Economic Achievements:
First Year of Prime Minister Shaukat Aziz's Government

By

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The Government of Prime Minister Shaukat Aziz is completing its first year on 28th August 2005. It is rather a short period to take stock of the achievements of the Government. However, it is customary the world over that analysts judge the performance of the Government in the first year as it shows the direction of various initiatives of the Government and possible outcomes of the policies. The Government of Prime Minister Shaukat Aziz has been illustriously prominent both on political as well as on the economic front. This paper documents the achievements of the government on the economic front in its first year.

The first year (2004-05) of Mr. Aziz's Government has indeed been an eventful year for Pakistan's economy. The year has posted several multiyear *"firsts"* in an extremely difficult external environment caused by the unprecedented rise in oil prices. Pakistan's real GDP growth of 8.4 percent in 2004-05 is the fastest pace in two decades; the fifth time in the country's history that it exceeded 8 percent growth mark; its per capita income crossed $ 700 mark; Pakistan achieved highest ever production of cotton *(14.6 million bales)* and wheat *(21.6 million tons)*; the privatization of 26 percent share of the PTCL amounting to $ 2.6 billion has been the single largest privatization transaction in the country's history; it has seen the largest ever expansion of private sector credit; exit from the IMF Programme marks an important milestone; Pakistan became the fourth sovereign to issue an Islamic Bond (Sukuk), following Malaysia, Qatar and Bahrain; the country's public and external debt burden declined to their lowest in decades; the passing of the Fiscal Responsibility and Debt Limitation Law has been one of the landmark achievements of the Government; current account balance slipped into the red after posting surpluses for three consecutive years; and inflation at 9.3 percent is the highest in 8 years.

Pakistan is in the midst of an economic upturn. Since 2002-03, the economy has mounted a strong recovery with a sustained improvement in prospects. During the first year of Mr. Aziz's Government (2004-05), many of its macroeconomic indicators show marked improvement over last year. The most important achievements of the year include: the fastest pace in real GDP growth (8.4 %) supported by a strong growth in large-scale manufacturing (15.6 %), a sharp pick up in agriculture (7.5 %), a continuing robust performance in services sector (7.9 %), and an extra-ordinary strengthening of consumer demand; a double-digit growth (12 %) in per capita income in dollar term, reaching $ 736; investment upturn gaining a

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stronger footing, particularly private sector investment which remained buoyant owing to a rare confluence of various positive developments; an unprecedented increase in credit to private sector (Rs. 390.3 billion) reflecting their growing confidence on the future prospects of Pakistan's economy; strong growth in the consumption of petroleum products (9.3 %), gas (9.6 %), electricity (7.4 %) and coal (9.6 %) reflecting rising level of economic activity; fiscal deficit remaining more or less on the target despite Rs. 60 billion shortfall in revenue, resulting from the freeze in domestic prices of petroleum products on account of protecting the people of Pakistan from the adverse consequences of the unprecedented hike in international price of oil; higher than targeted collection of taxes (Rs. 591 billion); a high double-digit growth in exports($ 14.5 billion) and imports ($ 19 billion); workers' remittances ($ 4.2 billion) maintaining their momentum; a continued accumulation of foreign exchange reserves ($ 12.6 billion) and stability in the exchange rate; a sharp decline in the public (61.7% of GDP) and external debt burden (32.5% of GDP); launching of first ever Islamic Bond (Sukuk) in international capital markets; and most importantly, the exit from the IMF program and the passing of the Fiscal Responsibility and Debt Limitation Act 2005 mark important milestones for the country.

After four years of weak and fragile growth the first year of Mr. Aziz's Government has seen *agriculture* staging a smart recovery by posting a growth of 7.5 percent on the back of an unprecedented rise in the production of cotton (14.6 million bales) and wheat (21.6 million tons) crops. These two crops account for over 24 percent of the value added in agriculture. Stellar performance of these two crops helped agriculture staging an impressive recovery in 2004-05. *Manufacturing* sector in general and *large-scale manufacturing* in particular, continued to maintain their impressive performance during the year under review. Overall manufacturing registered an impressive growth of 12.5 percent and large-scale manufacturing exhibited a sharp pick up of 15.6 percent. Various factors including accommodative monetary policy, financial discipline, consistency and continuity in policies strengthening of domestic demand, continuously improving macroeconomic environment, a stable exchange rate, continued global economic expansion fueling exports growth, and a general "feel good" environment have been responsible for sustained high growth in large-scale manufacturing. Growth in this sector has not only been impressive but has also been broad-based as many sub-sectors registered a high double-digit growth.

The first year of Mr. Aziz's Government also witnessed the emergency of a strong middle class with great buying powers. Three years of strong economic growth has given rise to the average income of the people. Such increases in income levels have led to a sharp increase in *consumer spending* – real private consumption expenditure grew by 8.2 percent in 2003-04 and further by 16.8 percent in 2004-05 (the first year of Mr. Aziz's Government). The extra-ordinary strengthening of consumer demand is feeding back into economic activity and is likely to support the on-going growth momentum. This extra-ordinary rise in consumer spending appears to have contributed in part in raising the general price level at a pace much faster than government's expectations.

The first year of Mr. Aziz's Government continued to make gains on *fiscal front*. The *overall fiscal deficit* remained on the target (3.2% of GDP) despite Rs. 60 billion hit to the budgetary revenue on account of not passing fully the rising cost of petroleum products to the domestic consumers. The policy of Mr. Aziz's Government has been to protect the people of Pakistan from the unprecedented rise in oil prices as much as possible and share the remaining burden with different segments of the society according to their ability to pay.

Public debt burden continues to decline rather sharply over the last five years with significant improvement in fiscal situation. During the year under review, public debt as percentage of GDP declined to 61.7 percent from the previous year's level of 67.7 percent. Until a few years ago, Pakistan was facing serious difficulties in meeting its external debt obligations. Not only was the stock of external debt and foreign exchange liabilities growing at a breakneck pace, but the debt carrying capacity remained stagnant. Following a credible strategy of debt reduction, Pakistan has succeeded in reducing the rising trend in *external debt and foreign exchange liabilities*. Pakistan's external debt and liabilities stood at $35.8 billion or public debt 32.5 percent of GDP in 2004-05 — down from 36.6 percent in previous year. Furthermore, the external debt and liabilities as percentage of foreign exchange earnings declined sharply to 137.2 percent in 2004-05 from 164.9 percent a year ago. It is important to note that Pakistan's external debt & Liabilities as percentage of foreign exchange earnings was 347 percent in 1998-99 – much worse than many Highly Indebted Poor Countries (HIPCs). Such a massive reduction in country's debt burden (from 347% to 137.2%) in a short period of six years is one of the greatest achievements of the Government for which, the credit goes to the dynamic leadership of President Pervez Musharraf and his economic team led by Shaukat Aziz. Prudent debt management, the continued build-up in foreign exchange reserves and the higher foreign exchange earnings, pre-payment of expensive debt and debt write-off are the major factors responsible for the reduction in the country's debt burden.

Workers remittances, the second largest source of foreign exchange inflow after exports, continued to maintain a rising trend. Workers remittances totaled $ 4.2 billion during the current fiscal year, as against $ 3.8 billion last year. Pakistan has been receiving, on average, $ 4.0 billion or 4.0 percent of GDP per annum of remittances during the last three years. Such a massive inflow of remittances has helped Pakistan building its foreign exchange reserves which, in turn, has provided stability in exchange rate.

Pakistan has succeeded in attracting $ 1524 million in *FDI during* the year under review as against $ 949.4 million a year ago, showing an increase of 60.5 percent. Over 70 percent of FDI has come into power sector; telecom sector; chemicals, pharmaceutical and fertilizer; oil and gas; and banking and finance. Almost 70 percent of FDI has come from USA, UK, Switzerland, Japan, UAE and Netherlands. Such inflows simply suggest that the first year of Mr. Aziz's Government has succeeded in further bolstering the confidence of the foreign investors on the growth prospects of Pakistan's economy.

Pakistan's *total liquid foreign exchange reserves*, maintained an upward trend during the year under review. By end fiscal year 2004- 05, reserves touched all time high at $ 12.6 billion — up from $ 12.3 billion last year. The continued build up in foreign exchange reserves has provided strength to the Pakistani rupee vis-à-vis US dollar. The inter bank exchange rate per US dollar averaged rupees 59.4 per US dollar in 2004-05 as against Rs.57.6 averaging last year, reflecting a marginal depreciation of 3.0 percent on the bank of a widening trade deficit. This simply suggest the growing strength of Pakistan's balance of payments which withstood the major adverse effects of rising oil prices. In general, Pakistan's exchange rate vis-à-vis US dollar has remained stable during the year under review.

Pakistan's *trade deficit* (-$ 4.5 billion) has widened beyond target for the current fiscal year owing to a much faster increase in imports ($ 19 billion) compared with exports ($14.5 billion). Given the stronger-than-anticipated surge in domestic economic activity, the widening of trade gap in the short-run is quite normal. The widening of trade gap is not worrisome as long as it is caused by rising imports which is expanding the production base of the economy. In the case of Pakistan, the trade gap has widened because of the extra-ordinary surge in investment driven imports, which is expanding the production base of the economy.

Pakistan's *current account balance* has slipped into red in 2004-05 after posting surpluses for three consecutive years. The current account deficit, excluding official transfers, stood at $ 1.77 billion (1.6% of GDP) during the year under review as against a surplus of $ 1.31 billion a year ago. Besides widening trade gap underpinned by a surge in investment-driven imports, higher freight charges by international shipping lines as a result of sharp increase in global trade and higher fuel cost and growth in personal travel due to the rising level of income of middle and high income groups, have also contributed in taking current account balance in deficit for the first time in three years. A deficit in the range of 1.5 – 2.0 percent of GDP is quite consistent with the growth target (6 – 8%) that Pakistan has set for itself in the next five years. If Pakistan succeeds in attracting FDI in the same range, it can finance the gap in current account without adding to the country's debt burden, as FDI is a non-debt creating inflow.

The first year of Mr. Aziz's Government also witnessed 8 years high *inflation* of 9.3 percent. Food inflation recorded at 12.5 percent while non-food inflation averaged 7.1 percent. It is not uncommon to find a country which lived through a low growth environment for quite sometime and then gradually move to high growth path to see inflation rising as a result of temporary disequilibrium in demand and supply. This sharp upturn in inflation is caused by demand side pressures on the one hand and supply shocks on the other. Three years of strong economic growth in succession have given rise to the income levels of various segments of society. The rising levels of income have strengthened domestic demand which contributed to the rise in inflationary pressure. Supply side pressures emanated from a combination of factors. Successive increases in the support price of wheat in the last two years, shortage of wheat owing to less than the targeted production (in 2003/04); and the mismanagement of wheat operation by two provinces, resulted in sharp increases in the prices of wheat and wheat-flour. The price of other food items registered sharp increases owing to 'sympathy effect' on the one hand and demand pressure on the other and some extra market manipulation of the prices of essential commodities by certain associations. In addition, a surge in international oil prices coupled with an unprecedented rise in world prices of commodities have combined to spark inflationary pressure. Cognizant of the impact of inflation on economy in general, and poor and vulnerable segments of society in particular, the government of Prime Minister Shaukat Aziz have taken wide ranging steps to bring the prices of essential items down. These measures include liberalization of import regime of essential commodities with a view to augmenting the supply of these commodities to put downward pressure on their prices and selling sugar and wheat flour at substantially reduce rates through the outlet of Utility Stores Corporation (USC), including the outlet of USC in different weekly bazaars and through their mobile units in far flung areas. These measures alongwith tightening of monetary policy on the one hand and freezing of the oil prices in domestic market on the other have resulted in decline in inflation from 11.1 percent in April 2005 to 8.7 percent in June 2005. Going forward these measures will help the stabilized the prices in the country.

While the year has seen improvements in many macroeconomic indicators, the first year of Mr. Aziz's Government has also seen improvements in social and living conditions of the people. Results from the recently concluded Pakistan Social and Living Standards Measurement (PSLM) Survey show a marked improvement in social and living conditions indicators. Key indicators such as literacy rate, gross and net enrolment in primary, middle and matric levels; access to sanitation and safe drinking water; use of electricity and gas as source of lighting and cooking fuel, respectively; various health indicators such as child immunization and treatment of Diarrhea, have all shown marked improvements over the last 4 – 7 years.

Pakistan's economy is no longer fragile and its balance of payments is no more vulnerable to external shocks. This fact was abundantly clear during 2004-05. The first year of Mr. Aziz's Government has seen the unprecedented rise in oil prices, touching $ 67 per barrel and yet the economy grew at its fastest pace, the exchange rate remained stable, foreign exchange reserves continued to build up despite $ 1.0 billion additional increase in import bills on account of rising oil prices, budget deficit remained more or less on the target despite a budgetary hit of Rs. 60 billion on account of freezing the domestic prices of petroleum products and most importantly, the country's balance of payments remained stronger than ever. Wide-ranging structural reforms, prudent macroeconomic policies, financial discipline, and consistency and continuity in policies have transformed Pakistan into a stable and resurgent economy. The landscape of Pakistan's economy has changed altogether. Therefore, its challenges have also altered. Six years ago the economic landscape was entirely different and the major challenges have been as how to revive the economic activity? How to improve country's macro economic environment? How to bring the debt problem under control? And how to restore the country's financial sovereignty? With the grace of almighty God, the Government has addressed these challenges:

The current challenges on the back of a different economic landscape include: as how to sustain the growth momentum and how to translate these economic gains into improving the lives of the people of Pakistan in general and common man in particular. Creating employment opportunities and strengthening of the country's physical infrastructure are yet other challenges faced by Mr. Aziz's Government. In order to address these challenges the Government has a clear road map and a workable strategy in place. The country's macro economic policies are being geared towards sustaining growth momentum. To this end, the government is making every effort to keep budget and current account deficits under control.

While growth is essential to create employment opportunities and improve the living conditions of the people, the Government has already initiated some direct interventions to improve the lives of the common man. These measures include the launching of Khushal Pakistan Program (KPP), Tameer-e-Pakistan Program, One Village One Product Program, Technical Education and Vocational Training Program, Clean Drinking Water for All Program, Hepatitus Program, Village Electrification Program, Mega-City Development Program and Livestock Development Initiative. All these Programs are designed not only to create jobs at local levels but improve the lives of the common people. The KPP is concerned with four core social issues:- clean drinking water, roads, sanitation and rural electrification & gas. Khushal Pakistan Fund has an initial outlay of US $ 1.00 billion and provision of Rs. 5.00 billion has subsequently been made in the PSDP 2005-06. Tameer-e-Pakistan program covers schemes such as gas, water, electricity, roads, education, telecommunication, health and sanitation. Allocation of Rs. 27.5 billion has been made for this program during the MTDF cycle. To increase income and well being of the local community another program with the name of One Village One Product is also ongoing. The aims of this program are to create jobs, promote human resource development and help small and micro enterprises prosper. To achieve a qualitative improvement in manpower to meet the growing needs of our economy. The government is launching Technical Education and Vocational Training (TEVT) Program. Under this program a large number of youth will be trained in vocational trades in the shortest possible period of time. Keeping in mind the problem of potable water in Pakistan, the program Clean Drinking Water For All is also under progress. Under this program, filtration plants will be installed in all the union councils by 2007. It has an initial investment outlay of Rs. 2.5 billion. To control diseases in the country, the Hepatitis Program is an eminent health initiative. The prime minister has approved Rs. 2.5 billion for the prevention and cure of this disease. With the passage of time electricity has become a necessity, in this context Village Electrification in Pakistan is another milestone project of the Government of Pakistan. This ambitious program aims at providing electricity to all villages of Pakistan by 2007. Around 34561 villages will be lightened under this program. Needless to say this is no trivial task by any means. To bring public and private sectors across the entire urban regions to formulate and carry out a coordinated set of targeted investments, the Mega-City Development Project has been launched. Pakistan being an agrarian country, the importance of agriculture and livestock cannot be ignored. Livestock Development Initiative is another link in this chain. The basic aim of this project is to alleviate poverty through exploitation of livestock resources consequently increasing returns to owners of Live Stock in Rural Areas.

Pakistan has lived through a difficult and testing period in the not too distant past; its economy was fragile; the Balance of Payments was highly vulnerable to external shocks; the country’s debt burden had reached alarming proportion; financial indiscipline was the order of the day and the country’s foreign exchange reserves were at dangerously low levels. After six years of hard work Pakistan economy is now resurgent, and the Balance of Payments has never been so comfortable. Pakistan has made remarkable economic progress in the last six years. During the first year of Mr. Aziz’s government Pakistan economy gained further traction. The Government is not complacent and it is fully aware of the new challenges. The first phase of reform agenda and policies transformed an ill-health economy to a healthy one. The challenge now is to keep the health of the economy intact. Pakistan today is vastly different than what it was half a decade ago. Under the leadership, the guidance and the support of President Pervez Musharraf and under the stewardship of the Prime Minister Shaukat Aziz, Pakistan economy has been brought from peril to stability. Going forward Pakistan will strive to attain its true potential. The one-hundred and fifty two million people of this country have enormous potential to excel in many areas. The intelligence, the dynamism and the ability to learn are second to none. What is required is the unlocking of the creative energies of the people. If we stay the course, we are confident that under the visionary guidance of the President and stewardship of the Prime Minister Pakistan will achieve its true potential. Going forward Mr. Aziz’s Government will devote its energy to further strengthen the economy and improve the life of the common man. Let us together make Pakistan a better place to live and bequeath a stronger country to our current and future generation.