.

With respect to the second proposition, the evidence that trade openness is an important determinant of growth is varied. First, we know that countries and regions that are sufficiently similar along a broad number of dimensions, such as states in the United States, regions of Europe, or even countries of the OECD, tend to converge to similar levels of income. It is plausible that trade openness is an important part of this convergence process and hence part of bringing poverty rates down in poorer countries. Of course, many other factors are potentially at play in this convergence process.

Cross-country and panel regressions allow us to examine the separate roles of some of these factors. In cross-country regressions of the level of income on various determinants, openness seems to be the most important policy variable, despite the measurement problems. The toughest question is how to disentangle the effects of openness from those of the good institutional environment that usually accompanies openness. A quick perusal of the variables considered in measuring good institutions makes it clear why these must be important in the development process: voice and accountability, lack of political instability and violence, effective government, manageable regulatory burden, rule of law, and absence of corruption. Trade can only be an aspect of the development process, and these institutions are also clearly environment. More broadly, the fact that openness is highly correlated with quality of institutions across countries should give long pause to anyone contemplating the adoption of what amounts to a novel (or tested and failed) development strategy that does not involve openness to trade.

Our third main proposition is that trade openness, conditional on growth, does not have systematic effects on the poor. The aggregate evidence shows that the income of the poorest tends to grow one-for-one with average income. Of course, in some countries and in some periods the poor do better than average, and sometimes they do worse. But openness does not help explain which of these outcomes occurs. The micro evidence from a large number of individual liberalization episodes also shows that there is no systematic relationship between trade liberalization and income distribution. Thus, trade openness has contributed to growth that has resulted in an unprecedented decline in absolute poverty over the past 20 years. Changes in income distribution within countries have, on the other hand, contributed little to net changes in poverty incidence (This is true also over longer periods). Indeed, the change in income distribution in the last 15 or so years has been slightly pro-poor.

Openness is not a ‘magic bullet,’ however. Trade policy is only one of many determinants of growth. Thus, it should not come as a surprise that, even though trade is an important determinant of growth, and there has been substantial trade liberalization in the last 20 years, growth in the 1980s and 1990s has been disappointing, resulting in a correspondingly modest (if unprecedented) decline in poverty. This should not distract us from the importance of trade liberalization in developing countries, however. Trade can only be an aspect of the development process. However, the breadth of evidence on openness, growth, and poverty reduction, and the strength of the association between openness and other important determinants of high per capita income such as the quality of institutions, should give long pause to anyone contemplating the adoption of a novel (or tested and failed) development strategy that does not center around openness to trade.

among four types of cases depending upon the rate of economic growth (fast or slow) and rate of expansion of exports (fast or slow). It is interesting to note that in 20 cases where rapid per capita economic growth is accompanied by rapid exports growth, poverty fell sharply in these cases by an average of 6.6 percent per annum. As opposed to this, in the 19 cases where export growth was relatively low and higher overall per capita growth, the performance with respect to poverty reduction was more still high at about 4 percent per annum. We also observe 12 cases where although the overall growth performance was relatively poor, exports performed strongly. In these cases, poverty fell by about two percent per annum. Finally, in the 35 cases of both slow economic and export growth, poverty fell by about one percent per annum. Hence, it appears that export growth has only a modest direct effect on poverty. Its effect has to be seen primarily via its bearing on the overall rate of economic growth.

Relationship between Exports Growth, Overall Growth and Poverty Reduction

	Number of Cases	Average Rate of per capita GDP Growth	Average Rate of Export Growth	Average Rate of Change in Poverty	Average Growth Elasticity of Poverty	Average Exports Growth Elasticity of Poverty
Fast growth of per Capita Income (over 3.8 percent per annum; rapid export expansion (over 10.5 percent per annum)	20	6.57	18.54	-6.55	-1.00	-0.35
Fast growth in per Capita Income (over 3.8 percent per annum; slow export expansion (less than 10.0 percent per annum)	19	5.54	7.54	-3.94	-0.71	-0.52
Slow growth in per Capita Income (less than 3.8 percent per annum; rapid exports expansion (over 10.5 percent per annum)	12	2.46	15.24	-1.92	-0.78	-0.13
Slow growth in per Capita Income (less than 3.8 percent per annum); slow export expansion (less than 10.5 percent per annum	35	1.73	5.73	-1.06	-0.61	-0.18
Total Sample	86	3.80	10.43	-3.09	-0.81	-0.30

Source: Trade Liberalization, Macroeconomic Performance and Poverty Reduction: The Asian Experience, UNDP

Hence, it appears that export growth has no significant direct effect on poverty. Its effect has to be seen primarily via its bearing on the overall rate of economic growth. Therefore, exports cannot be said to play a significant role in influencing the extent to which the process off growth is pro-poor or not."

The objective of the mentioned study was to examine how major economic aggregates shifted following external sector liberalisation in the late 1980s and early 1990s. The analysis indicates that the impact of trade liberalisation on same macro aggregates is clearer than others. Over all, the impact of trade liberalisation on employment and poverty reduction is ambiguous. The report states "this is because not only are there direct and indirect links between trade liberalisation and poverty reduction, but the impact could also vary from short-run to the long run. This depends upon production and consumption characteristics that a country produces and trades as well as the domestic economic policies pursued. Moreover, it seems that benefits of trade liberalisation either in promoting exports or sharing its benefits are not distributed equally. Overall, better trade performance is desirable if it leads to higher and sustained economic growth, employment growth, human development, and poverty reduction."

The analysis of the Report shows that the trade liberalisation linkages to poverty reduction are not so well established. There are certainly some cases for which the positive linkages are apparent. But overall it appears that export growth has no significant direct effect on poverty. Its effect has to be said to play a significant role in influencing the extent to which the process of growth is pro-poor or not.

Sixth WTO Ministerial Meeting

By Engr. M. A. Jabbar*

Limited success

World Trade Organisation (WTO) ministerial meeting has ended in Hong Kong. The meeting failed to engulf the gaps among major trading blocks/countries. And a serious crisis was avoided only at the cost of postponing until next year all of the most difficult negotiations. It averted a collapse of the Doha Round of multilateral trade negotiation. Domestic political constraints in EU, US and other regional business/trade organisations have limited the room for manoeuvre in several areas. According to UNCTAD the biggest achievement of the meeting was to keep the talks alive. Earlier WTO's meetings have failed in Seattle in 1999 and in Cancun in 2003. And recent meeting failure would have meant the end of Doha Round.

I was the part of the official delegation of Pakistan who attended the Ministerial Conference under the leadership of our Commerce Minister, Mr. Humayun Akhtar Khan. The role of the Commerce Minister is very much appreciable, he took a responsible step by protecting the interest of major exports, by bringing forth an enabling clause in the deal, which will allow Pakistan to compete in apparel against Bangladesh and other countries in the US market.

It is imperative to note that none of the major issues like, agriculture, industrial tariffs or services was advanced and only 5 percent progress was achieved during the six days, according to Director General, WTO. Important issues of the Doha Declaration 2001 were given least time as most of the time was consumed on the issue of agriculture subsidies by the negotiators.

Issues of DDA

The other issues of Doha Development Agenda namely: services, negotiations on rules, TRIPS, environment, trade facilitation, dispute settlement understanding, small economies, trade debt and finance, trade and transfer of technology, TRIPS non-violation and situation complaints, E-commerce, integrated framework, technical co-operation, commodity issues, coherence with the IMF and World Bank in the context of the WTO's mandate and aid for trade could not find time for advancement due to the stress of the work burden on reaching compromise on agriculture subsidies.

Developing countries as promised by the development round have the flexibility to protect percentage of their non-agriculture products by freezing the reduction in tariff. This exercise should be made by broad based consultation involving all stakeholders. Making research as to the qualification of product for consideration under the flexibility arrangements providing waiver from mandatory tariff reductions by WTO is another way to opt for. This way we can protect investment and also we can have a pre judgment as to the development of specific sectors in industry which maybe of our domestic interest creating outward movements of goods besides sharing imports.

It is necessary to understand the implications of Non Tariff Barriers and their affects on industrial goods. The identification, categorization and examination of NTBs is necessary so that the quality of industrial goods increases consumption in the domestic market and provide market access to industrial goods whose exports are more or less made hostage of technical barriers as applied by developed countries.

Services sector

Services sector constitutes 50 per cent of the GDP and the liberalization of services by Pakistan in all modes requires development of policy safeguards. There is a need of national investment in social sector so that knowledge based human capital contributes in promoting national service providers. We should recognize the progressive liberalization of services as the fuelling component for increasing competence of domestic service providers. In addition, we should join the forces following the philosophy of protecting and promoting domestic service providers.

** Former Vice President, FPCCI, Incharge WTO Resource Centre, FPCCI*

Issues not attended to in Hong Kong will be discussed in Geneva and care has to be taken to protect the domestic interest by joining forces of like economies. Two issues namely Agriculture and Non Agriculture Market Access (NAMA) were the key issues for Pakistan.

Agriculture

The agriculture issues road map to be finalized in Geneva next year will not amend the agreed end-date of 2013 for farm export subsidies. Pakistan needs to engage its agriculture stakeholders in policy formulations and facilitations to derive benefits of the Doha round. People with a more strategic perspective must be involved in policy making up to 2013 while closely watching the practical phasing out of subsidies and tariff reductions by developed countries.

The phasing out of domestic support, parallel elimination of all forms of export subsidies with respect to export credits, export credit guarantees or insurance programs, food aid programs substituting commercial substitutions by US, EU and OECD countries will increase the profitability of agriculture products in countries like Pakistan. This will motivate investment flows in the agriculture for market access in the developed countries due to combined effect of elimination of subsidies and reduction of tariffs.

For getting maximum benefit of the outcome of the Ministerial Conference, Pakistan has to remove its internal weaknesses in the agriculture area. Issues like implementation of water accord of 1991, consensus on building water reservoirs, popular acceptance of national finance commission award and encouraging the provinces to allocate more resources to agriculture are few to mention. The removal of internal weaknesses will raise the agro yields for setting up of value added industry based on agriculture products. Pakistan has to collect data on all Non Tariff Barriers (NTBs) and Technical Barriers (TBs) coming in the way of exports of agriculture products and value added thereof. The Centre of Sciences should be given the task of collecting all these data for in-house delivery of Science Based Certifications for creating the competence to claim the compliance of sanitary and phytosanitary conditions enabling ourselves to serve our people and consumers.

Remove weak-nesses in the agricul-ture area

NAMA

Hong Kong declaration is limited only to the agreement to apply a type of tariff reduction formula called Swiss Formula. Pakistan has proposed coefficient of 30 for reduction of tariffs by developing countries, including Pakistan. This coefficient of 30 will reduce our Bound Tariffs of 50 per cent meaning that the tariff protection for industrial products bound at 50 per cent will come down to less than 20 percent.

Pakistan should follow countries in Geneva pressing for higher coefficient for tariff reductions, so that our industrial and non agriculture product manufacturing is least disturbed and continues to make investments without being taken hostage of apprehension of reduction of tariff protection. Country like Pakistan has domestic policy room proportionate to level of tariff protection allowed by WTO in the agreement on Non Agriculture market access (NAMA).

Tariff protection

Other than tariff protection, the state of art infrastructures, technical assistance, institutes of training human capital, labs for testing in industrial areas, cheap utilities, less regulatory burden, good roads and transport and many other assisting factors are still absent in developing countries. In the absence of these helping ingredients we should have tariff protection at reasonable level to protect the domestic industry manufacturing non agriculture products.

The development of the country like Pakistan with population of 150 million people has to depend on inward oriented development of industries. Pakistan cannot afford the shift to trading country as the employment and the per capita income welfare would only be contributed by expansion of industrial base of the country, upgrading the technology and engineering. Therefore, the negotiators in Geneva in 2006 should go for higher coefficient so that committed tariff reduction level is low for keeping a reasonable level of tariff protection for saving present investments and motivate future investments.

WTO Ministerial Conference at Hong Kong
Pakistan's Perspective

At the Ministerial Conference in Hong Kong, held in mid December 2005, Pakistan was represented by its Commerce Minister, and technical negotiators, legislators, businessmen and others.

The country's trade is conducted on a multilateral basis and not under any Free Trade Agreement or Preferential basis such as those available to Least Developed Countries. Local exporters pay duty on exports to the US and Europe, while some of the competitors enjoy preferential rates either because they have free trade agreement or because they have LDC status. Farmers suffer because of huge subsidies paid to farmers in rich countries.

The WTO Wing, Ministry of Commerce had prepared a paper for the Conference in Hong Kong and later when the meeting was over a Press Release was issued. We give below excerpts from both the papers, sharing with our readers the important issues from Pakistan's point of view.

Agri-culture was a conten-tious issue

Agriculture was one of the most contentious issues. The reason being that developed countries have been following very distortionary practices and agriculture was excluded from any negotiations during the GATT era. In the Uruguay Round also there were no serious attempts to correct this imbalance. In case of Pakistan, agriculture provides for 25 percent of GDP and more than 50 percent of employment, consequently any decision in this area would have significant impact on our overall growth rate and incomes of our farmers. Therefore, keen interest in negotiations on this issue were taken.

While Pakistan has the potential to become a significant exporter of agricultural products, it can be realized only if distortions are removed by the elimination of subsidies and market access barriers. Pakistan's interest could be served if permissible subsidy levels are reduced as much as possible for developed as well as developing countries. It was felt that in the short to medium term the majority of our agricultural exports will have a better chance in developing country markets.

Although G20 and Cairns Group where Pakistan is a Member insisted for 2010 to be an end date but after intensive discussions and when it became apparent that the EU would not accept such an outcome, it was agreed that all export subsidies will be eliminated by 2013. However, it would be ensured that a substantial amount of those subsidies would be eliminated during the first half of the implementation period of the Doha Round i.e., during the next 3 to 4 years. It was also agreed that other related distortions in developed countries such as subsidized export credits, insurance programmes, State Trading Enterprises, etc. would also be brought under strict disciplines.

In case of cotton it was agreed that all forms of export subsidies would be eliminated in 2006.

In other areas of agriculture negotiations, progress was not significant but nevertheless there was some forward movement. In case of domestic support, a basic structure of reduction formula was agreed. Under this formula, there will be three bands for reduction. The EU with the highest level of domestic support will cut the most while the US and Japan will fall in the second band and would be required to cut less than EU but more than any other country. Developing countries such as Pakistan which have no a little trade distorting programmes would be exempt from reduction commitments.

Agricul-ture market access

In case of agriculture market access, progress has been very disappointing. According to a study by the World Bank more than 90 of gains would come from this pillar of reforms. The EU refused to improve on its earlier offer of making average cuts of 46 percent and also sought other flexibilities and therefore no meaningful discussions were held on this pillar. There was some progress regarding the basic structure of a formula for tariff cuts. It was agreed that there would be four bands and higher tariffs would be cut by a higher percentage. Also as a special and differential treatment for developing countries, it was agreed that they could designate special products and also resort to special safeguard mechanism. This means that for certain products they could make less cuts and also in case there is any surge in import levels in their countries, they can apply certain restrictions.

Non-agriculture market access

An important issue in the Doha Development Round from Pakistan's point of view is that relating to non-agriculture market access (NAMA). For NAMA, the Doha Development Agenda mandates:

- i Reduction or an appropriate elimination of tariffs.
- ii Reduction or elimination of tariff peaks, high tariffs and tariff escalations.
- iii Reduction or elimination of non-tariff barriers.
- iv That all of the above is required to be done in particular on products of export interest to developing countries. Furthermore, the special needs and interest of developing countries is required to be taken into account and one way for this will be that reduction commitments for developing countries will be on the basis of less than full reciprocity vis-à-vis developed countries.

The basic thrust of this negotiation is to encourage all members to reduce their non-agricultural tariffs over a period of time and bind them at the reduced level, thereby committing that these reduced tariffs will not be raised in future. The tariff reduction is not required to be uniform for all countries but it is envisioned to eventually bring the tariffs of most countries (except least developed countries) to a low level.

Reduce tariff peaks and tariff escalations

Pakistan's stance was to reduce tariff peaks and tariff escalations on products of our export interest. At the same time it was seeking a formula that would provide adequate special and differential treatment for developing countries so that it is able to maintain adequate tariff level for protecting our industries and for revenue purposes.

The Ministerial Conference agreed to adopt a so called Swiss formula. In this kind of formula, tariff cuts depend on the coefficients applied. If the coefficient is small there is a large tariff cut but if the coefficient is large then there is low reduction. Although there has been no agreement as to what the coefficient should be, it was agreed that coefficients should be at levels which ensure reduction of tariff peaks, high tariffs and tariff escalations on products of export interest to developing countries. At the same time the coefficient should take into account the special needs and interest of developing countries.

Swiss formula adopted

Pakistan's proposal to receive support

Pakistan's proposal to have two coefficients, one for developed countries which should be 6 and another for developing countries which should be 30, received strong support from all developing countries. If such coefficients are eventually agreed it would mean that tariffs on textile and clothing in the EU and US markets would be cut by more than 50 percent. In fact, they would be cut to less than 6 percent as against 12 -30 percent prevailing at present. This would considerably reduce discriminatory tariffs which our exporters face vis-à-vis our competitors many of which enjoy duty free access because of their LDC status or because they have FTA with major trading economies. It was also agreed that flexibilities should be an essential part of negotiations for any final outcome.

In the services sector, Pakistan like most developing countries had made very modest commitments, prior to the establishment of the WTO. Thereafter in 1997, commitments in the financial and telecommunications sectors were expanded.

Services sector

Given our liberal services regime in practice, the assessment is that Pakistan stands to gain from opening of the services market globally. This is because there are a number of services that Pakistan is already exporting, and there are others in which we have the potential to do so. From an import perspective also, it is likely to be beneficial in the overall context, if we commit our existing openness in this sector. Some of the advantages of doing so are as follows:-

- i Opening up the service sector to foreign competition will result in some foreign service providers (FSPs) providing a higher quality service at a lesser cost. This reduction in cost of doing business for Pakistani producers, traders and service providers will result in them becoming more competitive in the world market.

ii Opening up the service sector will result in a better service infrastructure, and this will be a positive inducement for FDI in the goods and the services sectors.

iii While binding commitments will give the necessary comfort to FSPs, they will also benefit local service providers and users by assuring them of a stable and predictable government policy framework.

iv Competition from FSPs will result in domestic service providers improving the quality and efficiency of their operations.

v Induction of FSPs will result in transfer of technology and knowledge to Pakistan.

In view of the above apparently Pakistan stands to benefit from supporting a consensus designed to further open up the services trade worldwide.

Develop-ment issues

One of the principles agreed at the 2001 WTO Doha Ministerial Declaration was to provide duty free quota free market access for products originating from least developed countries (LDCs). At Hong Kong, LDCs insisted that all developed countries and advanced developing countries should immediately allow duty free and quota free access for all products originating from all LDCs.

Since the EU and a number of other developed countries (except US which provide such access to some LDCs only) already provide duty free access under schemes such as ‘Everything But Arms’ (EBA), they also put pressure on the US to provide immediate duty free access.

Through this tactics, the EU was trying to deflect pressure on them to provide greater market access on agricultural goods. If this had succeeded, it would have meant duty free exports of textile and clothing to the US market from all LDCs including those which are efficient producers.

This would have resulted in serious erosion of Pakistan’s market share in the US. Pakistan, insisted that such concessions should take into account the impact on other developing counties at similar level of development. The US also showed reluctance to grant duty free access on textile and clothing to LDCs which have an efficient T&C industry. Eventually it was agreed that all developed countries would provide duty free access for 97 percent of products originating from LDCs. Accordingly 3 percent tariff lines which are likely to cover sensitive sectors such as textile and clothing would not be exempt from duty at present. Thus countries such as Pakistan would continue to enjoy level playing field vis-à-vis our competitors.

In this connection, Pakistan proposal was supported by Kenya and Sri Lanka which expected similar problems of market loss if duty free treatment was extended to LDCs. All these countries argued that they were not opposed to giving duty free access provided it did not impact their market share.

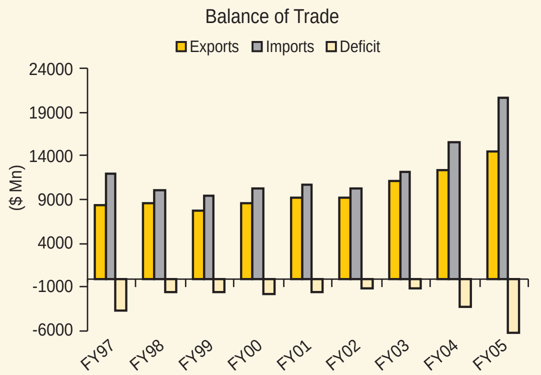
Others issues in areas such as services, TRIPS, Debt & Finance Trade and Transfer of Technology were also discussed but the progress was limited.

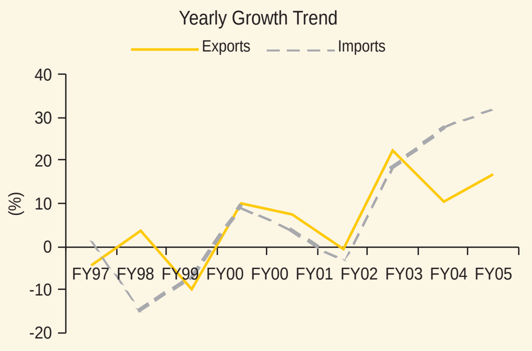
Pakistan's Mounting Trade Deficit

Rising trade deficit

Pakistan seems to be heading for a huge trade deficit this fiscal year. After averaging $2.44 billion in the five years to FY98, the trade deficit had narrowed to an average of $1.38 billion in the five years to FY03. Since then it is showing a rising trend, with the trade deficit widening to $3.28 billion and further to $6.21 billion in FY05.

Provisional data available for July-November '05 reveals further deterioration in the trade deficit, as it widened to $4.55 billion, up 146 percent compared to a deficit of $1.85 billion in the corresponding period last year. Based on current trends, the deficit is expected to reach an all time high of $8 billion for the full year. The unprecedented increase in the trade deficit is the outcome of high world oil prices and rapid expansion in overall imports.





Deficit not alarming

However, the increase in overall imports and trade deficit should not be a cause of worry. In developing countries, where the trade account is generally in deficit, GDP growth and import growth are highly correlated. According to Dr. Ishrat Hussain, the outgoing Governor, State Bank of Pakistan, the country is comfortably placed to manage a trade deficit of the order of $6.5 billion. Prior to FY98, the high trade deficit had become alarming due to a sharp surge in imports, particularly that of consumer goods, low levels of foreign exchange reserves, stagnant exports and weak economic growth.

Since FY02, both exports and imports have shown robust growth. The country is now enjoying comfortable foreign exchange reserves. This has been the result of deregulation, liberalization and privatization of the economy, and significant structural reforms in the last six years. Despite expanding exports, worsening trade deficit in FY04 was the result of a sharp surge in imports, particularly those of industrial raw materials and machinery, following strong recovery in the industrial activity and higher oil import payments on account of rising world oil prices.

Exports growing comfortably

For FY06, the government has projected exports at $ 17 billion, up 18 percent over preceding year's $14.39 billion. Provisional estimates for the first five months show that exports totaled $6.63 billion, attaining 39 percent of the target and are also 23 percent higher over the comparable period last year. On average per month basis, however, exports are currently growing by $1.33 billion, slightly short of the targeted $1.42 billion.

Imports sharply higher

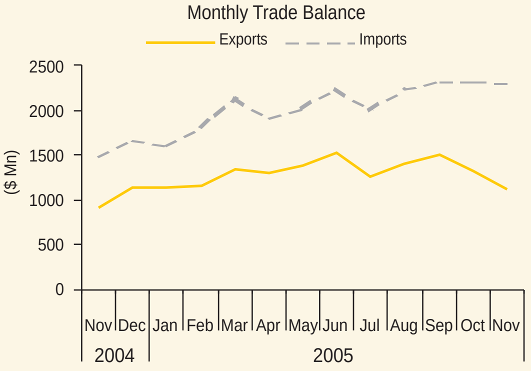
Imports, on the other hand, stood at $11.18 billion in July-November '05, slightly over 53 percent of the target and sharply higher by 54 percent over the corresponding period last year. Per month average comes to about $2.23 billion, significantly higher than the targeted average of $1.75 billion. For the full year (FY06), the Ministry of Commerce has projected imports at $21 billion, nearly 2 percent more over imports of $20.6 billion in FY05.

Trade deficit to be above $4 bn

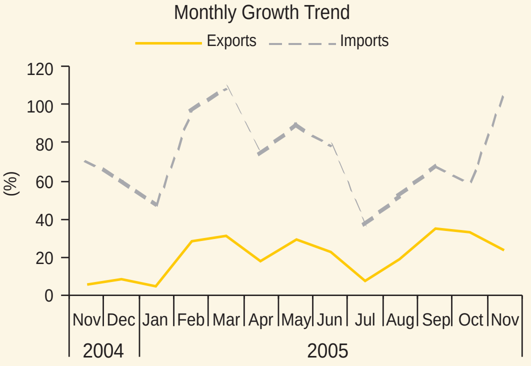
If the current trend persists during the remaining months, FY06 is expected to end up with exports of $16 billion and imports of $27 billion. Exports would thus be short of the target by nearly 6 percent, while imports are expected to exceed the target by 28 percent. Even if the Ministry of Commerce succeeds in attaining $18-20 billion of exports, trade deficit for the whole year could be well above the government projections of $4 billion.

The deficit of $4.55 billion in the first five months of the current fiscal year, has already surpassed the full year target by 13.7 percent. It is 146 percent above the $1.85 billion deficit recorded in the comparable five months of last fiscal year. Domestic demand is expected to continue growing with further expansion in economic activities, and oil import is likely to continue rising. This alongwith increasing import bill of machinery, raw materials and consumer goods would exert pressure on overall imports and further widen the trade gap.

Monthly Trade Balance



Monthly Growth Trend



Unit value & quantum indices of import rises

In the five years to FY05, Pakistan's exports rose by 57 percent to $14.410 billion, increasing at an annual average of 11.2 percent, mainly attributable to 6.4 percent growth in unit value indices and 5.3 percent growth in quantum indices. During the same period, imports surged 92.5 percent to $20.6 billion, growing at an annual average of 15.5 percent, mainly contributed by 46.3 percent growth in quantum indices, as against 31.5 percent growth in unit value indices.

Unit value of imports rose and quantum index of exports grew in FY96-00

Contrary to this, in the comparable five years to FY00, exports remained stagnant at around $8billion, increasing at an annual average of 4 percent. In contrast, imports averaged $11 billion, increasing by 6 percent per annum. Analysis further revealed that entire growth in exports during the period was attributable to high increase of 23 percent in quantum index as unit value indices declined by 2 percent On the other hand, real growth in imports was mainly attributable to 40 percent increase in unit value indices in contrast to 8 percent growth in quantum index.

Strong growth in economy in 2002-05

Since 1999 the government has assigned priority to an economic revival plan and has embarked upon implementing an export-led growth strategy. In view of past three years (2002-05) of strong economic growth, the strengthening of domestic demand together with a pick up in investment spending has fueled import growth. Rising oil import payments, as a result of higher oil prices in the international market further fueled overall import bill by 100 percent in FY 05 over FY 02. This more than offset the high growth in exports of over 58 percent in the same period.

Seven items account for 70 percent of imports

Machinery, petroleum and petroleum products, chemicals, transport equipments, edible oil, iron and steel, fertilizer and tea account for over 70 percent of Pakistan's total imports. Amongst these, machinery, chemicals and metal group alone account for 68 percent of total imports. The share of these three items has jumped from 39 percent to 68 percent in a short period of three years. The share of industrial raw material in total imports has also increased substantially. The surge in domestic demand in recent years has fueled an exceptional growth in non-food non-oil imports.

Oil, machinery & industrial raw material imports surges

A major shift was seen last year, when the oil import bill increased by nearly 20 percent and imports of machinery and industrial raw materials increased by 38 percent and

MAJOR EXPORTS AND IMPORTS 2001-2005

($ Million)

	FY01	% Share	FY02	% Share	FY03	% Share	FY04	% Share	FY05	% Share	Absolute Change FY05 over FY01 (%)
Exports	**9202**	**89.1**	**9135**	**90.1**	**11160**	**88.8**	**12313**	**88.7**	**14391**	**84.1**	**56.4**
Rice	526	5.7	558	6.1	555	5.0	634	5.1	933	6.5	77.4
Fish & Fish Preparations	138	1.5	126	1.4	136	1.2	153	1.2	129	0.9	-6.5
Textiles Manufactures	5756	62.6	5778	63.3	7225	64.7	8039	65.3	8569	59.5	48.9
Leather & Manufactures*	706	7.7	678	7.4	771	6.9	799	6.5	727	5.1	3.0
Carpets & Rugs	289	3.1	250	2.7	221	2.0	231	1.9	283	2.0	-2.1
Sports Goods	271	2.9	304	3.3	335	3.0	325	2.6	315	2.2	16.2
Petroleum & Products	184	2.0	191	2.1	249	2.2	294	2.4	427	3.0	132.1
Chemicals & Pharmaceuticals	164	1.8	153	1.7	261	2.3	263	2.1	382	2.7	132.9
Surgical & Medicinal Instruments	124	1.3	145	1.6	86	0.8	89	0.7	172	1.2	38.7
Engineering Goods	44	0.5	51	0.6	74	0.7	100	0.8	160	1.1	263.6
Imports	**10729**	**65.8**	**10340**	**64.3**	**12220**	**66.4**	**15592**	**64.0**	**20598**	**63.3**	**92.0**
Tea	206	1.9	157	1.5	173	1.4	193	1.2	231	1.1	12.1
Edible Oil	328	3.1	393	3.8	587	4.8	659	4.2	706	3.4	115.2
Crude Petroleum & Products	3361	31.3	2807	27.1	3066	25.1	3167	20.3	3813	18.5	13.4
Textile Machinery	370	3.4	407	3.9	532	4.4	598	3.8	902	4.4	143.8
Road Motor Vehicles	321	3.0	330	3.2	501	4.1	653	4.2	972	4.7	202.8
Other Machinery & Transport Equipment	1375	12.8	1470	13.7	1909	15.6	2969	19.0	3944	19.1	186.8
Iron & Steel	278	2.6	336	3.2	402	3.3	512	3.3	894	4.3	221.6
Fertilizers	170	1.6	176	1.7	240	2.0	285	1.8	384	1.9	125.9
Insecticides & Medicinal Products	300	2.8	314	3.0	280	2.3	399	2.6	419	2.0	39.7
Plastic Materials	354	3.3	314	3.0	421	3.4	549	3.5	774	3.8	118.6

* includes footwear

Source: SBP Monthly Bulletin June 2004 & December 2005

32 percent respectively, constituting over 71 percent of total imports. This year the oil bill has further risen by 68 percent, while machinery and industrial raw material imports have gone up by 53 percent, contributing over 75 percent to overall imports. Non-food and non-oil imports surged 52 percent in the first five months of this fiscal year

Share of capital goods rises in 2001-05

Economic classification of imports show that consumer goods import in FY05 increased by 37 percent over FY01, while import of capital goods surged 181 percent and that of industrial raw material for consumer goods and capital goods jumped 61 percent and 196 percent respectively. Their share in total imports, however, fell from 14 percent to 9 percent for consumer goods, while it increased for capital goods from 25 percent to 36 percent. The share of industrial raw materials for consumer goods has fallen from 55 percent to 46 percent, while for capital goods it inched up from 6 percent to 8 percent in the period under review.

High growth in consumer goods import

In contrast, import of capital goods had declined by 0.3 percent in FY00 over FY96. Growth in consumer goods was higher at 39 percent. In case of industrial raw materials imports, however, growth in consumer goods and capital goods at 59 percent and 36 percent was lower compared to the five years period of FY01 to FY05. At the same time the share of capital goods import had fallen from 38 percent to 26 percent and that of consumer goods from 17 percent to 14 percent. With regard to industrial raw material imports, consumer goods share jumped from 40 percent to 54 percent and that of capital goods remained unchanged at 5 percent.

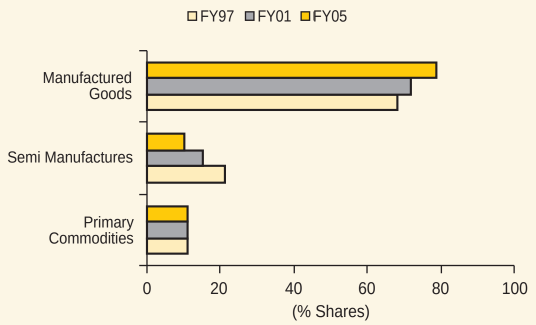
Share of semi-manufactures exports halved

On the export front, manufactured goods exports increased by 58 percent on year-on-year basis in the five years to FY05, while export of semi manufactures declined by 6 percent and that of primary goods increased by 15 percent. However, their share in total exports more than halved for semi manufactures from 15 percent in FY01 to 7 percent in FY05 and inched up from 72 percent to76 percent for manufactured goods. It remained almost unchanged for primary goods at around 13 percent.

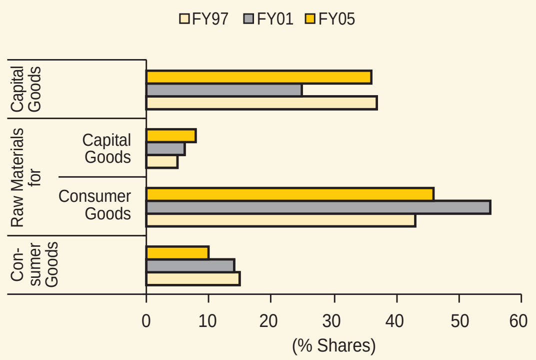
Growth in exports of manufactured goods

In the five years (FY96-FY00), growth in manufactured goods exports was significantly higher at 76 percent, while it was slightly lower at 12 percent for primary goods, and semi manufactures recorded growth of 7 percent. Share of manufactured goods exports to total exports rose from 65 percent to 73 percent, primary goods from 10 to 12 percent, while semi manufactures recorded a sharp fall in its share from 25 percent to 15 percent.

Economic Classification of Exports



Economic Classification of Imports



Unit value indices of exports increase

Group wise analysis of exports further reveals that in FY05 growth in manufactured goods exports was mainly on account of 2 percent increase in unit value indices over FY1, as quantum index recorded a decline of 2.3 percent. Compared to preceding five years to FY00, when both unit value indices and quantum index contributed a significant growth of 34 percent and 45 percent. Similarly growth in exports of other manufactures in the last five years is attributable to 11 percent growth in unit value indices and 13 percent growth in quantum index. While in the earlier five year period there was a significant (51 percent) growth in unit prices.

Oil import increases

On the import side, 186 percent surge in machinery and transport equipment in FY05 over FY01 is attributable to 174 percent growth in quantum index, while unit value indices increased 19 percent. This is in sharp contrast with the earlier five years (FY00 over FY96), when 19 percent growth in machinery & transport equipment import was contributed by 70 percent surge in unit value indices. Quantum index for this group had declined by 9 percent.

Import of mineral fuel and lubricants increased by 28 percent in FY05 over FY01. Despite 8 percent decline in quantum index, growth in import of this group was mainly contributed by 41 percent increase in unit value indices. This compares with the preceding five years (FY00 over FY96), when 41 percent growth in mineral fuel & lubricants import was the result of 86 percent increase in unit value indices and 11 percent growth in quantum index.

Exports/ Imports concentrated on few items

In the last one decade there has been a significant growth in the export of two main groups, classified as manufactured goods and other manufactures. However, overall exports are still heavily dependent on rice and cotton textiles, which constitute over 67 percent of total exports. On the import side, changes have taken place in the last three years. Revival of industrial activities, improved economic performance, liberal imports and rising oil import bill on account of increasing oil prices in the international market have resulted in

UNIT VALUE INDICES

(Base: 1990-91=100)

	FY96	% Change	FY97	% Change	FY98	% Change	FY99	% Change	FY00	% Change	Absolute Change FY00 over FY96 (%)
Exports	**185.36**	**9.93**	**204.85**	**10.51**	**245.62**	**19.90**	**258.40**	**5.20**	**253.77**	**-1.80**	**36.91**
Manufactured Goods	199.88	7.09	210.74	5.43	267.89	27.11	275.59	2.87	266.96	-3.14	33.56
Other Manufactures	174.29	18.03	213.59	22.54	246.64	15.47	259.80	5.33	263.04	1.24	50.92
Imports	**185.48**	**12.94**	**201.71**	**8.75**	**198.87**	**-1.41**	**223.32**	**12.29**	**259.03**	**15.99**	**39.65**
Mineral Fuel & Lubricants	110.70	15.75	134.14	21.17	121.46	-9.46	108.55	-10.63	206.30	90.05	86.36
Machinery & Transport Equipment	245.52	0.26	268.00	9.15	250.35	-6.59	355.79	42.11	417.87	17.44	70.20
Chemicals	187.06	21.22	193.88	3.64	185.97	-4.08	196.20	5.50	208.54	6.28	11.48

QUANTUM INDEX

	FY96	% Change	FY97	% Change	FY98	% Change	FY99	% Change	FY00	% Change	Absolute Change FY00 over FY96 (%)
Exports	**115.30**	**-4.90**	**115.48**	**0.16**	**118.91**	**2.97**	**114.54**	**-3.68**	**141.75**	**23.76**	**22.94**
Manufactured Goods	104.65	-9.11	116.80	11.61	122.75	5.09	117.84	-4.00	151.96	28.95	45.21
Other Manufactures	137.91	-6.43	141.37	2.51	130.70	-7.55	124.49	-4.75	144.38	15.98	4.69
Imports	**140.31**	**-5.67**	**145.74**	**3.87**	**139.67**	**-4.16**	**161.60**	**15.70**	**151.53**	**-6.23**	**8.00**
Mineral Fuel & Lubricants	164.52	20.53	154.89	-5.85	148.99	-3.81	172.01	15.45	182.26	5.96	10.78
Machinery & Transport Equipment	120.77	-25.04	114.94	-4.83	112.63	-2.01	149.51	32.74	110.12	-26.35	-8.82
Chemicals	156.47	13.10	169.58	8.38	175.54	3.51	194.49	10.80	196.16	0.86	25.37

UNIT VALUE INDICES

	FY01	% Change	FY02	% Change	FY03	% Change	FY04	% Change	FY05	% Change	Absolute Change FY05 over FY01 (%)
Exports	**271.47**	**6.97**	**271.18**	**-0.11**	**254.02**	**-6.33**	**279.65**	**10.08**	**288.84**	**3.28**	**6.41**
Manufactured Goods	279.04	4.52	281.83	1.00	248.93	-11.67	274.02	10.07	284.72	3.90	2.03
Other Manufactures	292.47	11.19	298.40	2.03	294.67	-1.25	318.55	8.10	324.17	1.76	10.83
Imports	**298.44**	**15.21**	**298.56**	**0.04**	**309.52**	**3.67**	**355.43**	**14.83**	**392.45**	**10.41**	**31.50**
Mineral Fuel & Lubricants	276.87	34.21	249.66	-9.83	297.20	19.04	306.38	3.08	389.16	27.01	40.55
Machinery & Transport Equipment	470.20	12.52	481.18	2.33	450.67	-6.35	537.55	19.27	561.15	4.39	19.34
Chemicals	228.06	9.36	239.29	4.92	245.60	2.63	313.15	27.50	334.10	6.69	46.49

QUANTUM INDEX

	FY01	% Change	FY02	% Change	FY03	% Change	FY04	% Change	FY05	% Change	Absolute Change FY05 over FY01 (%)
Exports	**152.15**	**7.33**	**145.47**	**-4.40**	**162.29**	**11.56**	**153.72**	**-5.29**	**160.20**	**4.21**	**5.27**
Manufactured Goods	161.88	6.52	160.01	-1.16	167.90	4.93	158.48	-5.62	158.15	-0.21	-2.30
Other Manufactures	160.80	11.37	150.78	-6.24	189.86	25.91	175.00	-7.83	181.94	3.96	13.14
Imports	**172.72**	**13.98**	**176.59**	**2.24**	**198.08**	**12.16**	**200.19**	**1.06**	**252.72**	**26.24**	**46.31**
Mineral Fuel & Lubricants	194.43	6.67	192.28	-1.11	180.59	-6.08	182.72	1.17	178.77	-2.17	-8.06
Machinery & Transport Equipment	156.86	42.44	148.00	-5.65	226.71	52.84	238.88	5.36	429.39	79.75	173.74
Chemicals	197.42	0.64	236.19	19.63	254.95	7.94	222.10	-12.89	226.70	2.07	14.83

Source: SBP Monthly Bulletin March 2001 & December 2005 significant surge in overall imports. These are concentrated in few items; machinery, petroleum and chemicals alone account for 64 percent of imports.

Liberal Trade Policy

The Trade Policy for FY06 focuses on eight areas that include; diversification of exports, trade facilitation, increased market access, enhancing export competitiveness, capacity building on WTO and trade negotiations, developing export of services and improving compliance and quality infrastructure. Priority countries have also been identified in Central Asia, Latin America and Africa to boost Pakistan's exports. The policy also focuses on special measures to enhance the country's exports to USA and Europe.

Pakistan's import regime has been reformed, restructured and liberalized over the years to meet the economy's ongoing structural shifts. Past policies of import substitution have been replaced by import liberalization and an export led growth strategy. Import related irritants impacting investment have been removed, to facilitate the import of capital goods and raw material, for no country has been able to enhance its exports significantly without liberalizing its import regime.

Import related irritants removed

The new trade policy has also further liberalised imports, particularly allowing imports of specified old vehicles under the gift, personal baggage, and transfer of residence schemes for Pakistanis residing abroad. The government has also announced zero rating of sales tax, customs duty, withholding tax on import of five major sectors — textile, carpet, sport, leather and surgical goods.

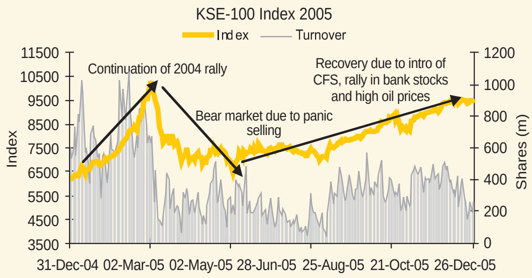
It is expected that exporters, taking advantage of liberalized trade policy, would import machinery for rehabilitating their production capacity, and import cheaper raw materials that could result in increasing the import bill of the country. This would exert pressure on trade balance and further deteriorate the trade gap.

Market Analysis

Market Review & Outlook

High-lights - CY2005

The KSE-100 index during the year under review exhibited extreme volatility characterized by continuing upsurge and dramatic declines. Overall, the KSE-100 Index jumped by 54% or 3338 points for the year ended December 31, 2005 to 9557 points on an average daily volume of 365m shares. Looking back at the last 12 months, the market can be segmented into 3 distinct phases: 1) bullish start; 2) bearish quarter; and 3) recovery.



Bullish start

The bull market that began near the end of 2004 continued into the first two-and-a-half months of 2005. During this period from January 1 to March 15, 2005, the KSE-100 Index jumped by 66% or 4,085 points to a record high closing of 10,303 on average daily turnover of 682m shares. The steep rise in the Index during this period can be attributed to the following factors:

- §PTCL privatization rumours.
- §Speculative/Punter and foreign buying in bellwether petroleum scrips such as OGDC, PPL, POL and PSO.
- §Retail buying.
- §Strong annual/quarterly earnings results.

Bearish quarter

The speculative bubble which had burst during 'March Crises,' marked one of the darkest periods in the bourse's history. The crises shattered the confidence of many participants especially at the retail level and consequently the market entered the bearish phase which prolonged from mid-March to the end of May. The index during the period did not challenge the 9000-barrier but instead dipped below the 7000-level for a few days in April and May.

The KSE-100 Index from March 15-May 27 '05 dropped over 3,800 points or 37% to 6467 and the average trading volume declined to 267m shares. The major developments that affected the market behavior during this period are as follows:

- §Panic selling by retail investors
- §Over leverage situation in the COT/Badla market in major index stocks such as OGDC.
- §March futures settlement crisis and SECP intervention by strengthening risk management rules to avoid default.
- §The SBP raised the discount rate by 150bps to 9% during April due to continuing inflationary pressure in the economy.
- §Gradual phasing off of COT financing and replacement with Margin Financing.
- §Reduction in number of scrips to 7 (based on the free float methodology) in the futures counter.

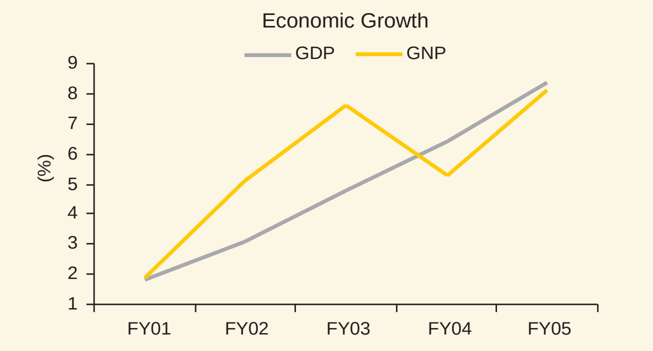
Second-half recovery

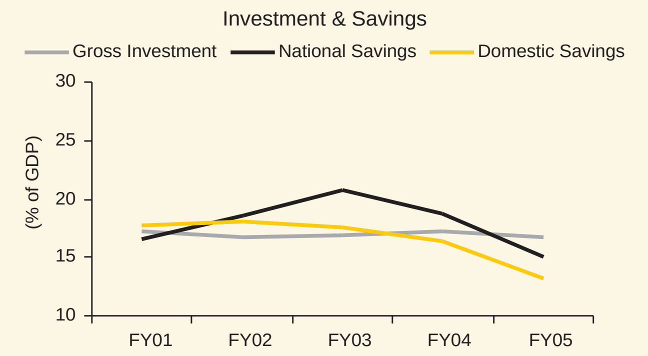
From the end of May to the end of the year, the market staged a later half recovery and bull run of over 2699 points or 39% to 9557. The average daily turnover during the last 7 months of the year improved to 291m shares. The market was positively affected by the following factors below:

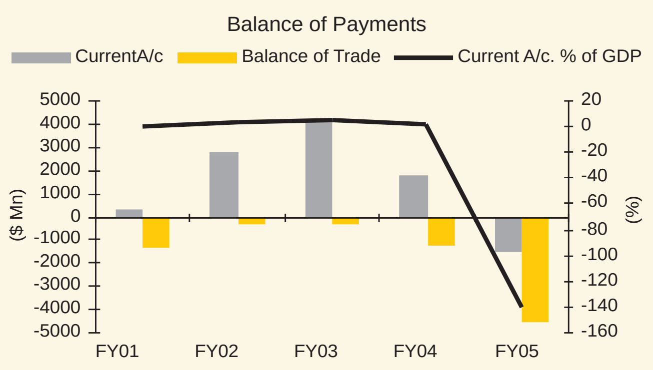
- §FY06 Budget was positively received by investors.
- §Privatization of National Refinery to Attock Oil Group.
- §Privatization of PTCL to Etisalat on June 18, 2005.
- § Privatization Commission sold 15% shares of UBL to the public through IPO.
- § Settlement of the dispute between margin financing and COT and the introduction of CFS on August 22, 2005 which replaced COT/Badla.
- § Rally in bank and cement companies' stocks due to strong earnings growth and relatively attractive valuations.
- § High oil prices during August and September led to buying interest in petroleum stocks as they have heavy weightage on KSE-100 Index.

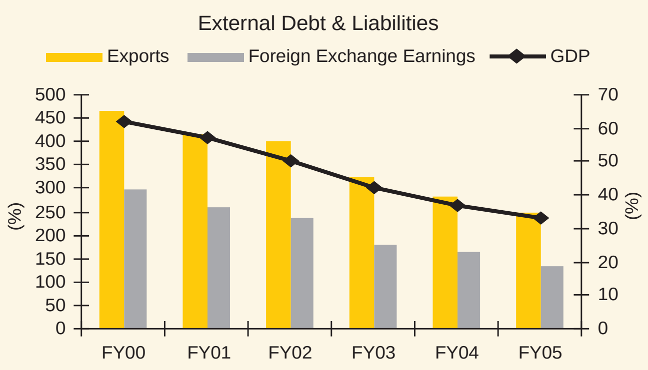
(Contributed by Taurus Securities Ltd, a subsidiary of National Bank of Pakistan)

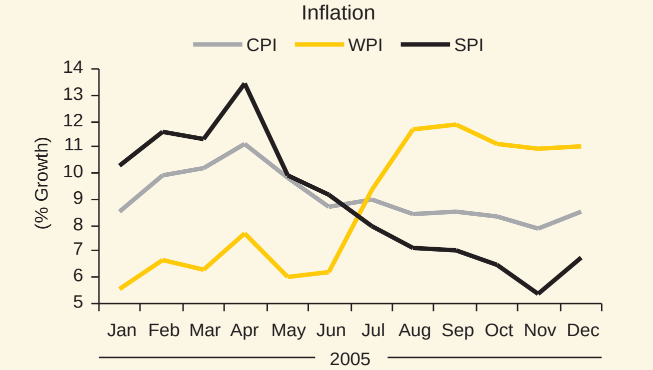
Pakistan Economy - The Year 2005

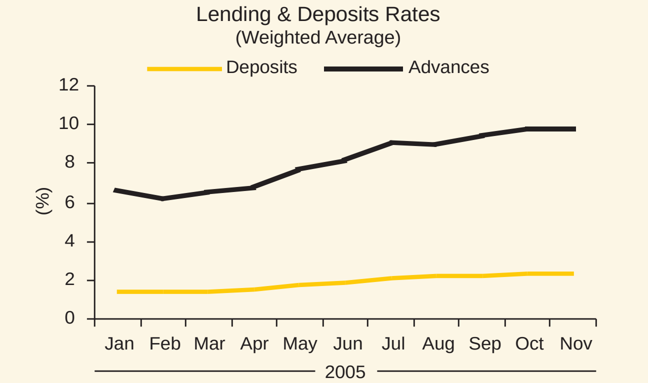


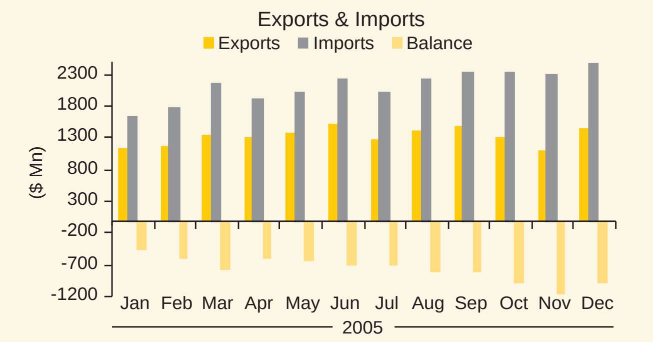


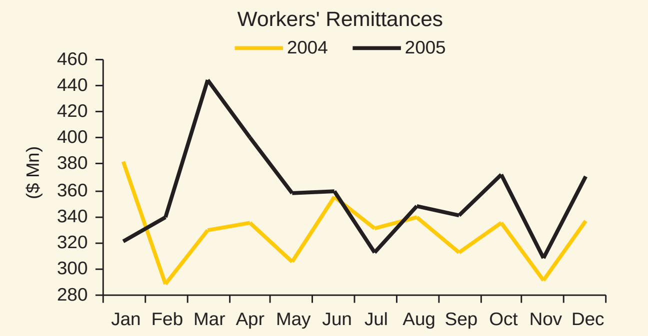


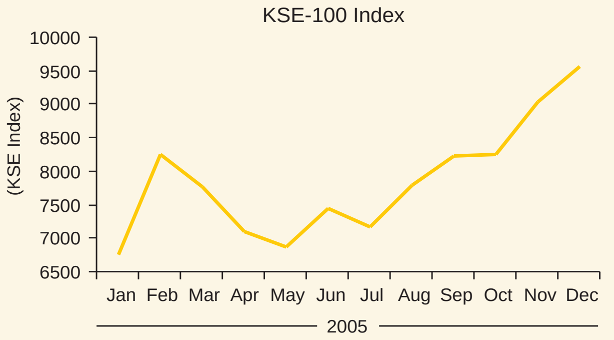


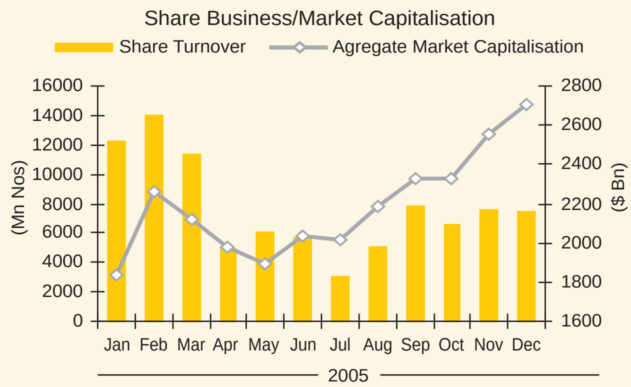


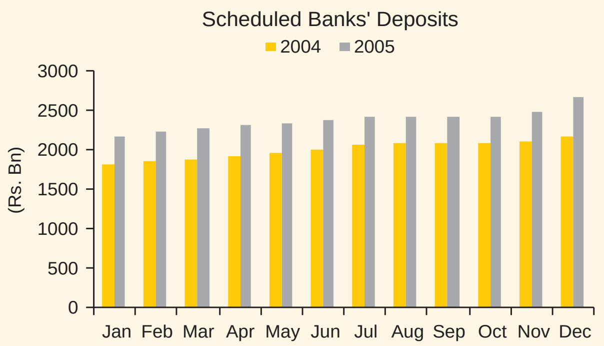


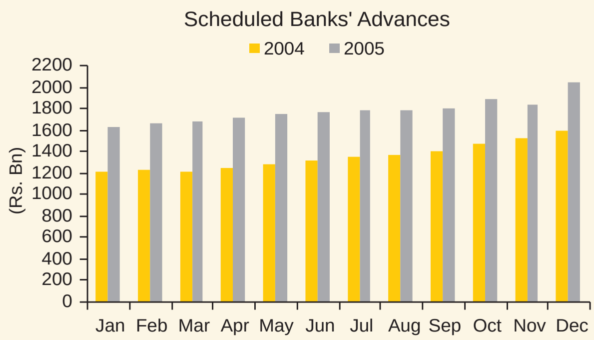


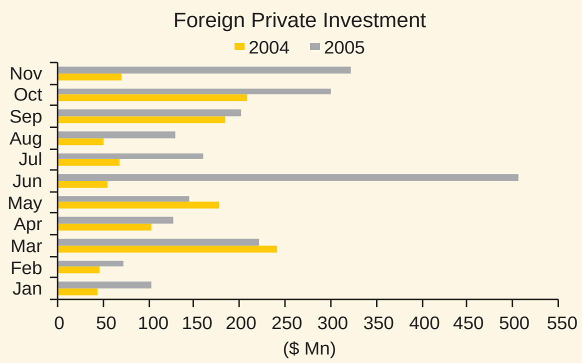


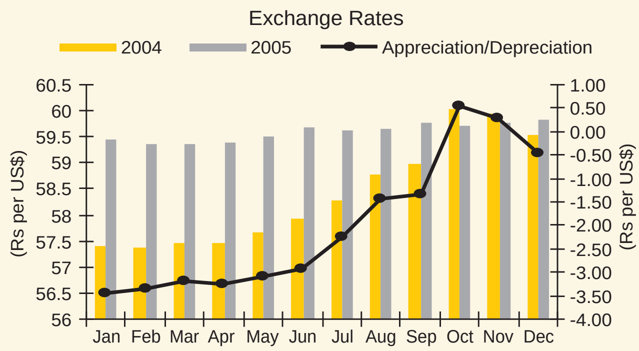

KSE-100 Index
(KSE Index)
10000
9500
9000
8500
8000
7500
7000
6500
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec
2005

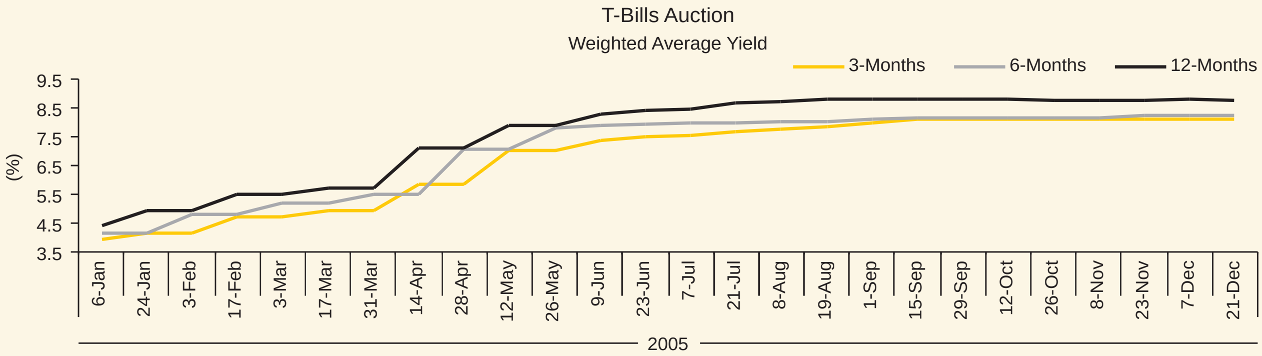

Share Business/Market Capitalisation
Share Turnover
Agregate Market Capitalisation
(Mn Nos)
16000
14000
12000
10000
8000
6000
4000
2000
0
($ Bn)
2800
2600
2400
2200
2000
1800
1600
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec
2005


Scheduled Banks' Deposits
2004
2005
(Rs. Bn)
3000
2500
2000
1500
1000
500
0
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec


Scheduled Banks' Advances
2004
2005
(Rs. Bn)
2200
2000
1800
1600
1400
1200
1000
800
600
400
200
0
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec


Foreign Private Investment
2004
2005
Nov
Oct
Sep
Aug
Jul
Jun
May
Apr
Mar
Feb
Jan
0 50 100 150 200 250 300 350 400 450 500 550
($ Mn)


Exchange Rates
2004
2005
Appreciation/Depreciation
(Rs per US$)
60.5
60
59.5
59
58.5
58
57.5
57
56.5
56
(Rs per US$)
1.00
0.50
0.00
-0.50
-1.00
-1.50
-2.00
-2.50
-3.00
-3.50
-4.00
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec


T-Bills Auction
Weighted Average Yield
3-Months
6-Months
12-Months
(%)
9.5
8.5
7.5
6.5
5.5
4.5
3.5
6-Jan 24-Jan 3-Feb 17-Feb 3-Mar 17-Mar 31-Mar 14-Apr 28-Apr 12-May 26-May 9-Jun 23-Jun 7-Jul 21-Jul 8-Aug 19-Aug 1-Sep 15-Sep 29-Sep 12-Oct 26-Oct 8-Nov 23-Nov 7-Dec 21-Dec
2005

NBP Performance at a Glance

(Rs. Bn)

Items	2000	2001	2002	2003	2004
Total Assets	371.6	415.1	432.8	468.9	549.7
Deposits	316.5	349.6	362.9	395.5	465.6
Advances	140.3	170.3	140.5	161.3	221.4
Investments	72.6	71.8	143.5	166.2	144.7
Shareholders' Equity	11.4	12.0	14.3	18.1	25.2
Pre-Tax Profit	1.03	3.02	6.04	9.01	12.02
After-Tax Profit	0.46	1.15	2.25	4.20	6.24
Earning Per Share (Rs.)	1.24	3.08	5.49	8.53	12.68
Return on Assets (Pre-Tax Profit) (%)	0.3	0.8	1.4	2.0	2.4
Number of Branches	1428	1245	1204	1199	1226
Number of Employees	15351	15163	12195	13272	13745

NBP Products

NBP Saiban

- Finance available for home purchase, home construction and home improvement.
- Period of repayment ranges between 3-20 years.
- Loans available upto a maximum of Rs.10 million.
- Mark-up choices available. Rate ranges between 9.0 - 12.85 percent. Rates subject to change.
- Minimum approval and disbursement timing.
- Limited to areas where there are no documentation, fee, resale and foreclosure related issues, so to protect the bank's interest.

NBP Advance Salary

- 15 months salary in advance (certain conditions apply).
- Minimum documentation.
- Repayable in 5 years.
- No processing charges; no collaterals, no guarantees, no insurance.
- Mark-up charged at 13 percent per annum on reducing balance method.

NBP Cash n Gold

- Facility of Rs.6000 against 10 gms of gold.
- Mark-up 11 percent per annum.
- No maximum limit of cash.
- Repayable after one year.
- Roll over facility.
- No penalty for early repayment.

NBP Kisan Dost

- Loans available for the farmers for production, development purposes, for purchase of tractors, for installation of tubewells, for purchase of agricultural implements, mirco loans, for godown construction, for construction of fish pond, for livestock farming, for milk processing, for cold storage, bio-gas plants etc.
- Mark-up 11 percent per annum.
- Loans available at the farmer's doorsteps.
- Agricultural experts to guide farmers.
- Loans available against agricultural passbooks, gold ornaments and paper security.