Contents

Editor's Corner

Dear Readers,

In Pakistan, inflation in food products has been a cause of concern for policymakers in recent months. Year-on-year growth in food inflation was 9.68 percent in June 2007 over a year earlier, having declined from year-on-year figure of 11.3 percent a month earlier. Any movement in the food component of CPI, with a weight of 40.34 percent has an impact on overall inflation. Though in recent months, food inflation has exhibited higher variability, overall inflation has remained in single digits, as food increases have been offset by a decline in the nonfood component of CPI.

CPI inflation for FY07 is estimated at 7.77 percent, slightly below 7.92 percent registered a year earlier. Meanwhile, food inflation was higher at an average of 10.3 percent for the year against previous year's 6.9 percent. The items which have shown an increase in prices during the last few months, include, wheat, flour, milk, rice, onions, tomatoes, vegetables, fresh fruits, cooking oil, eggs, potatoes among others.

The rise in food inflation could be partly explained by the supply side problems. There has been some deceleration in supply growth which has driven prices up. For instance, there has been a drop in the production and yield of pulses like mung, maash, masoor, in oilseeds like rapeseed and mustard, including canola. Yield of onions has stagnated at 13.0 - 13.8 tonnes per hectare in the last five years and of tomatoes it has averaged 10.5 tonnes per hectare. Production of fruits has not shown any substantial increase.

Supply constraints of agricultural food items, coupled with rising per capita incomes and increased urbanisation is supporting the acceleration in demand for some of the basic food items and higher consumption of milk, chicken and meat.

The government has had to import a number of food items. During the period July-May 2006-07, Pakistan imported food items worth Rs2.5 billion. The major chunk (33 percent) was spent on import of soyabean and palm oil. $230 million was spent on the import of pulses. A year earlier while soyabean and palm oil were consuming the large part of food imports, $600 million was spent on the import of sugar and wheat.

Given the importance of the farm sector, the Federal Budget 2007-08 has taken certain steps, like giving subsidy on fertilizer, on electricity charges of tubewells, larger allocation from PSDP for the agricultural sector, undertaking water and power projects, village electrification, and building of roads and highways to benefit the rural economy and the farmers.

Also being developed is the livestock sector, which would help diversify the agricultural economy. The Government has set up a Livestock & Dairy Development Board, undertaking major initiatives, like milk collection and dairy development programme – livestock production and meat production programme. These initiatives would help increase milk collection and increase meat production.

An increase in the supply of essential food items, accompanied by adequate financing to support rural sector, alongwith government's administrative measures and with the State Bank retaining an anti-inflation bias in its policies, the impact of food inflation is expected to be minimized.

Ayesha Mahmud

Federal Budget 2007-08 – An Overview

Economic Scenario

The economy maintained strong growth in 2006-07, driven by improved performance of the commodity producing sector and robust growth in the services sector. Overall investment picked up, so did revenue generation, fiscal deficit declined and the public debt burden fell. However, some macroeconomic indicators remained disconcerting during the year. Consumption inequality rose, inflation remained high, trade gap widened and the current account deficit rose further on account of weak export performance and widening deficit in the services account.

Growth Trends

In FY07, the economy (real GDP) grew by 7.0 percent and this growth was evenly distributed across sectors of the economy. Agriculture and manufacturing grew at 5 percent and 8.4 percent respectively. Better agricultural performance over last year was mainly due to higher production of wheat and sugarcane. Minor crops showed a weak growth, because of declines in the production of onions and chillies and while availability of oil seeds has increased, nearly three fourths of the demand is met through imports. Livestock, which is an important sub-sector of agriculture accounting for 10.4 percent of GDP, registered a slippage in its growth from 7.5 percent in FY06 to 4.3 percent in FY07.

LSM growth slows

While the manufacturing sector showed a positive trend during the year, the growth of 8.4 percent was lower over last year's 10 percent. Slightly lower growth in largescale manufacturing was a result of lower production of fertilizer, bicycles, paper, TV sets and a somewhat subdued growth in the assembly/ manufacturing of automobiles. Increases in output were noted for cotton cloth, cotton yarn, sugar, cement, tractors, among others.

In the last few years, the contribution of the services sector to the economy has grown. In FY07, while finance and insurance led the growth, wholesale and retail, as well as social services registered good performance.

Invest-ment picks up

Investment has gradually picked up in the economy. In FY07 it was 23 percent of GDP. The composition of investment reflects the growing share of private sector investment in domestic fixed investment. The large public sector spending especially in infrastructure has had spillover effects on the private sector.

Alongwith an increase in local investment the net inflow of foreign investment has also risen. During July-May, it rose to \$6.3 billion against \$4.2 billion in the corresponding period a year earlier. Foreign direct investment constituted \$4.5 billion, portfolio investment \$1.11 billion (GDRs of MCB Bank fetched \$857 million) and \$654 million was foreign public investment.

Food inflation high

Higher food inflation (10.2 percent over 7.0 percent in FY06) drove the annualized inflation to 7.9 percent against the target of 6.5 percent for the year. The core inflation (nonfood non-energy) declined to 6.0 percent against 7.7 percent a year earlier. Major part of the rise in food inflation is attributable to domestic price increase of rice, edible oil, pulses, milk, tea, eggs, wheat, vegetables and fruits.

The monetary policy pursued in FY07 sought to maintain a balance between sustaining economic growth and low and stable inflation. While economic growth was sustained, inflation remained higher than the target. SBP recognizes that food inflation is typically less responsive to monetary tightening. SBP depends more on market dynamics and government's administrative measures to contain food inflation, while retaining a tightening bias to ensure that inflationary expectations are contained, states the SBP's third quarterly report for the year 2006-07 on the State of Pakistan's economy.

Reserve require-ments raised

During the year, the State Bank maintained a tight interest rate environment, primarily with the objective of curtailing demand, thereby reducing inflation. It raised the reserve requirements (SLR raised from 15 to 18 percent and CRR from 5 to 7 percent) and the discount rate.

As a result, these measures were instrumental in containing the aggregate excess demand in the economy, and figures show that growth in private sector credit slowed to 12.5 percent (July-May '07) compared to 20.0 percent during the corresponding period of FY06.

Bank credit rises

Bank credit to the government sector however, rose substantially in FY07. While the government retired credit on account of commodity operations, budgetary borrowings from the banking sector rose to Rs212 billion (July-March) against the annual target of Rs120 billion. Last year the SBP was directly financing the budgetary needs.

It frequently conducted open markets operations to drain excess liquidity from the interbank market, and raised the yield on T-bills.

Stock markets perform well

During FY07, the stock markets performed well. The aggregate market capitalisation rose to $59.4 billion by April '07, while the index reached all time high of 12961 points on May 31, 2007.

The measures taken by the government, like for protection of small investors, automation, curbing insider trading, alongwith an improvement in the economic fundamentals, M&A, stability in exchange rate, have all started to pay dividends.

Banking sector performance has significantly improved, foreign investors have shown interest in the local stock market, foreign investment inflows have increased to $6.2 billion (July-May '07), and government bonds have been well received in the international markets.

Exports slow

During July-May '07, growth of exports slowed. Exports rose by 3.62 percent to $15.48 billion against $14.94 billion in the corresponding period a year earlier. Exports were targeted to grow by 13 percent to $18.6 billion in the year. Slower growth was mainly because of declines in the export of rice, raw cotton, cotton cloth and bedwear, carpets and rugs, sports good, leather and its manufactures, chemicals etc.

The decline in exports is because of a number of factors; the fall of unit values in the international market, bedwear made less competitive because of a 5.8 percent dumping duty, poor quality of cotton on account of contamination, adversely affected the export of spinning industry and the rise in prima cotton price (a genetically modified version) which is imported from the US and a critical input for producing higher quality bedwear and fabrics, has made these items less competitive in the international market.

Imports rise

Imports were targeted to decline by 2.1 percent in FY07 to $28 billion from previous year's $28.6 billion. During July-May '07, imports grew by 8.4 percent to $27.74 billion against $25.59 billion in the corresponding period of FY06. Petroleum which constitutes nearly 24 percent of the total import bill grew by 11 percent and machinery group by 12.0 percent. Food group import bill grew by only 1.75 percent because of decline in import of wheat and sugar. Import of fertilizer, iron and steel, automobile also fell.

Trade deficit widens

The trade deficit widened to $12.26 billion against $10.65 billion a year earlier. Meanwhile, the current account deficit further widened to $7.4 billion during July-May '07. Despite a growth in private transfers, the rising current account deficit is a result of the large trade deficit and the deficit in the services account.

Debt reduction strategy adopted by the government has brought positive results. The public debt burden has been reduced from 100.3 percent of GDP in end FY99 to 53.4 percent of GDP by end March '07. Meanwhile, the external debt & liabilities which stood at $38.86 billion as of end March '07, was 26.3 percent of GDP against 50.9 percent of GDP at the end of FY02.

While there has been improvement in the economic indicators, there are challenges like job creation, poverty alleviation, improving social indicators and strengthening the physical infrastructure to sustain the growth of 7-8 percent in the medium term.

Box

Economy 2006-07
Highlights

Growth Trends

- GDP grew at 7.0%, surpassing last year's growth of 6.6%.
- Agriculture grew by 5% against a modest 1.6% last year. The major crops sub-sector showed an impressive growth of 7.6%, mainly due to higher production of wheat and sugarcane.
- Manufacturing growth slowed to 8.4%from 10.0% a year earlier.
- Services sector grew by 8%, with finance and insurance sub-sectors remaining the major drivers of growth.
- Per capita income rose to $925.
- Total investment as a proportion of GDP is estimated at 23%.
- Domestic savings have risen to 16.1 percent.
- Inflow of foreign private investment has crossed $5 billion.
- Almost 78% of foreign direct investment has come from the UAE, US, China, UK and Netherlands.
- Inflation is estimated at 7.9%. Food inflation averaged 10.2%, while nonfood inflation averaged 6.2%.

Fiscal and Monetary

- Overall fiscal deficit estimated at 4.2% of GDP.
- The package of reforms introduced in the last six years has brought positive results.
  - Fiscal deficit has been reduced from an average of almost 7% of GDP in the 1990s to 3.7% in FY07.
  - Tax collections by CBR increased by 81% during the last six years.
  - Revenue deficit as percent of GDP has turned into revenue surplus.
  - Share of direct taxes in total taxes (collected by CBR) has increased from 18% in 1990-91 to 39% in FY07.
- Tax-GDP ratio remained stagnant at 9.5%.
- Public debt to GDP ratio has declined from almost 92% in 1990 to 53.4% in FY07.
- Interest payments as a percentage of total revenue have been reduced from 41% in FY00 to 17% in FY07.
- The State Bank of Pakistan continued with a tight monetary policy during the year.
- It raised the SLR from 15 to 18%, CRR for commercial banks from 5 to 7% and the discount rate from 9 to 9.5 %.
- Credit growth to private sector slowed.
- Banking spread was at 6.6% in March '07 with weighted average lending rate at 10.6% and weighted average deposit rate at 6.6%.
- Overall money supply (M2) grew by 14% as against a growth of 12.1% in the same period last year. This was mainly caused by a sharp rise in net foreign assets of the banking system and higher government borrowing for budgetary support.
- The impact of tight monetary policy was felt considerably in textiles, cement, commerce and personal loans.
- There has been significant merger and acquisition activity in the banking industry over the last couple of years.
- Asset quality of the banks has improved as NPLs have been declining.

Capital Markets

- The stock market performed well during the year, as the KSE 100 index rose to 12370 points by April '07 and the aggregate market capitalisation increased to $59.4 billion.
- Foreign investor's interest in the stock market was sustained. Foreign portfolio investment increased to $1.82 billion.
- Several key takeovers took place in the corporate sector.

Balance of Payments

- During FY07 (July-April) exports are provisionally estimated at $13.9 billion and imports at nearly $25 billion, resulting in a trade deficit of $11.1 billion.
- Current account deficit has widened to $6.2 billion in July-March 2006-07.
- Workers' remittances totaled $4.45 billion in the first ten months of FY07.
- Total liquid foreign exchange reserves stood at $13.7 billion at the end of April 2007.
- Exchange rate remained more or less stable during the year.

External Debt

- External debt and liabilities at the end of March '07 were $38.86 billion.
- As a proportion of GDP, the external debt and liabilities declined from 51.7% in FY00 to 27.1% by end March '07.
- During July-March 2006-07 total disbursements stood at $1.8 billion.

Social Sector

- Literacy rate has risen to 54%.
- Public sector expenditure on education stood at 2.42% of GDP.
- Health expenditure as percentage of GDP improved marginally to 0.57%.
- Poverty has declined and now 23.9% live below the poverty line.

Outlay of the Federal Budget

The Federal Budget 2007-08 has a total outlay of Rs1874 billion (includes Rs275 billion defence spending). The budget documents show total expenditure at Rs1599 billion; of which current expenditure has been allocated 66 percent, development expenditure 32.5 percent and other development expenditure is to receive 1.45 percent.

Current expenditure rises

Revised estimates for FY07 show that while current expenditure exceeded the budgeted figure of Rs879.8 billion by 17.5 percent, development expenditure fell short by 9.3 percent. This has been the pattern for the last number of years and it was only in FY06, that development expenditure had surpassed the year's target. Increase in current expenditure over the budgeted figure last year was primarily because of a 50 percent higher expenditure on servicing of domestic debt, higher (74 percent) transfer payment and 57 percent higher expenditure under general economic, commercial and labour affairs.

Higher servicing expenditure

Bulk of the expenditure (60.8 percent) in 2007-08 under the current expenditure head is categorised under *General Public Services*, followed by *Defence Affairs & Services* (26 percent). In the former category, higher allocations have been budgeted for foreign loan repayments and its servicing and servicing of domestic debt. Servicing alone is constituting 35 percent of current expenditure. By following the debt reduction strategy the government has been able to bring down the public debt burden in relation to revenue. Consequently the debt service obligations which were consuming 69 percent of total revenues leaving only 31 percent for development programmes, the social sector, defence, civil administration etc, has since seen a change and this ratio is now around 28 percent of gross revenue.

Last fiscal year saw a 9.3 percent shortfall in the Public Sector Development Programme. This has been a common pattern for the last number of years, where the development budget has had to face the burden of adjustment. In FY06 PSDP had been higher over the budget expenditure, while a year earlier it met the target.

For FY08 the government has budget Rs520 billion development programme so to accelerate infrastructure development, create job opportunities and help build the social sectors. Of the total PSDP, Rs370 billion will be the Federal Programme, where Rs49.6 billion is for Corporations (WAPDA gets Rs20.6 billion and NHA 29.0 billion) Rs69.4 billion is allocated for Special Programmes, Rs21.2 billion for Special Areas, Rs150 billion is the Provincial Programme.

Revenue Receipts

Direct taxes grow

In 2006-07, revenue receipts (net) grew by 16.8 percent (revised figures) over the year's target of Rs704.5 billion. This is attributable to higher non-tax revenue, as tax revenue fell short of the target of Rs840.9 billion by 0.16 percent. The performance of direct taxes has been good as the revenue target has been surpassed by Rs48.7 billion. On the other hand, there has been revenue loss on account of sales tax and customs duties by Rs30.6 billion and Rs23.1 billion respectively. Because of a drop in these two revenue heads, indirect tax revenue missed the target of Rs569.0 billion by 8.8 percent.

In FY07, direct tax collection grew by 18 percent or by Rs48.7 billion in absolute terms over the budgeted amount of Rs271 billion. This reflects better resource mobilisation efforts, improved profitability of the corporate sector, particularly banking, telecommunication, oil & gas sector; improved voluntary compliance by the taxpayers. The collection from the corporate sector has gradually picked up, with the lowering of corporate rates for banking and private companies and the enhanced profitability of the corporate sector. Profitability of the banking sector has tremendously improved with collection of nearly Rs37 billion during the last fiscal year.

Fiscal Measures

*Some of the measures adopted in the Federal Budget 2007-08**

Income Tax	Customs Duty	Sales Tax	Federal Excise
▪ Present corporate tax rate of 35% to continue. ▪ Income of Micro Finance Banks (MFBs) exempted from tax for five years. ▪ Amendments proposed in legislation relating to Holding Companies. ▪ 75% shareholding required if none of the companies is a public listed limited company. ▪ 55% shareholding required if one of the group companies is a public listed limited company. ▪ Holding companies and subsidiary companies of 100 percent owned group may opt to be taxed as one fiscal unit. ▪ Group taxation will be restricted to domestic companies only. ▪ Acquisitions and mergers to be treated as non-taxable event. ▪ Inter-corporate dividend shall be liable to 10% adjustable withholding tax. ▪ A separate schedule to be added to the Income Tax Ordinance 2001 for computation of income of the banking companies. ▪ Exemption of tax on capital gains extended for further one year. ▪ CNIC to be used for identification purpose, as an alternate, where NTN is not obtained. ▪ Income arising on sale of immoveable property to Real Estate Investment Trust (REIT), exempted from tax for three years. ▪ Withholding tax @5% on purchase of locally manufactured cars. ▪ Withdrawal of CVT on import cars and power of attorney executed between first relations. ▪ Withdrawal of withholding tax on payments to travel agents on sale of air tickets where withholding tax on commission is already deducted. ▪ Tax in respect of income from construction contracts outside Pakistan to be charged at the rate of 1% of the gross receipts provided that such income is brought into Pakistan in foreign exchange through normal banking channel.	▪ Tariff Reforms process to continue. ▪ Zero-tariff slab has been proposed. ▪ Duty to be withdrawn from machinery used in horticulture, furniture, marble and granite, surgical and medical instrument business, on components used in alternative energy sources such as solar energy and wind energy. ▪ Duty reduced by 5% on raw material used in the electrical, capital goods, paper & paper board, chemicals, plastic and rubber industries. ▪ Reduction in duty proposed on generators for home consumption and for industrial usage and on energy saving lamp. ▪ DTRE system being revamped. ▪ Special surcharge @1% levied on all imports with the exception of petroleum products, edible oil, fertilizer, medicine, necessary food items. ▪ Later the 1% surcharge levied on import of raw materials imported by textiles, leather, carpets, footwear and surgical goods (the zero rated sectors) was withdrawn. ▪ New sectors/sub-sectors, have been added under the incentive regime for local manufacturing. Existing exemption regime available to different industrial segments has been deepened. ▪ Merger of Capital Value Tax (CVT) in Customs duty. ▪ Levy of regulatory duty on export of specified metals and articles thereof. ▪ Reduction/elimination of duty rates on specified diesel generating sets. ▪ Inputs used by the newspaper industry are being provided at concessionary rate.	▪ The scope of zero percent rate of sales tax enhanced to more items. ▪ Sales tax on cottonseed oil has been exempted. ▪ Amnesty scheme for waiver of default surcharge and penalty announced. Taxpayers who wish to avail the amnesty may deposit the principal amount of tax by 30.06.2007. ▪ It is proposed to exempt the arrears of sales tax of industries located in FATA/PATA subject to the condition that disputed excise duty and customs duty is duly deposited by them. ▪ Exemption of sales tax on glass bangles, surgical tapes, and ultrasound gel announced. ▪ Increase in rate of sales tax from 15% to 20% on specified raw materials. ▪ Collection of sales tax of CNG stations from gas distribution companies. ▪ Input tax adjustment disallowed on electricity and gas supplied to residential colonies within factory. ▪ Withdrawal of special procedures for commercial importers, iron and steel sector, restaurants, biscuits and confectionery. ▪ A single sales tax return and summary statement proposed. ▪ Sales tax leviable on advance payments received by registered persons is being abolished.	▪ Excise duty on exchange companies and health insurance withdrawn. ▪ Federal Excise duty proposed to be abolished on motor gasoline, jet fuel, and petroleum bitumen. ▪ Levy of excise duty proposed on all non-funded banking services except cheque book issuance charges, Umra and Hajj service charges, cheque return charges, and utility collection charges. ▪ Exemption of payment of excise duty for passengers coming from abroad is proposed to be withdrawn. ▪ Retail price of cigarette proposed to be increased by 7%. ▪ Abolition of excise duty on cable TV operators. ▪ Excise duty shall now be leviable on supplies instead of clearance as done in sales tax and shall be deposited with the return on the 15th day of the following month.

** There have been some revisions in the measures announced. These are given at the end of the article.*

Revenue Receipts

	2006-07		2007-08
(Rs Bn)	Budget	Revised	Budget
Tax Revenue	**840.9**	**839.6**	**1030.5**
Direct Taxes	271.9	320.6	408.2
Income Tax	257.8	305.0	388.0
Workers Welfare Tax	1.0	1.5	2.8
Workers Participation Fund	6.5	6.5	7.7
Foreign Travel Tax	3.7	2.6	0.0
Capital Value Tax	2.9	5.0	6.5
Foreign Travel Tax (Arrears)	0.0	0.0	3.2
Indirect Taxes	**569.0**	**518.9**	**622.3**
Customs	157.1	134.0	154.0
Sales Tax	341.6	311.0	375.0
Federal Excise	68.1	72.0	91.0
Other Taxes	1.1	1.1	1.2
Airport Tax	1.1	0.8	0.0
Airport Tax (Arrears)	0.0	0.0	1.1
Non-Tax Revenue	**241.9**	**374.4**	**337.6**
Income from Property & Enterprises	**115.2**	**118.7**	**144.5**
Profit	6.0	11.8	9.9
Interest (Provinces)	22.8	18.0	18.2
Interest (PSEs & others)	31.6	28.5	37.5
Dividends	54.8	60.4	78.8
Receipts from Civil Admn & Other Functions	**53.6**	**143.7**	**86.3**
General Admn	2.4	1.6	1.8
SBP Profits	35.0	60.0	60.0
Defence	15.2	80.9	23.1
Law & Order	0.2	0.3	0.3
Community Services	0.5	0.6	0.6
Social Services	0.3	0.3	0.3
Miscellaneous Receipts	**73.1**	**112.0**	**106.9**
Economic Services	1.8	1.9	2.1
Petroleum Development Levy	0.0	27.0	25.0
Gas Development Surcharge	18.0	33.2	22.2
Discount Retained on Local Crude Prices	0.0	0.0	4.0
Royalty on Oil	9.3	8.1	8.6
Royalty on Gas	20.5	19.8	21.4
Passport & Copyright Fee	6.3	6.5	7.3
Others	17.0	15.5	16.2

Source: Federal Budget in Brief 2007-08

Income tax collections grow

Income tax receipts have grown and surpassed the year's target, as revenue from voluntary payments have increased, and has emerged as a leading component of income tax. Both its components, i.e. payments with returns and advance tax have increased. CBR's emphasis on promoting voluntary compliance through simplified laws and procedures, the introduction of the self-assessment scheme and reduction in corporate taxes have had positive results.

Indirect taxes fall

Revised estimates for FY07 show that indirect tax collection fell short of the target of Rs569 billion by 8.8 percent to Rs518.9 billion, primarily because of lower customs duty and sales tax collection. Decreased customs duty collection in the year has been partly due to slowdown in growth of imports and a reduction in dutiable imports. During 2006-07, customs duty on about 500 items were either reduced or exemptions were given. These included sectors like IT, Telecom, steel & constructions, textile processing, chemicals, machinery & equipment etc. As a result, the dutiable import base grew smaller — the overall share of duty free imports increased to 33 percent compared to a year earlier.

Due to tariff rationalisation and reduction, the effective rate with dutiable imports for 15 major commodity groups has declined says the CBR Quarterly Review (Jan-Mar '07). The rates of customs duty have been curtailed over time to provide impetus to growth by bringing down the cost of inputs and machinery for expansion of investment.

Customs duty collection dips

Disaggregated figures for customs duty collection (CBR Quarterly Review Jan-Mar '07) show that three fourths of the gross collection is realized from fifteen major revenue earners. Of these, 13 commodity groups have either registered low growth or there has been a decline in collection. The autosector, which is the top contributor towards customs duty, saw a decline, mainly due to revised policy for the imports of old and used vehicles. Similar decline was seen in custom duty collection from mechanical machinery, iron and steel etc. For FY08, customs duty is budgeted at Rs154 billion, 15 percent higher over the revised estimates for FY07.

Sales tax is the major source of federal tax receipts and contributed nearly 60 percent to the indirect tax collections, and 37 percent of tax receipts in FY07. It's coverage has expanded over the years. Levied on manufacturers and retailers with an annual turnover of more than Rs5 million, as well as on the importers, wholesalers, distributors, dealers and specified services at 15 percent. Certain exemptionis are being given on items like foodstuff, agriculture produce, medicines, books and software etc. Sales tax collection last fiscal year fell short of the year's target of Rs341.6 billion by 9 percent or in absolute terms by Rs30.6 billion. Collections have fallen short of the target due to a decelerated growth in imports and higher payment of extraordinary refunds to the power sector; says the CBR Quarterly Review (Jan-Mar '07).

Sales tax collection

Sales tax is collected both at the import stage and on domestic sales. Domestic sales tax has been generated by telecom services, POL products (including LPG), electrical energy, natural gas, sugar, cigarettes, cement, services, beverages and auto-parts. Figures for the first nine months of 2006-07, show that there was a reduction in collection from natural gas and lower collection from cement. As the telecom services have continued to grow its share in collection has also increased. Collection from POL has been a major revenue source. While gross collection from electrical energy grew, the net collection declined, due to huge refund payments, with a major proportion going to WAPDA.

Sales tax levied at the import stage constitutes slightly more than half of total sales tax collection. There was a decline under this head, as sales tax collected from vehicles, iron and steel, electrical machinery, sugar, coffee, tea and spices declined. Last year's budgetary measures restricted the import of old and used cars and as such revenue loss was registered. Despite an increase in the import of electrical machinery, sales tax collection declined from this source, mainly due to reduction in rates of duty.

Federal excise collection rises

Revised estimates for FY07, show that federal excise duty collected during the year surpassed the target of Rs68 billion by nearly 6 percent. This year's target has been set at Rs91 billion, 26 percent higher over last year's revised estimates. This also includes airport taxes. Nearly 85 percent of excise duty collection accrues from five major items i.e. cigarettes, beverages, POL products, cement and natural gas. In 2006-07, higher collections accrued from cement, POL products, and natural gas. Higher collection from cement is because its demand has risen due to higher construction activities. To meet the rising demand production has gone up. Collection from cigarettes, beverages has been low and also from the services sector.

Higher non-tax receipts

Non-tax receipts are estimated to be 54.8 percent higher in FY07, over the earlier set target of Rs241.9 billion. The increase is attributable to higher receipts from civil administration, more specifically from defence services (Rs80.9 billion against the target of Rs15.2 billion) and from higher SBP profits (revised figures are Rs60 billion against the budget Rs35 billion), and substantially higher development surcharge and royalties.

Petroleum levy imposed on per litre price of various selected products in 2001 netted in Rs27 billion (in the budget 2006-07, the government had decided that petroleum development levy would not be used as a source of budgetary revenue) and the gas development surcharge (the government fixes the sale price for the consumers and prescribes a price for the gas companies. The difference between the two is the margin available to the government as development surcharge) was higher at Rs33.2 billion against the target of Rs18.0 billion. For 2007-08 non-tax receipts are budgeted at Rs337.6 billion, smaller over last year's revised estimates.

External resources

External resources which were projected at Rs239.3 billion for the year 2006-07, have been revised upwards and are placed higher by 15.6 percent at Rs276.6 billion. Under this head, Eurobonds are placed significantly higher at Rs45.6 billion over the target of Rs30.2 billion, and programme loans are higher by 74 percent over the year's budgeted figure of Rs76.5 billion. In FY07 like the preceding fiscal year there was a substantial drop against the year's budgeted figure in aid received from the Islamic Development Bank. For 2007-08, external resources are budgeted at Rs258.5 billion, over preceding year's revised estimates of Rs276.6 billion.

External Resources

(Rs Bn)

	2006-07		2007-08
	Budget	Revised	Budget
External Loans	213.4	250.4	229.7
Project Loans	76.4	57.9	66.6
Programme Loans	76.5	133.2	125.8
Foreign Currency Bonds	30.2	45.6	31.0
Other Aid	30.2	13.7	6.2
External Grants	25.9	26.1	28.8
Total	239.3	276.6	258.5

Source: Federal Budget in Brief 2007-08

For 2007-08, total internal resources are budgeted at Rs1.135 trillion against an expenditure of Rs1.6 trillion. The gap is to be met through inflow of external resources Rs258.5 billion, Rs75 billion from privatisation proceeds and Rs130.9 billion from bank borrowing.

Financing of the Budget

(Rs Bn)

	2006-07		2007-08
	Budget	Revised	Budget
Expenditure	1314.8	1428.0	1599.6
Current	879.7	1033.5	1056.3
Development	435.0	394.5	520.0
Other Development	-	-	23.2
Internal Resources	860.3	1021.2	1135.1
External Resources	239.3	276.5	258.5
Privatisation Proceeds	75.0	75.0	75.0
Bank Borrowing	140.0	55.2	130.9

Source: Federal Budget in Brief 2007-08

Higher subsidy

For 2007-08, the Federal Budget has set aside Rs113.9 billion as subsidy. Last year's expenditure under subsidies exceeded the budgeted figure of Rs88.8 billion by 21 percent, primarily because of higher subsidies to oil refineries and oil marketing companies, (there is a subsidy on kerosene, diesel, LDO as the government has capped the sale price of these products at an affordable level. In case of rise in international oil prices, the government pays the price differential to OMCs), a Rs9.6 billion support for R&D to textile sector (versus zero budgeted amount) and larger than budgeted allocation to KESC.

This year nearly 64 percent of the subsidies have been allocated for WAPDA and KESC. The government would be subsidising to the tune of Rs7.5 billion on the import of sugar against Rs354 million provided in FY06, and DAP fertilizer receives subsidy of Rs9 billion (versus zero last year) and on the import of urea fertilizer Rs4 billion has been allocated.

Other than the above noted subsidies, a number of welfare measures were also announced in the budget:

- Government employees salaries are being increased by 15 percent.
- Government pensioners to get 15-20 percent increase.
- Worker's widow shall now get pension of her deceased husband as per entitlement. Earlier she used to get minimum pension.
- Upgradation of scale of government employees in BPS 5, 7 and 11.
- Construction of 5000 housing units for government employees in Islamabad.
- Around 250,000 housing units would be constructed in Islamabad for government employees in the next five years.
- Minimum wage of unskilled worker has been raised from Rs4000 per month to Rs4600 per month.
- Old age pension has been increased by 15 percent. Minimum pension raised from Rs1300 to Rs1500 per month.
- In case of disability caused during performance of duty, the worker regardless of monthly income would be entitled to compensation.
- Workers Welfare Fund Ordinance 1971 being amended.
- Around 5000 utility stores will be established in every union council over the next 6 months.
- The Budget has allocated Rs7.5 billion for Pakistan Baitul Maal for the benefit of the poor.
- There has been an increae in the limit of death grant from Rs200,000 to Rs300,000.

Implications of the Budget

The Federal Budget has announced besides the welfare initiatives, some measures for the agricultural sector, changes in various taxes to boost development activities, continuity of schemes which help in employment generation and a higher PSDP with larger allocations for infrastructure development and social sector spending.

Agriculture

Agriculture is still a crucial contributor to the national economy, as it contributes 21 percent to GDP, employs 43 percent of the labour force, nearly half of industrial production comes from agrobusiness, earns directly or indirectly 70 percent of export revenues and provides livelihood to the bulk of rural households.

Agriculture has strong linkages to poverty reduction as it contributes to rural economy (farm/non-farm) and creates livelihood for the poor in the non-farm sector. As it bears a huge burden, development of this sector sends out positive signals for the rest of the economy.

This year's budget has taken certain steps for the development of the sector. This includes:

- Tubewell subsidy of 25 percent payable on electricity charges for tubewells. Subsidy to be shared between the Central and Provinces equally.
- Subsidy on the import of fertilizer. Import of urea fertilizer to receive subsidy of Rs4 billion, DAP fertilizer Rs9.5 billion.
- Farmer markets being set up at federal, provincial and district level. Once these markets have been set up it would enable farmers to bring their goods directly to the market, thereby circumventing the middle-men and profiteers.

If we can increase agricultural yield not just of the major crops but also of the minor crops like chillies, onions, pulses, edible oil, large expenses incurred on its imports could be better utilised elsewhere. Also it would help in improving the supply situation and containing the rising food inflation. This would help in mitigating the sufferings of the common man who will be able to purchase food items at affordable prices. The PSDP allocates Rs15.6 billion for food, agriculture and livestock division.

Infrastructure

A large public sector development programme is a good sign. Infrastructure spending constitutes the major portion of PSDP (water & Power Division receives Rs63.5 billion, Water (power) Rs20.6 billion, NHA Rs29.0 billion, village electrification 2.5 billion). In the budget FY08, the government has reserved Rs500 million for Bhasha Diamir Dam; the construction of Neelam-Jhelum project would cost Rs84.5 billion. Work on Gomal Zam Dam, Kurram Tangi Dam, Subak Zai Dam and the work on raising of Mangla Dam is in full swing. Similalry work on highways is also underway.

Large infrastructure projects would increase the demand for cement, and the industry stands to benefit from the development work to be undertaken in the coming year.

Prospects for 2007-08

The government has set a real GDP target of 7.2 percent for FY08, on the back of a 7.1 percent growth in the services sector, 12.5 percent by large scale manufacturing and a projected 4.8 percent growth by the agricultural sector. Monetary expansion will be around 14.4 percent and CPI inflation is targeted at 6.5 percent. Trade deficit is expected at $10.6 billion and the current account deficit at $8.1 billion. Gross reserves are expected to reach $17.7 billion in 2007-08.

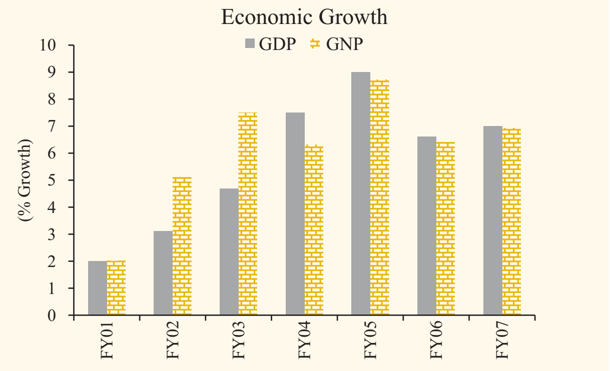
Social sector receives focus so does rural development. The later encompasses development of agriculture, augmenting social and physical infrastructure in the rural areas and involvement of community in development activities.

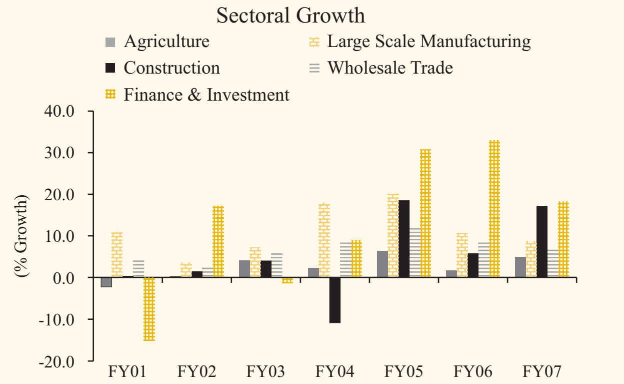
Revision in some Taxes

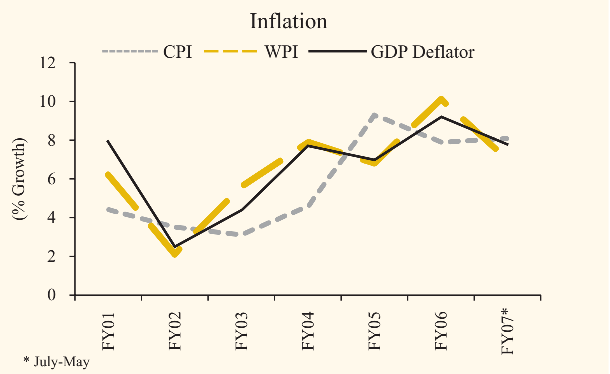
Certain revisions have been made in the taxation measures announced in the Federal Budget 2007-08. We give below the major changes announced: -

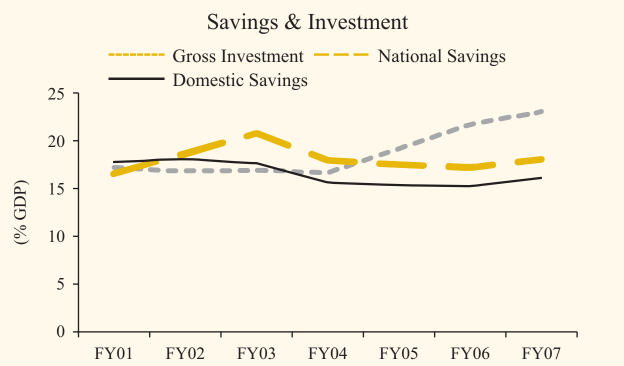
- One percent special surcharge on the import of inputs and raw materials by manufacturers-cum-exporters of textile, leather products including artificial leather footwear; carpets; sports and surgical goods has been withdrawn.
- Capital Value Tax (CVT) on the import of motor vehicles has been abolished effective June 9. Earlier, the CVT was withdrawn on motor vehicles with effect from June 18. Any CVT paid during June 9-18 would be refunded to the taxpayers..
- The government has reduced withholding tax on the locally purchased cars from 5 percent to 2.5 percent. The levy would now be applicable from September 1, 2007 instead of July 1. The tax collected is adjustable and the taxpayers are entitled to claim credit of the same while filing return of income for the relevant tax year.
- In the 2007-08 budget, the Central Board of Revenue (CBR) had proposed imposition of sales tax on computers and handsets at retail level. The government has, however, deferred imposition of sales tax on computers and hand-sets (laptops) at retail level.
- The CBR has decided to slash income tax on CNG stations from 6 percent to 4 percent. However, All Pakistan CNG Association will not be able to claim credit on other withholdings such as utility bills, vehicles and cash withdrawals from banks.
- The government has withdrawn 20 percent sales tax on import of scrap/ingot iron and imposed a fixed sales tax of Rs3,800 per ton at melting/billet-making stage. The fixed sales tax of Rs3,800 per ton on billet and ingot stage will be in addition to 1 percent excise duty that will add around Rs440 in the cost of one ton of steel for the consumers. The government had, earlier proposed 5 percent increase in sales tax from 15 to 20 percent on import of scrap/ingot iron .
- The government has reduced withholding tax on transport services from 6 to 2 percent.
- The WHT on import of energy saver lamps; bitumen; fixed wireless terminal and pesticides has also been reduced to 2 percent.
- Withholding tax on import of edible oils including crude oil imported as raw material for manufacturer of ghee or cooking oil has also been revised down from 3 to 2 percent. The CBR has notified the changes in the withholding tax regime introduced in the budget 2007-2008.
- A uniform adjustable withholding tax at 1 percent on import of capital goods and raw material imported, exclusively for its own use, has been introduced for a manufacturer registered with sales tax department. Manufacturer-cum-exporters registered with sales tax department will not be subject to WHT at import stage pertaining to capital goods and raw material. Inter corporate dividend was liable to WHT at 5 percent which was final tax liability in the case of a company.

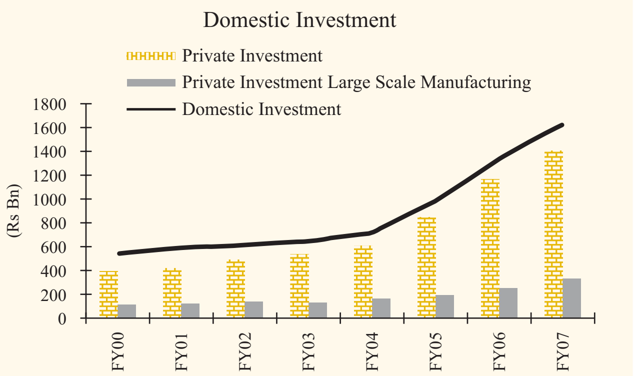
Trends in the Economy

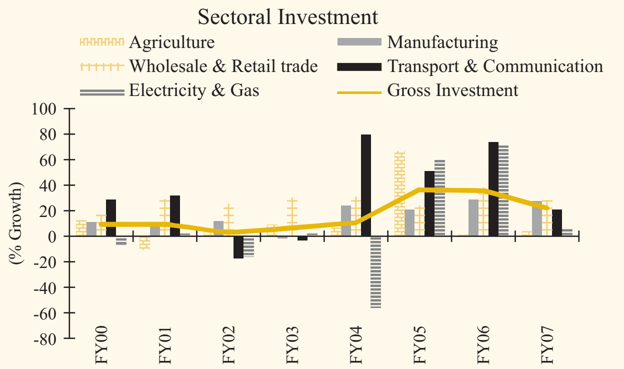


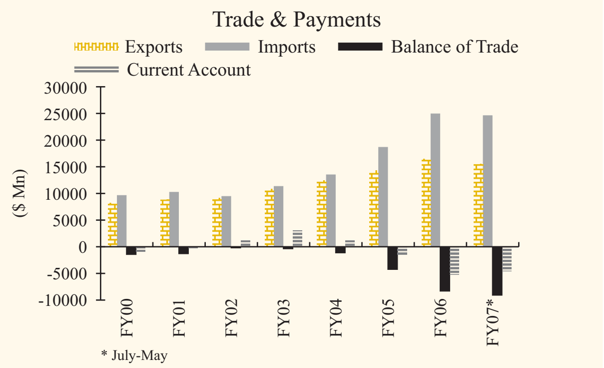


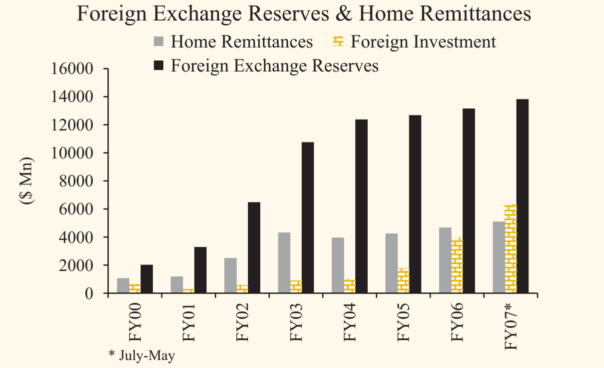




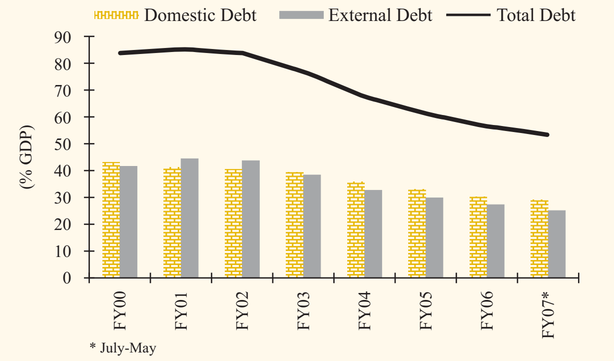




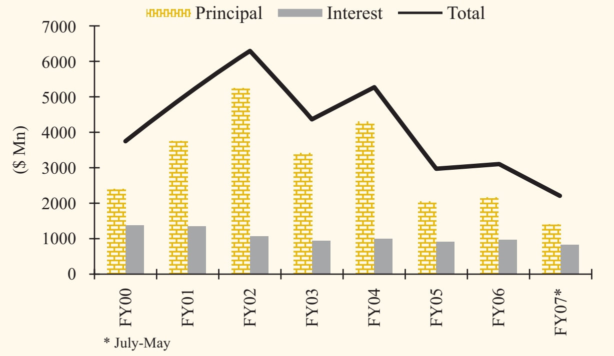




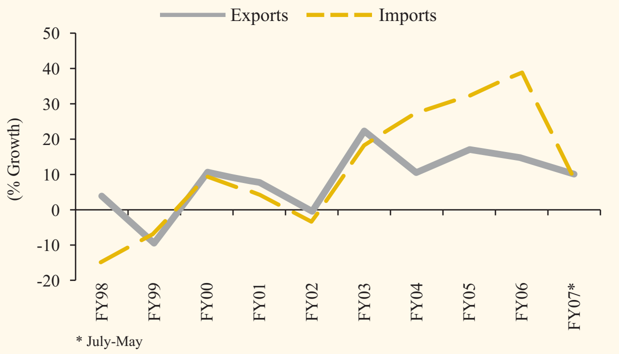
Domestic/External Debt



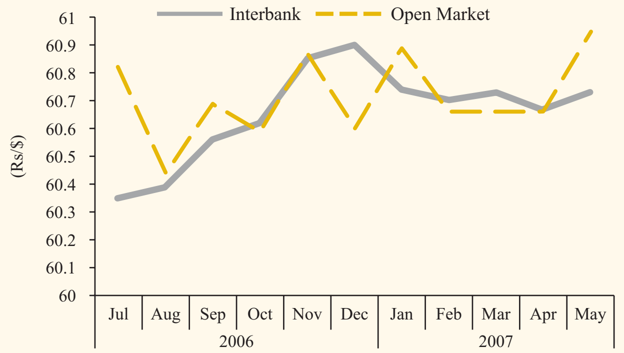
Debt Servicing



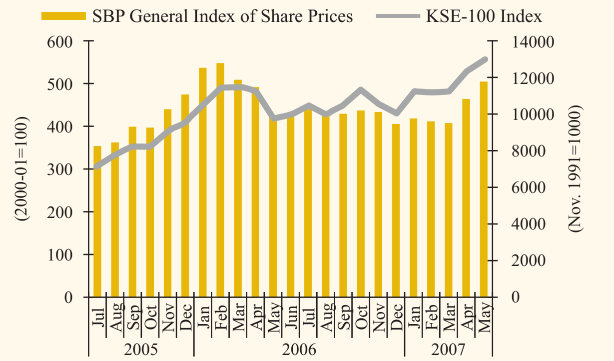
Export/Import Trend



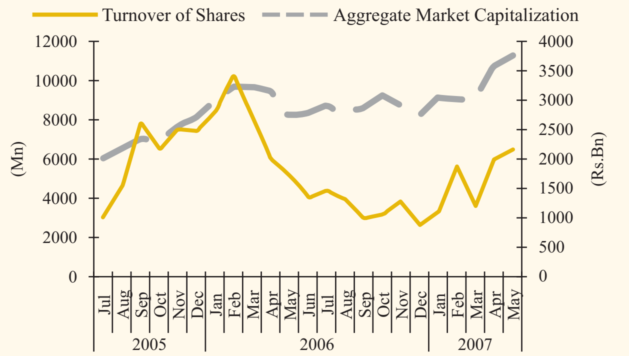
Exchange Rate



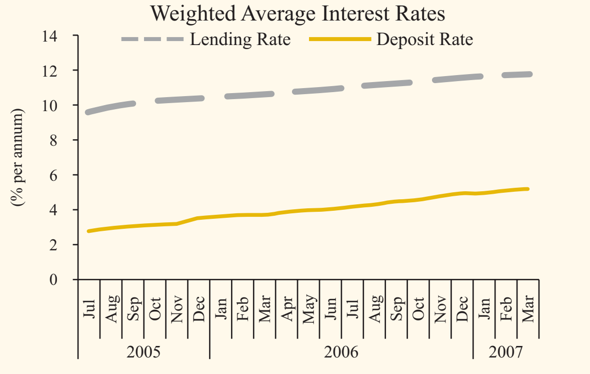
Karachi Stock Exchange Indices



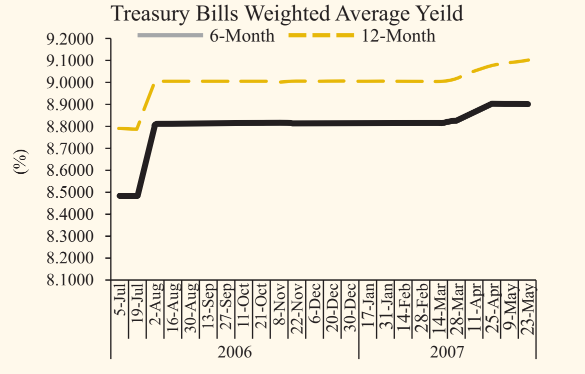
Market Capitalisation

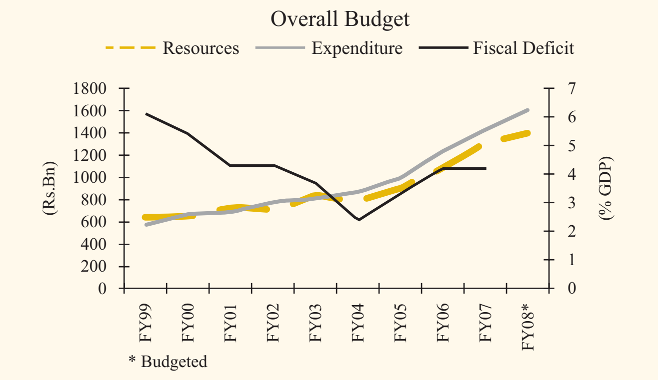


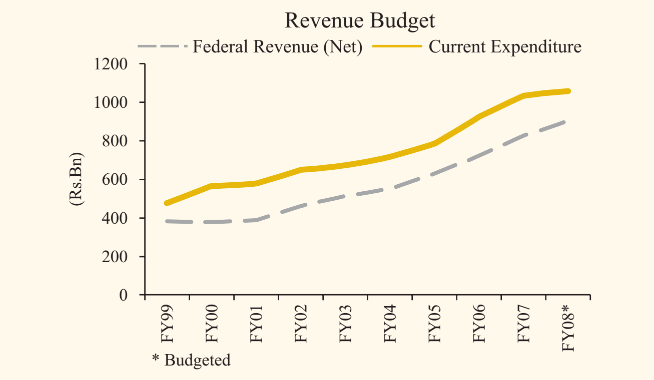
Weighted Average Interest Rates

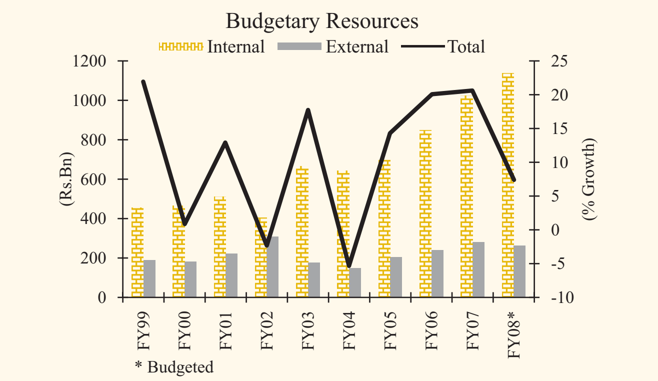


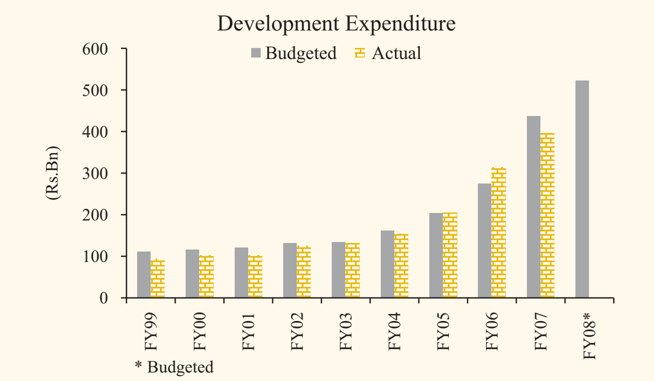
Treasury Bills Weighted Average Yeild

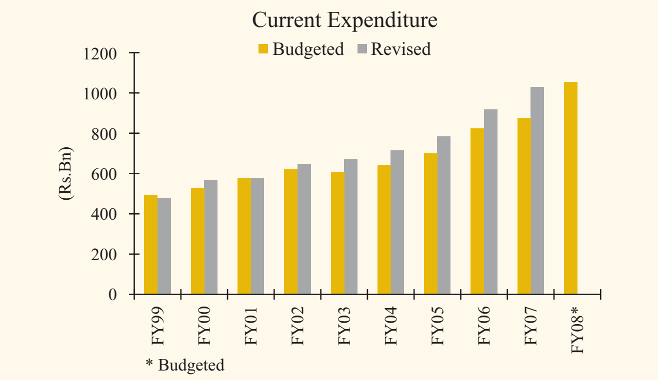


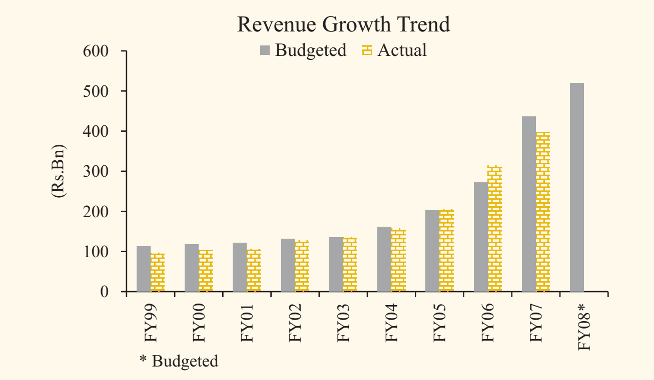

Overall Budget
Resources
Expenditure
Fiscal Deficit
(Rs.Bn)
(% GDP)
FY99 FY00 FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08*
* Budgeted

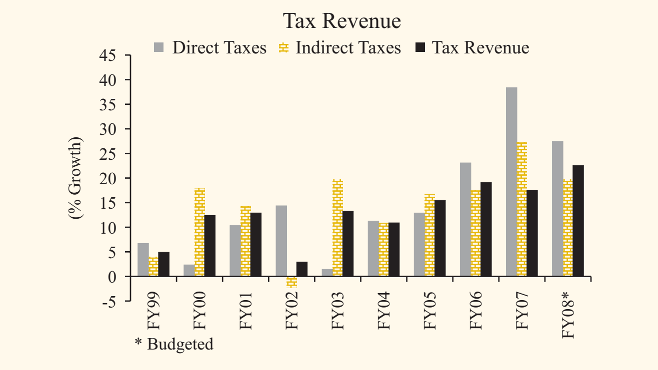

Revenue Budget
Federal Revenue (Net)
Current Expenditure
(Rs.Bn)
FY99 FY00 FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08*
* Budgeted

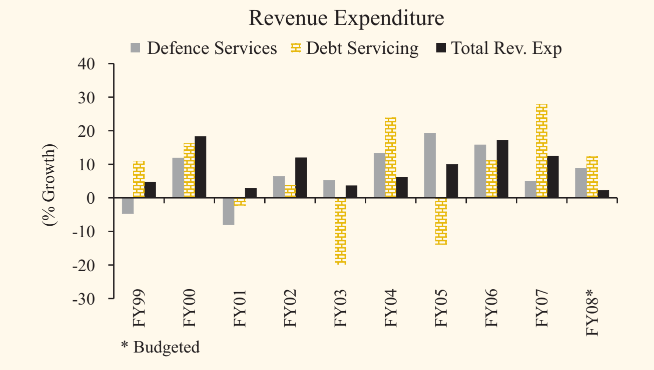

Budgetary Resources
Internal
External
Total
(Rs.Bn)
(% Growth)
FY99 FY00 FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08*
* Budgeted


Development Expenditure
Budgeted
Actual
(Rs.Bn)
FY99 FY00 FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08*
* Budgeted


Current Expenditure
Budgeted
Revised
(Rs.Bn)
FY99 FY00 FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08*
* Budgeted


Revenue Growth Trend
Budgeted
Actual
(Rs.Bn)
FY99 FY00 FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08*
* Budgeted


Tax Revenue
Direct Taxes
Indirect Taxes
Tax Revenue
(% Growth)
FY99 FY00 FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08*
* Budgeted


Revenue Expenditure
Defence Services
Debt Servicing
Total Rev. Exp
(% Growth)
FY99 FY00 FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08*
* Budgeted

Federal Budget – Impact on Private Sector

Zubair Tufail
Vice President, FPCCI

Every year in the month of June, the common man of Pakistan as well as people involved in business and industry wait for the new budget which in one way or the other effects the life of majority of the people, business/ manufacturing sector of Pakistan.

Forward looking budget

At the outset, I appreciate the Government for presenting a pragmatic and forwarding looking budget, which aims at facilitating both salaried class and poor segment of the society. The steps like reduction in the prices of certain key food items including sugar, ghee, rice, pulses would definitely provide relief to the poor, which are in fact administrative measure to control food inflation, which, presently is more that 10 percent.

These food items will be available through Utility Stores at subsidized price, though Utility Stores are limited in numbers and small percentage of population can reach them in major cities. It is necessary that the Government take suitable measures so that food items are available to low and middle income people across the country at reduced prices. It was announced that wages of the workers will be increased to Rs4600 from the present minimum of Rs4000 as well as salaries of Government employees would be increased by 15 percent. This will help reduce some of the inflationary burden.

Suppor-tive policies

The agriculture sector of Pakistan has shown an extraordinary growth of 7 percent as compared to 2.5 percent last year. This is indeed due to the supportive Government policies and it is expected that the agriculture sector will grow even further as the Government has announced the subsidy in form of the electricity bills and fertilizers which is an encouraging move. If our agriculture sector makes some extra efforts, crops of wheat, rice, sugar, cotton etc can increase substantially and create exportable surplus. Sufficient rains this year will help the crops.

However, surprisingly no incentives have been given to industries, including, textile which is considered as the back bone of the economy. In view of present scenario, we do not expect major investment in industrial sector and investor would prefer to invest in stock market and property which are considered as safe with better returns.

Unemployment is a serious issue in Pakistan. Jobless youths are allured by various groups resulting in robbery/car snatching and creating grave law and order situation. Government is spending billions of rupees for improving the situation in major cities. If a similar amount is offered to new industries in the form of incentive, it would create lot of new jobs and reduce the crime on the streets.

Government of India announced in 2006 that new Industries setup till 2010 in various Industrial zone will be free of Income Tax, Sales Tax and Central Excise duty for a period of 5 years from the start of production date. I would suggest concerned persons in our Ministry to visit these Industrial zones across the border near Simla and Chandigarh and see how fast Industries are being setup in these zones. It would be in our national interest to announce similar policy in Pakistan to reduce unemployment, increase production and create exportable surplus.

Textile sector is facing stiff competition from China, India, Bangladesh, and Thailand as our cost of production is increasing. It is expected that Government would offer some support to the textile industry by giving some relief either by offering low markup rate or with drawing at least 2 percent of levies/taxes and at the same time the industrial sector take suitable steps to reduce their cost of production.

The allocation of Rs520 billion for the development programmes is really noteworthy as this amount is not only 37.7 percent greater than the current fiscal year but is the ever highest in the budget history of Pakistan. We are of the opinion that through proper allocation of this money into development projects would help in creating employment opportunities and aid in alleviating poverty in the country.

There was a near consensus that real estate sector, which is non-productive would be taxed. However, no such step was taken in the Budget. Exempting this sector, where daily transactions are made in billions of rupees is only benefiting the privileged class. It is suggested that this sector be also brought under tax-net with imposition of duty at some reasonable rate. Otherwise business sector is of the opinion that tax collectors are intentionally not interested to collect the tax from this sector which has potential to pay billions of rupees at the time of sale purchase of property/land.

Of course revenue target of Rs1025 billion for 2007-08 is achievable provided tax base is widened and all incomes including from Real Estates and stock market are reasonably taxed as well as suitable Industrial policy is announced without delay.

I conclude with optimistic remarks that the Government and Federal Board of Revenue will bring more reforms this year and maintain friendly relation between tax payers and collectors as it was initiated about four years ago.

Provincial Budgets 2007-08

Highlights

Punjab

- Punjab has presented a Rs356 billion budget for FY08.
- The size of the Annual Development Programme is Rs150 billion, a 50 percent increase over previous year's estimates of Rs100 billion.
- Current year's budget has not levied any new taxes, nor raised the existing ones.
- In line with the Federal Budget's focus on relief measures for the poorer section of society, the Punjab Budget too has announced a relief package. This includes: -
  - 15-20 percent increase in employees salaries and pension,
  - discount in electricity bills for agricultural tubewells,
  - cash subsidy for the poorest of the poor,
  - distribution of 2 kanal plots of land among the rural poor,
  - launch of self-employment loan scheme.
- Of the Rs150 billion allocated for ADP, Rs93 billion is for core provincial development programme, Rs40 billion for special programmes, Rs14 billion for district development programme, and development of katchi abadis would cost Rs3 billion.
- Sixty six percent of the funding has been allocated for ongoing projects, while 34 percent funding will go to new projects.
- Social sector i.e. education, health, water supply and sanitation will receive 48 percent increase in funding, infrastructural investment 35 percent and pro-poor sectors 82 percent.

Sindh

- A Rs236 billion budget proposed for the year.
- Total estimated receipts stand at Rs223.9 billion.
- The budget shows a deficit of Rs12.34 billion.
- The Annual Development Programme is proposed at Rs71 billion.
- Rs50 billion has been allocated for ADP. The development outlay includes Rs10 billion for district governments.
- Communication sector receives priority. 19 percent or Rs7.66 billion of ADP has been allocated for the sector.
- Allocation for agriculture has been doubled from current year's Rs1.5 billion to Rs2.95 billion.
- Major projects to be undertaken next year include the upgrading work of keenjhar lake system to increase water supply to Karachi, construction of Bund Weir III across river Malir to harness rain water for agricultural purposes and execution of ongoing federally funded mega projects such as revamping and rehabilitation of irrigation and drainage system, among others.
- A modern meat, fish and vegetable market would be set up near Super Highway at a cost of Rs1.96 billion.
- Construction of cold storages at Mirpurkhas, Tando Allahyar and Shahpur Jahanian would be undertaken at a cost of Rs500 million.
- While no new tax has been imposed in the budget, some adjustments of existing provincial taxes have been announced.
- Salaries of all provincial government employees has been raised by 15 percent.
- Increase in pension from 15-20 percent.
- Current expenditure is budgeted at Rs166.65 billion against total current revenue resources of Rs176.59 billion.
- Of the total revenue resource, Rs151.29 billion is Sindh's share in federal taxes, while the provincial government expects to generate Rs25.30 billion.

NWFP

- The provincial government has presented a Rs114 billion budget.
- Total receipts are budgeted at Rs109.01 billion, which shows a deficit of Rs5.49 billion.
- Rs39.5 billion has been allocated for the Annual Development Programme.
- The budget consists of three categories; 46 percent is the welfare component, 15 percent is the administrative expenditure and 39 percent is to be spent on development projects.
- About 34 percent of the development budget has been allocated for the social sector.
- The provincial government has announced a 15 percent increase in the salaries of government employees, while pensions would be raised by 15-20 percent.
- In the education sector, female education would receive priority. Facilities have been enhanced and incentives provided to encourage girls to receive education.

Balochistan

- Balochistan government presents a Rs63.08 billion provincial budget.
- Total receipts are budgeted at Rs53.248 billion, with a resource gap of Rs10.278 billion.
- The province will receive Rs40.86 billion from the federal divisible pool.
- The current revenue expenditure is estimated at around Rs41.49 billion, capital expenditure amounts to Rs8.11 billion and the public sector development programme is of a size of Rs13.47 billion.
- The government announced a 15 percent increase in salaries and 20 percent in pension.

Federal Budget & Capital Market Implications

The Federal Budget 2007-08 has implications for the capital market. In terms of the equity market, the measures introduced will likely receive a mixed reaction from investors. The positive measures that have been introduced are as follows:-

Positive measures

- Reconfirmation of extension on capital gains tax exemption on sale of shares for another year to June 30, 2008.
- Maximum limit of investment in IPOs to avail tax credit enhanced from Rs200,000 to Rs300,000.
- Private equity and venture capital funds receive an income tax exemption till June 2014, which might lead to more foreign investment in the country as it will provide them with more avenues for investment.
- Capital Gains of private limited companies on sale of their assets to private equity and Venture Capital Funds to be taxed at 10 percent instead of the normal corporate tax rate of 35 percent.
- Income arising on sale of immoveable property to Real Estate Investment Trust (REIT), exempted from tax for three years.
- Mergers and acquisitions treated as a non-tax event.
- Group taxation for holding companies allowed.

The following measures might be considered negative for the equity markets but we feel that the reaction from investors may be mute:

- Withdrawal of exemption to mutual funds on CFS interest income.There is some apprehension that this may cause a credit crunch as around a quarter of CFS financing is provided by them but we feel that this is not likely to happen.
- The federal excise duty on stock brokerage commission has been raised from 5 percent to 15 percent.

Banking & Insurance Sectors

Budgetary Impact - Banking Sector

Measures

- Excise duty of 5% extended to include all non-fund banking services except cheque book issuance charges, Umra and Hajj service charges, cheque return charges and utility collection charges.
- Income of Micro Finance Banks (MFBs) exempted from tax for five years.
- Mergers and Acquisitions to be treated as non tax events.
- Separate schedule for computation of profits and gains of banking companies introduced (but subsequently deferred for one year). Income under the head of dividend and capital gains on listed shares chargeable to tax at the rate of 10 percent.
- Amendment in Banks (Nationalization) Act, 1974 that seeks to facilitate further off-loading of government shareholding upto 49 percent - National Bank of Pakistan and Khushali Bank.

Implications - Mixed

Measures positive for the banking sector

The implications of the measures proposed in the Budget FY2007-08 with regards to the banking sector can be viewed positively. The massive expenditure outlay to keep domestic demand buoyant alongside rising per capital incomes and wage levels (for the second consecutive years) will likely keep consumption strong which in turn bodes well for the banking sector. Moreover, continued attention towards infrastructure projects will support the overall decelerating credit off-take. Within the PSDP allocation, Rs84 billion has been earmarked for the water and power sector compared to last years' Rs70 billion. Most importantly, however, some budgetary measures such as the increase in wage levels have the potential to translate into higher inflation in days to come which in turn may compel the central bank to further tighten its monetary posture.

The levy of excise duty on non-fund based services will simply be passed on the consumers. The exemption of Micro Finance Banks from taxation for five years is a positive step. Furthermore, the tax neutrality of M&A transactions is also a positive for the sector due to the ongoing consolidation and foreign acquisition boom in the industry. Last but not least, an amendment is proposed (to be approved by the National Assembly) that seeks to facilitate further off-loading up to 49 percent of equity of National Bank of Pakistan and Khushhali Bank.

On the negative side, the Seventh Schedule aims to provide guidelines regarding the computation of profits and gains of a banking company and regarding the admissibility of depreciation, initial allowance and amortization as allowable expenses while disallowing deductions on assets held under finance lease. Moreover, advances classified as per the Prudential Regulations will be allowed as part of deductions if classified as 'doubtful' or 'loss' while such expenses will not be allowed if classified as 'substandard'.

In case of Shariah Compliant Banking, the schedule does not allow any special treatment and the adjustments will be required to convert the transactions recorded as per the Islamic modes of financing to one as per normal accounting principles. The equality in treatment regarding the computation of taxes between the two parallel forms of banking will likely have a negative impact on Islamic Banks in most cases.

Budgetary Impact - Insurance Sector

Measures

- Abolition of excise duty on exchange companies and health insurance.

Implications - Positive for non-life

The much talked about reforms in the industry sector to improve the prevailing low penetration rates in the industry (both life and non-life entities) and also to improve savings' rate (via life insurance products) have not been introduced as part of the Federal Budget FY2007-08. Nonetheless, the abolishment of excise duty of 5 percent on health insurance has been implemented to provide a level playing field to non-life insurance companies in the field of health insurance vis-à-vis life insurance companies.

Textile & Synthetics Sectors

Measures

- Imports of Polyester filament fiber yarn subject to WHT @5 percent.
- Increase in the minimum wages from Rs4000 per month last year to Rs4600 per month this year.
- Incentive given to spinners for debt swapping under LTF – EOPs.

Implications - Uncertain

Textile relief package is expected to be announced later this month which will probably be more comprehensive than what was stated in the budget. With the imposition of 5 percent WHT on the import of Polyester filament fiber yarn together with imposition of anti dumping duty on import of PSF from Thailand, Korea and Indonesia, is positive for the synthetic sector.

Increase in the minimum wages of unskilled workers will increase the cost of production for the textile sector as it is a labor intensive industry. Allowing the textile spinners to refinance their loans under the Long Term Finance for Export Oriented Projects (LTF-EOP) will probably not have a significant impact on the textile spinning sector as not many spinning companies fulfill the requirement of 50 percent export revenue. According to the latest federal trade figures of July to April 2007, yarn export was only 14 percent of total textile group export.

Cement Sector

Measures

- Increased expenditure allocation for Public Sector Development Program (PSDP) from budgeted amount of Rs435 billion for FY07 to Rs520 billion for FY08 (+19.5% YoY). Share of federal government has been increased from Rs270 billion to Rs335 billion (+24% YoY) coupled with 30 percent (y-o-y) increase in share of provincial government to Rs150 billion.

Implications - Positive

With this significant jump in the expenditure allocation for Public Sector Development Program (PSDP) by both the federal and provincial governments in the budget FY07-08, we anticipate positive impact of this increase in developmental expenditure on the cement sector. Out of Rs335 billion federal budget, we estimate over 50 percent allocation for infrastructural development compared to 44 percent last year (+13.6% YoY). We also have estimated the growth in local cement consumption during the next fiscal year. With correlation of 0.99 between PSDP expenditure and local cement consumption, the total allocation of Rs520 billion might result in local consumption of cement to the extent of 24.85 million tons despite the fact that cement is one ingredient of PSDP allocation besides other material expenses such as iron/steel, land, labor, machinery and equipment etc.

Growth in economy and continuous public sector development increased the PSDP allocation in budgets from Rs90 billion in FY01 to Rs435 billion in FY07, a 6 year CAGR of 30 percent. This increased local cement consumption from 9.9 million tons in FY01 to 20.7 million tons in FY07 (10 million FY07 annualized) at a 6 year-CAGR of 13 percent. Consistency in government policies and favorable economic conditions resulted in robust demand for locally produced cement. This coupled with timely expansion by the sector to cater to both local and regional demand led to windfall earnings for cement producers during FY07; however, for a short span of time, a supply glut led to plummeted cement prices; negatively affecting the profitability of these cement companies during FY07.

However, our expectation for FY07 local cement consumption is around 21.5 million tons and we expect 15 percent YoY growth in FY08 to 24.7 million tons mainly depending on increase in PSDP expenditure in FY08 budget and continuation of current policies. Other factors which might bode favorably for the cement sector are the strong housing sector growth including recently announced project of 250,000 low cost housing units, continuation of 1450 ongoing projects and development of 669 new projects including allocation for large hydel projects like for Neelam-Jehlum hydro power (Rs10 billion out of total cost around Rs84.5 billion), Basha Diamer dam (Rs500 million), Golan Gol hydro power project (Rs 450 million), Khan-Kuar hydro power (Rs 700 million), Allai Khawar hydro power (Rs1 billion) and Dubir Khawar (Rs1.5 billion). The government has a history of rushing to meet the PSDP target in the end of the fiscal year and we expect the same for the upcoming fiscal year of FY08 as the target of Rs520 billion seems to be relatively optimistic.

E&P/OMC Sector

Measures

- Abolition of excise duty of Rs0.88 per litre on motor gasoline and Rs0.06 per litre on jet fuel.
- Exploration & Production companies are exempted from withholding tax on imports (other than vehicles).
- Non resident exploration and production companies are exempted from withholding tax on supply of crude oil and gas.

Implications - Neutral

The government has abolished excise duty on mogas and jet fuel to extent of Rs0.88 and Rs0.06 per litre respectively. This measure is likely to have negative implication on the Oil marketing companies as the price at the retail level will reduce thus reducing per litre gross profit of these companies in absolute terms; however, gross margin is likely to remain same @2.83 percent after GST (or 3.50 percent before GST). Therefore, at the current Motor Spirit price of Rs53.70, removal of excise duty of Rs0.88/litre is expected to bring down OMCs gross profit from Rs 1.52/ litre to Rs1.49/litre.

However, reduction in price of motor spirit may increase volume sales thus mitigating the impact of reduced gross profit. We expect that the Petroleum Policy 2007 will be approved shortly which would provide incentives for further exploration activity. Also, the wellhead pricing would not be capped at $36.00 a barrel as per 2001 policy but would allow marginal increase on new concessions provided international crude oil prices cross $45.00 a barrel.

Auto Assembler Sector

Measures

- Proposal of levying 5 percent Withholding Tax (WHT) on locally assembled cars which subsequently was reduced to 2.5 percent.
- Import of used cars further restricted from 5 years to 3 years old.
- Removal of Capital Value Tax (CVT) on imported cars. However, custom duty further enhanced to offset the impact on the local industry

Budgetary Impact - Positive

The implementation of AIDP will have a positive impact on the sector which includes pre-determined five year tariff plan for both local and imported parts and vehicles, expansion by industry to 500k units per annum, increasing exports of parts and vehicles, auto clusters, research and development activities and projects, incentives on human resource development by assemblers or vendors, incentives to new entrants, reduced depreciation on import of used cars and other non tariff incentives.

Enhanced restriction on the import of 3 year old cars will bode favorably to the local assemblers as the relative benefit of buying an imported car is likely to reduce due to its expensive maintenance and non-availability of spare parts.

Fertilizer Sector

Measures

- Increase of subsidy for DAP from Rs400 per 50kg bag to Rs470 per bag.
- Abolition of custom duty on phosphoric acid from 5 percent to 0 percent, whereas GST on import of phosphoric acid has been increased from 15 percent to 20 percent.
- 25 percent decrease in the electricity charges for tube wells.

Budgetary Impact - Positive

Current budgetary measure of allocation of Rs13.5 billion subsidy on fertilizers, as compared to Rs12.3 billion last year, is expected to have a positive impact on the sector. Subsidy by GoP on DAP will amount to Rs9.5 billion, coupled with Rs4 billion for the imports of urea. These subsidies will directly be passed on to the farmer who can produce essential crops at lower cost. It will help the farmer to improve the nutrient level of the soil for better crop yield. By using the ideal ratio of 1 bag of DAP to 2 bags of urea, this will perk up the deteriorating soil conditions. Increase in the water utilization may have a positive impact on the area under cultivation hence increasing the demand for fertilizers.

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

Book/Report Reviews

Gender & Education in Pakistan
Edited by Rashida Qureshi
& Jane F. A. Rarieya

The book on Gender & Education is a collection of research based essays that studies gender issues in education in Pakistan. These issues are reflected in educational policies, teachers lives, classroom practices, educational leadership and educational research.

The book is divided into six parts, starting with the changing educational landscape, and provides a picture of how girls' education, despite the commitment to equal rights, universal primary education and literacy, remains more limited than boys in the region.

In Chapter 1, '*Female Education in Pakistan: A Review*', the author analyses the quantitative and qualitative outcomes of the government's efforts towards reducing the gender gap in education. While gains have been made in providing access to and enrolment of children, especially girls in school, the overall gender disparities have persisted resulting in rural girls being more disadvantaged. Recognition must be given to other sectors of women's development alongwith education to change her status in society. The need for partnership between the government and non-governmental organizations has been discussed.

Part II *Gendered Teaching* has three articles on the subject. In one of the articles the author has discussed the role of the family in career progression of women – is the family supportive or does it stifle the ambitions of the woman. In another chapter the author examines the complexity of being a woman teacher. One of the authors has used life histories of women teachers in northern areas of Pakistan and examined how education and employment opportunities for women in the mountainous communities impact the traditional image of women by expanding the boundaries of their traditional roles.

Part III comprises studies that deal with *Gendered Schooling Practices*. In the chapter *Gender and Language in Higher Education*, the difference between males and females competency in regional languages and the factors responsible for such phenomena are explored. Also discussed are the implications of their findings for language policy in higher education. *Gendered Leadership* is covered in Part V.

Third Punjab Development Forum 2006
Planning & Development Department
Government of Punjab

The Government of Punjab since the last three years has been holding the annual Punjab Development Forum. Invited to the Forum are stakeholders involved in the wide ranging governance, fiscal and financial, and other reforms in the province to improve the economic and social sectors.

This Report is the third in the series and records the papers presented at the three day conference. The first session discussed the Punjab's Development Framework. The provincial government gives priority to literacy, employment, development of skills, improving primary health, among others.

The Province's economic performance was discussed. Punjab has undertaken governance reforms and poverty alleviation programmes. It is striving to create a conducive and business friendly environment in the province where existing and prospective entrepreneurs are able to focus their creative energies on maximizing business opportunities. It has also undertaken pro-poor investment in education and health sectors.

At the end of each session on various issues there was an exchange of dialogue with the international development partners. This exchange of ideas allowed all to take stock of progress which ultimately leads to an improvement in the design of policies and institutions.

Pakistan Economy – Key Economic Indicators

	FY '03	FY '04	FY '05	FY '06	FY '07
Domestic Economy					
Size*					
GNP (Rs.bn)	5027.5	5765.1	6634.2	7743.8	8867.7
GDP (Rs.bn)	4875.6	5640.6	6499.8	7593.9	8706.9
Per Capita Income (US$)	586	669	733	833	925
Growth** (%)					
GNP	6.3	7.3	8.3	6.4	6.9
GDP	4.7	7.5	9.0	6.6	7.0
Agriculture	4.1	2.4	6.5	1.6	5.0
Manufacturing	6.9	14.0	15.5	10.0	8.4
Services Sector	5.2	5.8	8.5	9.6	8.0
Consumer Price Index (%)	3.1	4.6	9.3	7.9	7.8
Wholesale Price Index (%)	5.6	7.9	6.8	10.1	6.9
Total Revenue (Net) (% GDP)	14.9	14.3	13.7	14.0	13.4
Tax Revenue	*11.4*	*11.0*	*10.1*	*10.6*	*11.7*
Total Expenditure (% GDP)	18.6	16.7	17.0	18.2	17.6
Overall Deficit (% GDP)	(-)3.7	(-)2.4	(-)3.3	(-)4.2	(-)4.2
Domestic Debt (Rs.bn)	1894	2012	2158	2314	2523
as % GDP	39.3	35.7	32.8	30	28.4
Education Expenditure (% GDP)	1.86	2.20	2.13	1.92	2.42
Health Expenditure (% GDP)	0.59	0.58	0.57	0.51	0.57
States and Markets					
SBP General Index of Share Prices[x] (% Growth)	91.9	57.8	12.2	17.7	18
KSE 100 Index[a] (% growth)	92.2	55.2	41.1	34.1	29.7
Aggregate Market Capitalisation (% growth)	119.9	88.0	45.2	35.8	35.3
Domestic Investment (% GDP)	16.9	16.6	19.1	21.7	23.0
National Savings (% GDP)	20.8	17.9	17.5	17.2	18.0
Domestic Savings (% GDP)	17.6	15.7	15.4	15.3	16.1
Reserve Money (M_O) % growth	14.5	15.4	17.6	10.2	20.3
Broad Money (M_2) % growth	18.0	19.6	19.3	15.2	16.1
Deposit Rates (Weighted average % pa)	1.61	0.95	1.37	1.96	2.53[b]
Lending Rates (Weighted average % pa)	9.40	7.28	8.81	10.61	11.12[b]
Global Links					
Exports (f.o.b.) $mn	10974	12459	14482	16553	15530
Imports (f.o.b.) $mn	11333	13738	18996	24994	24654
Trade Balance $mn	(-)359	(-)1279	(-)4514	(-)8441	(-)9124
Services Account ($mn)	(-)2	(-)1316	(-)3293	(-)4430	(-)4277
Income (net) ($mn)	(-)2211	(-)2207	(-)2386	(-)2667	(-)3372
Current Transfers (Net ($mn)	6642	6114	8659	10548	9394
Current Account Balance ($mn)	4070	1812	(-)1534	(-)4990	7379
External Debt & Liabilities ($bn)	35.47	35.26	35.83	37.26	38.86[c]
as % GDP	42.5	36.4	32.7	29.4	27.1
Public Debt to GDP (%)	75.1	67.1	62.2	56.9	53.4
Foreign Investment ($mn)	816.3	912.7	1676.6	3872.5	6282.4
Portfolio	*18.2*	*(-)27.7*	*152.6*	*351.5*	*1761.6*
Direct	*798.0*	*949.4*	*1524.0*	*3521*	*4520.8*
Foreign Exchange Reserves ($mn)	10719	12328	12623	13137	13834
Exchange Rate (Rs/$)	58.4995	57.5745	59.3576	59.8566	60.5770
People					
Population (mn)	146.7	149.6	152.5	155.4	158.2
Labour Force (mn)	43	44.1	45.9	46.8	50.5
Literacy Rate (%)	51.6	53	53	54	54
Telephones (mn)	4.0	4.5	5.1	5.1	5.2
Mobile Phones (mn)	2.4	5	12.8	34.5	55.5
Motor Vehicles on Road (mn)	5.3	5.7	6	7.1	8.1

* Market Prices ** Constant Factor Cost of 1999-2000 [x] 2000-01 base [a] Nov.1991=1000 [b] As of Dec [c] July-March

M_O = currency in circulation + other deposits with SBP + currency in tills of scheduled banks + bank's deposits with SBP.

M_1 = currency in circulation + other deposits with SBP + scheduled bank's demand deposits.

M_2 = M_1 + scheduled bank's time deposits + resident foreign currency deposits.

Source: Economic Survey FY07 & SBP website