PAKISTAN
ECONOMIC UPDATE
(JULY - SEPTEMBER 2003)

ASIAN DEVELOPMENT BANK

DECEMBER 2003

Pakistan Resident Mission
Asian Development Bank

ASIAN DEVELOPMENT BANK
December 2003
Pakistan Resident Mission
OPF Building, Shahrah-e-Jamhuriyat
G-5/2, Islamabad, P.O. Box 1863
Islamabad, Pakistan.

Tel : (92-51) 2825011-16
Fax: (92-51) 2823324
(92-51) 2274718
E-mail: adbprm@adb.org

FOREWORD

The Asian Development Bank is a long-standing development partner of Pakistan, having provided a total of US$12.4 billion to the country in development assistance from December 1968 to December 2002. Of this amount, US$1.1 billion were provided in 2002. The projected assistance for the period 2003-2005 amounts to US$2.4 billion. Historically, the major development sectors in which ADB has invested have included agriculture and rural development, energy, social sectors, finance and trade, and transport and communications. Under its Country Strategy and Program for Pakistan for 2002-2006, reduction of poverty is the central objective, which is operationalized through promoting sustainable pro-poor growth, inclusive social development, and good governance, with governance being the key area of focus.

Together with this extensive lending portfolio, the Pakistan Resident Mission (PRM) is actively engaged in Economic and Sector Work to develop an understanding of important economic policy and sector concerns, particularly with regard to poverty and governance issues. To bring this work to a wider audience, PRM published, in July 2002, a country poverty assessment titled "Poverty in Pakistan: Issues, Causes, and Institutional Responses", after extensive consultations and dialogue with the key development partners. PRM has also started a working paper series on topical issues, and the first one titled "Escaping the Debt Trap: an Assessment of Pakistan's External Debt Sustainability" was published in December 2002. In addition, PRM published Pakistan: Sector Assessment Review in October 2003, which provides an overview of ADB's operations in Pakistan, particularly over the last five years.

In 2002, PRM initiated a quarterly series to provide a regular update on the state of the national economy. The first Pakistan Economic Update was published in April 2002. The present report provides an analysis of economic trends in Pakistan in the first quarter of fiscal year (FY) 2004 along with the outlook for the whole year. The report also discusses Government's economic policies and reforms and reviews poverty related expenditures in FY2003. We hope that the contents of this report will be of use to all stakeholders including the Government, civil society, donors, academia, media, and others. We look forward to receiving comments on the report, and also suggestions for improvement of future reports in this series.

M.ALI SHAH
Country Director, Pakistan

Contents

TABLES

FIGURES

BOXES

PAKISTAN ECONOMIC UPDATE

(JULY - SEPTEMBER 2003)

With continued buoyancy in both domestic and external sectors of the economy in the first quarter of FY2004 and presence of a number of factors conducive for growth, the prospects for the realization of the overall growth target of 5.3 percent for the year look good. The overall fiscal deficit so far is on the target, and growth of exports and imports is likely to exceed the target for the year.

Economic recovery, which had started last year, continued in the first quarter of FY2004, with both domestic and external sectors remaining buoyant. The Government pushed forward its economic reform agenda and made further progress in privatization of public sector enterprises. Data on poverty related public expenditure, now available for the full FY2003, also shows a substantial growth, reflecting the Government's commitment to poverty reduction. This report analyses macroeconomic developments in the first quarter of FY2004 along with the outlook for the whole year in section I, Government's economic policies and reforms in section II, and poverty related expenditures in FY2003 in section III.

I. MACROECONOMIC DEVELOPMENTS

Performance thus far indicates that the Pakistan economy is on track to achieve the overall growth target of 5.3 percent in FY2004. Two of the three major summer crops, for which output data is available, show growth over last year, and prospects for winter crops look good, given the greater availability of water. Growth in the large-scale manufacturing (LSM) sector in the first quarter of the year was almost twice that of last year, and the large increase in private sector credit and double-digit growth in exports augur well for manufacturing growth during the rest of the year. Despite some slowdown in tax collection, fiscal deficit remained on target, and inflation was low. Both exports and imports showed double-digit growth and the current account of the balance of payments continued to show a comfortable surplus in the first quarter of FY2004. With global recovery gaining momentum, growth in exports is likely to be sustained.

Domestic Sector

Growth: The real sector of the economy showed a robust growth in the first quarter of FY2004 and the outlook for the rest of the year looks good. In the agriculture sector, rice and sugarcane crops are estimated to be 13.9 percent and 1.1 percent larger than last year, while the cotton crop may be 2.0 percent smaller. Greater availability of water for winter crops along with the 16.7

Growth of manufacturing production in the first quarter of FY2004 was twice that in the same period of last year.

percent increase in procurement price of wheat announced in November 2003 has greatly improved the prospects of the wheat crop. A sharp increase in the price of cotton (43.5 percent in October 2003 over October 2002) should more than compensate for the lower cotton yields because of the pest attack, and enable farmers to purchase necessary inputs for winter crops. In the large-scale manufacturing (LSM) sector production increased by 11.7 percent in the first quarter of FY2004, compared with growth of 5.2 percent in the same period of last year. The growth was broad-based, with increases being particularly large in the case of cement, electronics, and automobiles (see table 1). Financial sector, telecommunications, electronic media, and construction led growth in the service sector.

Prices: Price stability seen in FY2003 continued in the first quarter of FY2004. The annual rate of inflation based on a comparison of 12-month moving average of the Consumer Price Index (CPI) decreased to 2.6 percent in September 2003 from 3.1 in June. However, reports of a shortage of wheat stocks to fully cover requirements for the period to the next harvest and Ramadhan associated spike in food prices has raised the inflation rate in the last two months. It is to be seen whether this is a temporary phenomenon or start of uptrend in inflation in response to growing consumer demand pressures.

Monetary Developments: In an environment of stable prices and appreciating Pak Rupee, the State Bank of Pakistan (SBP) continued to pursue an easy monetary policy in the first quarter of FY2004. Money supply increased by 2.1 percent compared with the same percentage increase recorded in the corresponding

Table-1: Growth in the Large-scale Manufacturing Sector

		July - September		
	Weights (%)	FY2002	FY2003	FY2004
Textiles	**19.1**	**3.0**	**3.2**	**5.1**
Of Which:				
Cotton Yarn	8.9	3.8	6.1	2.0
Cotton Cloth	4.9	10.4	-3.4	19.4
Food, Beverage, Tobacco	**17.3**	**17.9**	**-5.2**	**10.6**
Of Which:				
Vegetable Ghee	3.0	-5.5	-9.6	3.8
Tea (blended)	1.8	16.2	0.9	3.3
Cigarettes	2.5	N.A.	N.A.	16.4
Fertilizers	**5.8**	**2.3**	**-1.9**	**3.0**
Basic Metal Industries	**3.2**	**-3.2**	**1.0**	**13.5**
Of Which:				
Pig Iron	1.5	-6.5	-2.4	18.7
Coke	1.3	2.2	-4.9	22.5
Non-metallic Mineral Products	**1.9**	**-9.1**	**7.3**	**16.4**
Of Which:				
Cement	1.8	N.A.	9.7	17.2
Electronics	**2.2**	**19.5**	**2.7**	**48.8**
Automobiles	**2.3**	**12.6**	**24.1**	**27.7**

Source: Federal Bureau of Statistics.

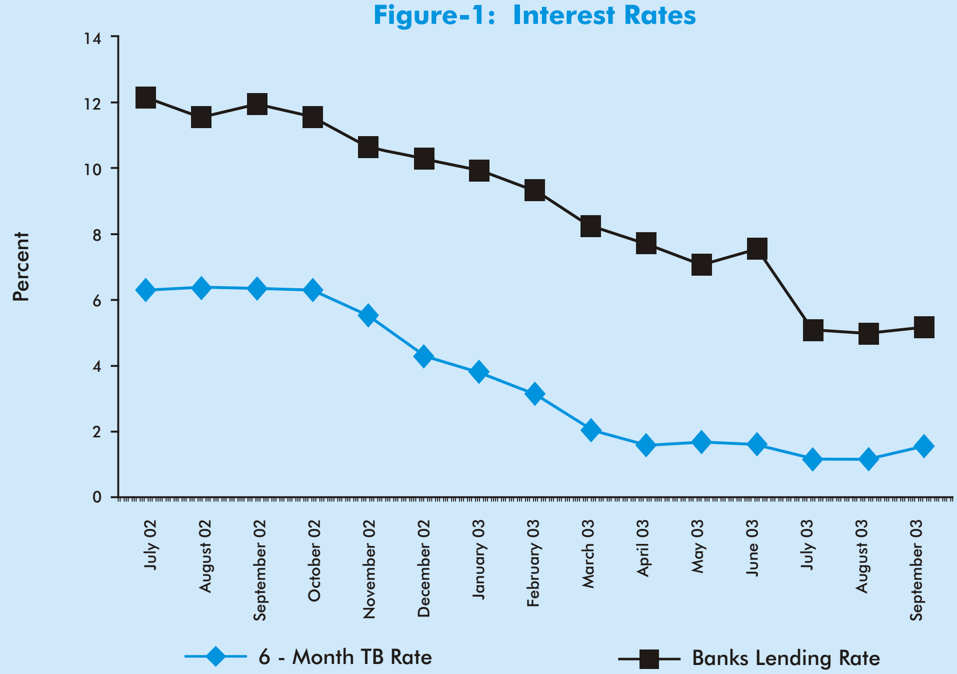
quarter of FY2003.[1] Increase in money supply came mainly from increase in net foreign assets of the banking system (7.8 percent), reflecting further increase in foreign exchange reserves. Net domestic credit increased by only 0.1 percent. However, this small increase in domestic credit conceals significant expansion in credit to the private sector and some net borrowing by the Government for budgetary support, which was almost entirely offset by retirement of bank loans by public sector enterprises and government's borrowing for commodity operations, and contraction in other items of the banking system. There was a net increase of Rs 23.1 billion in bank credit to the private sector in the first quarter of FY2004 in contrast with a net retirement of Rs 26.8 billion in the corresponding quarter of FY2003.[2]

Historically, there has been a pattern of seasonal contraction in bank credit to the private sector in the first quarter, before it picks up in the second quarter with the commencement of borrowing by the textile industry to finance purchases of cotton from the new crop. Continued recovery in the economy, strong investment growth in the telecom sector, increase in consumer credit, and higher prices of cotton explain the sharp growth in private sector credit in the first quarter. Net increase in budget-related borrowing (Rs 9.9 billion) in the first quarter of FY2004 in contrast with retirement in the corresponding period last year is explained by lower external assistance flows (see page 7).

There was a remarkable increase in private sector credit in the first quarter of FY2004.

The discount rate remained unchanged at 7.5 percent, and yields on 6-month treasury bills and 10-year Pakistan Investment Bonds, and the lending rate charged by banks, despite increasing somewhat, remained at historically low levels (see figure 1).

Figure-1: Interest Rates



1. The latest data put on its website by SBP shows that money supply increased by 3.2 in the first four months of FY2004.
2. The net disbursement of credit to the private sector increased further to Rs 60.8 billion in the first four months of FY2004.

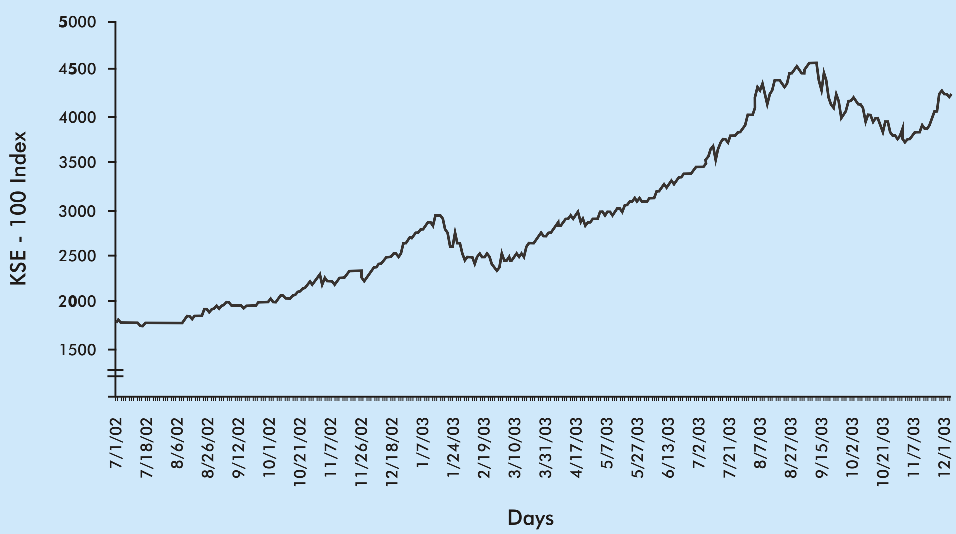
The Government was able to further reduce the fiscal deficit to 0.9 percent of GDP in the first quarter of FY2004.

Stock Market: Share prices continued their rising trend in the first two and half months of FY2004 and the KSE-100 index touched the peak of 4,604 and market capitalization rose to Rs 1,016 billion by 12 September 2003 (see figure 2). Thereafter, equity prices declined amid fluctuations and the KSE-100 index fell to 3,732 by 6 November, but the recent improvement in relations with India has again pushed up share prices, with the KSE-100 index rising to 4,246 on 8 December. Thus in FY2004 the KSE-100 index has increased by 24.8 percent so far.

Fiscal Policy: The Government continued to pursue the policy of fiscal stabilization during the first quarter of FY2004, and was able to further reduce the overall fiscal deficit to 0.9 percent of GDP, compared with 1.0 percent in the corresponding quarter of FY2003 (see table 2). Expenditure increased by 6.2 percent, while revenues increased by 7.9 percent.

The Government was able to contain the increase in expenditures because of a sharp decline in subsidies and lower interest payments on domestic debt. Expenditure on subsidies was only 4.0 percent of the total amount provided in the budget for the full year, mainly because of switchover from accrual basis to cash basis for recording expenditure under this heading. In addition, improvement in cash flow of PSEs also contributed to reduction in subsidies (see page 16). Interest payments on domestic debt were down by 12.0 percent because of lower interest rates in the domestic market. Interest payments on foreign debt, which had shown a large decline last year, remained unchanged in the first quarter of FY2004. Saving in interest payments on domestic debt could have been even larger, but for the slow pace of adjustment of rates of interest on high-cost National Saving Schemes (NSS) instruments.[3] Savings in aforementioned expenditure heads was more than offset by a large increase in

Figure-2: Stock Market Performance



3. Downward adjustments have recently been made in rates of return available on NSS instruments to bring them closer to rates of return on medium - and long - term Pakistan Investment Bonds (PIBs). However, NSS rates are still higher than on comparable PIBs. Also, the two new NSS instruments introduced for widows and pensioners offer considerably higher rates than other NSS instruments.

Table-2: Consolidated Federal and Provincial Fiscal Position (Billion Rs)

	July - June		(%) Change	July - September		(%) Change
	FY2002 (Revised Estimate)	FY2003 (Prel. Estimates)		FY2003	FY2004	
Total Revenue	**633.4**	**720.7**	**13.8**	**153.5**	**165.6**	**7.9**
Tax Revenue	425.7	487.5	14.5	98.1	103.8	5.8
Federal Taxes	407.0(a)	465.7 (b)	14.4	92.2 (d)	95.3	3.3
Provincial Taxes	18.6	21.9	17.4	6.0	8.5	41.7
Surcharges	54.0	68.2	26.4	17.4	15.9	-8.6
Non-tax Revenues	153.7	164.9	7.3	38.0	45.8	20.5
Federal	132.3	139.6	5.5	34.1	40.1	17.6
Provincial	21.4	25.4	18.7	3.9	5.7	46.2
Total Expenditure	**873.1**	**898.1**	**2.9**	**194.5**	**206.5**	**6.2**
Current Expenditure	723.1	781.9	8.1	161.2	158.9	-1.4
Federal	544.8	590.0	8.3	116.4	116.7	0.3
Of Which:						
Interest	245.8	199.8	-18.7	49.1	44.2	-10.0
Domestic	184.6	160.5	-13.1	41.0	36.1	-12.0
Foreign	61.1	39.3	-35.7	8.1	8.1	0.0
Defense	149.0	159.7	7.2	32.6	45.7	40.2
Running of Civil Administration	83.5	98.1	17.5	17.3	18.4	6.4
Subsidies	23.4	50.0	113.8	13.7	2.6	-81.0
Provincial	178.3	191.9	7.6	44.8	42.2	-5.8
Development Expenditure and Net Lending	155.5	106.5	-31.5	21.1	33.1	56.9
Development Expenditure	123.6	129.2	4.5	21.7	24.9	14.7
Federal	98.4	90.0	-8.5	14.6	14.6	0.0
Provincial	25.2	39.2	55.3	7.1	10.2	43.7
Net Lending by Federal Government	31.9	-22.7	-	-0.6	8.3	
Unidentified Expenditure	-5.4	9.8	-	12.3	14.5	17.9
Budget Deficit	**240.0**	**177.4**	**-26.0**	**41.0**	**40.9**	**-0.2**
Budget Deficit (Excluding one-off expenditure)	**187.7**	**177.4**	**-5.5**	**41.0**	**40.9**	**-0.2**
GDP	**3,628.7**	**4,018.1**	**10.7**	**4,018.1**	**4,420.0**	**10.0**
Budget Deficit (As % of GDP)	6.6	4.4		1.0	0.9	
Budget Deficit (Excluding one-off expenditure) (As % of GDP)	5.2	4.4		1.0	0.9	

(a) Includes other taxes amounting to Rs 3.1 billion.

(b) Includes foreign travel tax of Rs 4.1 billion.

(d) Includes foreign travel and other taxes of Rs 0.6 billion.

Source: Ministry of Finance Website

expenditure on defense (40.2 percent). Expenditure on running of civil administration also increased reflecting a 15 percent increase in salaries of government employees.

There was a discernable slowdown in tax collection in the first quarter of FY2004.

After a sharp increase in FY2003, there was a discernable slowdown in tax collection in the first quarter of FY2004. Gross tax collection by the Central Board of Revenue (CBR), at Rs 113.0 billion, was more or less the same as in the corresponding quarter of FY2003. Last year there was a 14.2 percent increase in tax receipts over the corresponding period of the preceding year. Only receipts from customs and general sales tax (GST) on imports showed increases of 15.9 percent and 6.1 percent, respectively. Receipts from direct taxes remained unchanged at last year's level and GST collection on domestic production declined by 11.7 percent. Net federal tax collection, at Rs 95.3 billion, was 3.3 percent higher than in the corresponding period of FY2003, because of a substantial decrease (14.8 percent) in tax refunds.

The slow-down in gross collection of direct taxes may be partly attributable to tax measures announced in the FY2003 budget, such as increase in the minimum threshold for personal income tax and reduction in corporate tax rates for banking and private companies. The decline in GST on domestic production, despite continuing recovery of domestic economic activity, may be partly explained by advance payments of GST last year by Pakistan Telecommunication Company Ltd. (PTCL) and electric power generation and distribution companies and consequently lower payments (due to readjustment for advance payments) in the first quarter of FY2004 (see table 3). Collection from these two sources was less than half that in the corresponding quarter last year. However, it is not clear why GST collection after excluding the collection from these two sources was still only 1.8 percent higher than last year, when production was significantly higher.

The Government financed almost three-fifths of the deficit by borrowing from the non-bank domestic market, mainly through NSS instruments.

The overall fiscal deficit, at Rs 40.9 billion, in the first quarter of FY2004 was more or less the same as in the corresponding quarter of FY2003. The Government financed almost three-fifths of the deficit by borrowing from the non-bank domestic market, mainly through NSS instruments (see table 4). With external assistance substantially lower than last year, the Government also borrowed from the banking system in contrast with net retirement of bank borrowing last year.

Table-3: Collection of General Sales Tax on Domestic Production (Billion Rs)

	July - September		(%) Change
	FY2003	FY2004	
Total	30.9	27.3	-11.7
Services (including telecom)	4.9	2.2	-54.8
Electric energy	2.7	1.3	-50.1
Total (excl. services and electric energy)	23.3	23.7	1.8

Table-4: Financing of the Fiscal Deficit
(Billion Rs)

	July - September		(%) Change
	FY2003	FY2004	
Overall Fiscal Deficit	41.0	40.9	-0.2
Financing			
External Borrowing (net)	34.6	4.9	-85.7
Domestic Non-bank Borrowing (net)	19.7	24.1	22.6
Domestic Bank Borrowing (net)	-14.1	9.9	-
Privatization Proceeds	0.8	2.0	150.0

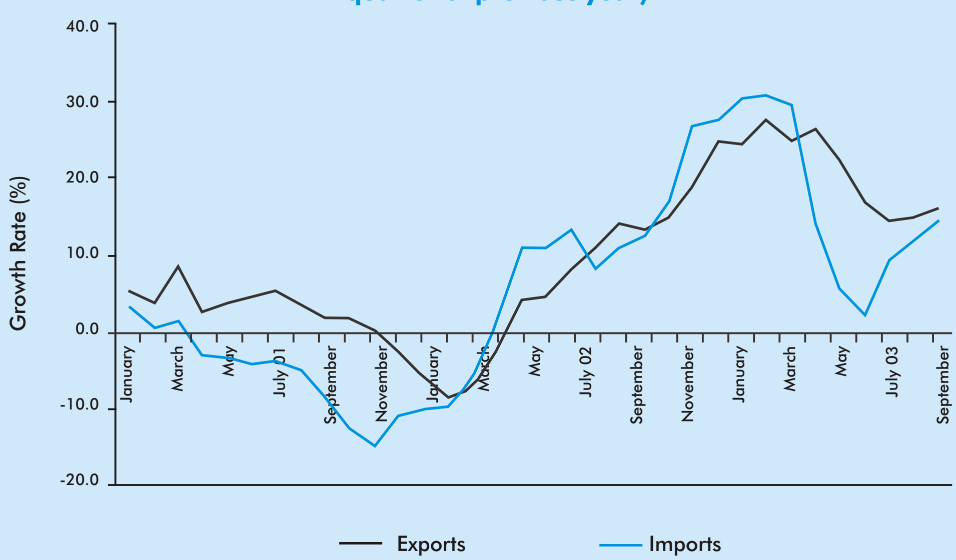
External Sector

Balance of Trade: Exports and imports continued to grow at a robust double-digit rate in the first four months of FY2004. Exports increased by 14.2 percent and imports by 12.9 percent, compared with the corresponding period last year. This growth in exports and imports was on the back of growth of 20.8 percent and 17.8 percent, respectively, seen last year. Growth of both exports and imports in the period under review exceeded the targets given in the Trade Policy announced in July 2003. However, growth of both exports and imports decelerated in May-July 2003, and seems to have picked up again in September and October (see figure 3). The trade deficit in the first four months of FY2004, at $310 million, was slightly lower than in the corresponding period of FY2003.

Exports and imports continued to grow at a robust double-digit rate in the first four months of FY2004.

As in FY2003, textiles led growth in exports in the first four months of FY2004.

Figure-3: Growth of Exports and Imports
(% change over corresponding quarter of previous year)



Textile exports increased by 15.6 percent and accounted for 71.3 percent of the total export growth.

Textile exports increased by 15.6 percent and accounted for 71.3 percent of the total export growth (see table 5). As a result, concentration of exports in textile manufactures increased further to 65.5 percent of total exports. Better access to the European Union and US markets and improved competitiveness of the domestic textile industry continued to boost textile exports. Recovery in the global economy also helped maintain the tempo of growth of textile exports.

Textile exports continued to benefit from both rising volume and higher unit prices in the first four months of FY2004. Of textile exports for which quantity data is available, three-fourths showed increases in volume, with knitwear and bed wear registering quantum increases of 29.4 percent and 20.4 percent, respectively. All textile export items, except canvas and tents, showed increases in prices. The shift away from low value-added items, which was seen last year, continued in the first four

Table-5: Structure of Exports
(Million $)

Commodities	July - October FY2003	July - October FY2004	(%) Change
Primary Commodities	**325**	**328**	**1.0**
Of Which:			
Rice	144	197	36.8
Fish & Fish Preparations	49	66	35.0
Wheat	73	6	-91.7
Textile Manufactures	**2,251**	**2,603**	**15.6**
Of Which:			
Cotton Yarn	315	311	-1.3
Cotton Cloth	426	497	16.6
Knitwear	365	483	32.1
Bed Wear	388	488	25.8
Towels	104	120	15.9
Readymade Garments	358	348	-2.8
Art, Silk & Synthetic Textile	161	194	20.1
Madeup Articles (include.other Tex.)	116	144	24.0
Other Manufactures	**676**	**664**	**-1.8**
Of Which:			
Carpets, Rugs & Mats	68	67	-1.3
Petroleum Products	41	71	70.1
Sports Goods	99	88	-11.1
Leather Tanned	80	67	-16.9
Leather Manufactures	150	149	-0.8
Surgical Goods & Medical Instruments	47	35	-25.6
Chemicals And Pharm. Products	80	86	7.5
Engineering Goods	22	28	28.8
Others	**228**	**379**	**65.9**
Total	**3,480**	**3,974**	**14.2**

Source: Website of the Federal Bureau of Statistics.

months of FY2004. While the share of cotton yarn declined to 11.9 percent from 14.0 percent in the corresponding period of FY2003, the share of five higher value-added items, bed wear, knitwear, towels, readymade garments, and synthetic textiles, increased to 62.7 percent from 61.1 percent.

Among non-textile manufactures, export of petroleum products recorded a sharp increase of 70.1 percent to $71 million in the first four months of FY2004 on the back of an equally impressive growth (62.9 percent) recorded last year. Another noticeable development is substantial increase (28.8 percent) in export of engineering goods. Last year also, their export had increased by 33.1 percent.

Among primary commodities, export of rice increased by 36.8 percent on the back of a 21.8 percent increase last year. Increase in rice export is attributable mainly to increase in quantity, although its price also showed some increase. Rice accounted for 60.1 percent of primary exports compared with 44.3 percent in the same period last year. However, wheat, which was the third largest export earner among primary products in FY2003, declined sharply in the first four months of FY2004. The bulk of the carry-over stock of wheat from previous years crops was exported last year.

Growth in imports in the first four months of FY2004 was broad-based with all commodity groups, except food and petroleum, showing significant increases, ranging from 11.8 percent for textile group to 31.7 percent for metals (see table 6). Non-food, non-oil imports increased by 22.4 percent, reflecting continued upturn in the economy. Machinery imports were up by 15.4 percent. Higher demand for automobiles fuelled by expanding consumer credit resulted in a 28.9 percent increase in import of knocked down kits of motor vehicles on the back of a 49.2 percent increase last year. Increased availability of consumer credit also continued to push up imports of electrical machinery and apparatus for production/assembly of electronic goods. Import of synthetic and artificial silk yarn for use in textile industry, iron and steel, and aluminum also showed substantial increases.

A noticeable development is substantial increase (28.8 percent) in export of engineering goods.

Table-6: Structure of Imports (Million $)

Commodities	July - October FY2003	July - October FY2004	(%) Change
Food Group	**343**	**322**	**-6.1**
Of Which:			
Tea	50	59	19.5
Edible Oil	177	221	24.9
Pulses	63	23	-63.8
Machinery Group	**714**	**824**	**15.4**
Of Which:			
Power Generating Machinery	95	98	3.4
Office Machine Incl.data Proc Equip;	68	68	-1.2
Textile Machinery	158	166	5.4
Construction & Mining Machinery	33	36	7.5
Electrical Machinery & Apparatus	60	75	24.5
Roadmotor Vehicles	**149**	**192**	**28.9**
Petroleum Group	**941**	**889**	**-5.5**
Petroleum Products	517	370	-28.4
Petroleum Crude	424	519	22.5
Textile Group	**76**	**84**	**11.8**
Of Which:			
Synthetic Fibre	30	32	6.2
Synthetic & Artificial Silk Yarn	32	38	18.6
Agricultural And Other Chemicals Group	**734**	**872**	**18.8**
Of Which:			
Fertilizer Manufactured	90	104	15.0
Insecticides	32	49	53.1
Plastic Materials	136	164	20.6
Medicinal Products	68	87	27.9
Metal Group	**151**	**198**	**31.7**
Of Which:	15	31	113.8
Iron And Steel	119	145	21.7
Miscellaneous Group	**100**	**123**	**22.3**
Of Which:			
Rubber Tyres & Tubes	27	30	13.1
Paper & Paper Board & Manuf. there of	43	51	18.3
Others	**586**	**778**	**32.8**
Total	**3,795**	**4,284**	**12.9**

Source: Website of the Federal Bureau of Statistics.

Current Account: The current account of the balance of payments continued to show a comfortable surplus in the first quarter of FY2004, although the size of the surplus shrank after consistently increasing in the preceding seven quarters (see table 7). Overseas workers' remittances,[4] which had been an important factor in the upward trend in the current account surplus in the past two years, started to decline in the quarter. This marked a break with the rising trend seen in the preceding two years (see box 1). Sharp increase in payments on account of foreign travel by Pakistanis and shipping also contributed to decline in the current account surplus. These developments were partly offset by continued decline in interest payments on external debt, and a smaller trade deficit.[5]

The current account of the balance of payments continued to show a comfortable surplus in the first quarter of FY2004.

Table-7 : Balance of Payments
(Million $)

	July - June		(%) Change	July - September		(%) Change
	FY2002	FY2003		FY2003	FY2004	
Trade Balance	**-294**	**-536**	**82.3**	**-147**	**-60**	**-59.2**
Services (net)	-2617	-2,173	-17.0	-229	-404	76.4
Current Transfers	5,744	6,737	17.3	1,826	1,499	-17.9
Of Which:						
Workers' Remittances	2,390	4,237	77.3	1,053	906	-14.0
Official Transfers	1,495	1,000	-33.1	275	216	-21.5
Purchases from Kerb Market	1,376	0	-	0	0	-
Current Account Balance	**2,833**	**4,028**	**42.2**	**1,450**	**1,035**	**-28.6**
Current Account Balance (excl. official transfers)	**1,338**	**3,028**	**126.3**	**1,175**	**819**	**-30.3**
Capital Account (net)	**-1,107**	**114**		**-217**	**-347**	**-**
Errors and Omissions	928	448	-51.7	210	82	-61.0
Exceptional Financing	138	620	349.3	269	0	-
Change in Reserves (-Inc/+Dec)	-2,792	-5,210	-	-1,712	-770	-
Official Reserves (End-period)	**4,337**	**9,529**	**119.7**	**5,941**	**10,019**	**68.6**
(In months of projected/actual merchandise imports)	4.6	8.9	93.5	6.2	9.3	50.0

Source: Website of State Bank of Pakistan.

4. Inclusive of encashment of foreign exchange bearer certificates (FEBCs) and foreign currency bearer certificates and receipts for sponsoring Hajj and the 1991 Gulf war compensations.
5. The trade balance numbers quoted here are derived from export receipts and import payments based on foreign exchange transactions and, because of leads and lags, differ from trade numbers based on the physical movement of goods across borders discussed earlier. The trade deficit based on physical movement of goods declined by 27.0 percent to $138 million in the first quarter of FY2004 compared with the same period last year.

Box-1. Workers' Remittances

Overseas workers remittances, excluding encashment of foreign exchange bearer certificates and foreign currency bearer certificates and inflows on account of sponsorship of Hajj and the 1991 Gulf War compensation, declined by 6.1 percent in the first four months of FY2004 compared with the same period of FY2003. Among major sources of remittances, there were large declines in remittances from United Arab Emirates (44.4 percent), United States of America (15.8 percent) and Kuwait (24.9 percent). These declines were partly offset by increases in remittances from United Kingdom (30.1 percent), Germany (181.5 percent) and Saudi Arabia (6.4 percent). The panic liquidation of financial and other assets by Pakistanis living abroad, particularly in the USA, and transfer of proceeds to Pakistan is declining. Inflow in the form of remittances of tax-evaded money parked overseas in the past may also have fallen after USA and UAE authorities recently started monitoring transfers of $5,000 or more and dirhams 10,000 or more, respectively. However, the switchover to use of banking channels for remittances and the preference of overseas Pakistanis to place their savings in Pakistan instead of foreign currency accounts (as in the past) remain in place. As a result, remittances are expected to remain at a higher level than was the case in the pre-September 2001 period and the SBP target of $3.6 billion for FY2004 is likely to be met.

Slowdown in accumulation of reserves held by SBP reflects the central bank's recent policy of allowing the Rupee to appreciate.

Capital Account: The capital account recorded a deficit of $347 million in the first quarter of FY2004 compared with $217 million in the corresponding period of FY2003, mainly because of a sharp decrease in disbursement of foreign long-term loans and credits (36.3 percent). Foreign direct investment also was lower than corresponding quarter last year when a multinational chemicals company had made a large investment through a rights issue by its Pakistani subsidiary. The increase in the capital account deficit because of these factors was partly offset by lower amortization payments of external debt.

Prospects for the realization of the overall growth target of 5.3 percent for FY2004 look good.

Foreign Exchange Reserves: Foreign exchange reserves continued to increase in the first quarter of FY2004, but their growth seems to be tapering off after the very sharp increases seen in the preceding two years. Foreign exchange reserves held by the SBP increased to $10.0 billion by the end of September 2003, compared with $9.5 billion as of end June 2003.[6] At this level, reserves are sufficient to cover about nine months of imports projected for FY2004. Slowdown in accumulation of reserves held by SBP reflects the central bank's recent policy of reducing purchases of foreign exchange in the inter-bank market and letting the Rupee appreciate. The Rupee appreciated from Rs 57.82/US$ on 30 June 2003 to Rs 57.20/US$ on 25 November.

Outlook

With robust growth in the real sector of the economy and presence of a number of factors conducive for growth, prospects for the realization of the overall growth target of 5.3 percent for the year look good (see table 8). Recent improvement in relations with India will further improve investment climate in the country and give a boost to economic activity. The growth performance of agriculture may be less than last year, but still it should be in the range of 3.0-3.5 percent. Summer crops output is estimated to be somewhat higher than last year and the outlook for winter crops has been greatly improved by greater availability of water and announcement of 16.7 percent increase in procurement price of wheat. With the end

6. Foreign exchange reserves held by SBP increased further to $10.3 billion and total foreign exchange reserves, including those held by commercial banks, increased to $11.8 billion by 15 November 2003.

Table-8: Medium-term Outlook

	FY2003	Projections FY2004	FY 2005
	(Annual changes in percent)		
Real GDP	**5.1**	**5.3**	**5.8**
Agriculture	4.1	3.2	4.3
Large-scale Manufacturing	8.7	9.2	9.0
Other Sectors	4.3	5.5	5.0
Inflation Rate (CPI)	**3.1**	**4.0**	**4.0**
Merchandise Exports	**20.8**	**12.0**	**6.4**
Merchandise Imports	**17.8**	**11.0**	**8.0**
	(In percent of GDP)		
Budgetary Deficit	4.4	4.2	3.7
Trade Balance	-1.5	-1.0	-1.4
Current Account Balance (excl. Official Transfers)	4.2	2.6	0.1

Pakistan: Federal Budget in Brief 2003 2004 and ADB Staff Estimates

of the drought, livestock production is also expected to show a robust growth.

The manufacturing sector is likely to post a higher growth than last year. Continuing double-digit growth in textile exports in the first four months of the year (see page 7) augurs well for the textile industry, which is the single largest industry in Pakistan. Domestic demand for manufactures boosted by higher cash income of cotton farmers and sharp increase in consumer credit should result in strong performance by the manufacturing sector. Industrial growth should also benefit from higher hydel power generation resulting from greater availability of water, and increased gas distribution from fields that have come on line recently. Large increase in the sales of cement (18.0 percent) in the first quarter of FY2004 indicates that construction activity has gained further momentum. Fiscal incentives provided in the FY2004 budget for construction industry and aggressive marketing of housing loans by banks (at interest rates as low as 8.5 percent) should continue to encourage construction.

The service sector also looks set to record strong performance with financial results for most banks in the first quarter indicating robust growth in value-added in the financial sector. Telecommunication, particularly cellular phone service, and electronic media are expanding at a very rapid pace and with deregulation of the sector and issuance of licenses to new operators this rapid growth should continue (see box 2).

With deregulation of the sector, telecommunication, particularly cellular phone service, is expected to expand at a rapid pace.

Fiscal balance in the first quarter of FY2004 was in line with the fiscal deficit target of 4.0 percent of GDP. However, this was achieved mainly through expenditure control; tax collection showed a significant slow down. Unless tax collection picks up in the remaining three quarters, achievement of the fiscal deficit target may be difficult. With tight fiscal policy, continued excess capacity in the manufacturing sector, appreciation of the Rupee, and global price

Box-2: Telecommunication and Electronic Media: Two Emerging Growth Areas

Telecommunication sector, particularly the cellular phone and inter-net service providers, has expanded at a phenomenal speed in recent years, with the number of cellular phone subscribers recording more than three-fold increase in the last two years (see table). This increase was sustained in the first quarter of FY2004, with the number of subscribers increasing by 19.4 percent to 2.8 million. The number of cellular phone subscribers is fast approaching the fixed phone connections of about 4.0 million. The cellular phone service providers have announced plans to increase their capacity by another three million connections over the next year or so. With the increasing induction of wireless local loop (WLL) technology in the sector, there is a tremendous scope for extension of telephone and inter-net services to rural and remote areas. A number of inter-net service providers (ISPs) are currently providing domestic and international inter-net services through expensive international bandwidth. With the recent decision of PTCL to provide peering bandwidth, ISPs will be able to handle domestic data traffic without going international by connecting to PTCL's Pakistan Internet Exchange for a much lower fee. This new facility is expected to boost the expansion of domestic inter-net service. There has also been rapid growth in electronic media. During the last year, Pakistan Electronic Media Regulatory Authority has auctioned 29 FM radio licenses, 26 in the private sector and three for public sector universities. Four of these FM radio stations have become operational. Over two dozen more applications for FM radios are currently in the pipeline. Three off-shore Pakistani TV stations are already transmitting programs and 1100 licensed cable operators are in the market to provide viewers access to foreign channels. Four satellite TV stations, two for public sector universities and two in the private sector, have been approved. All these developments are giving rise to new economic activities. However, the contribution of these activities to GDP is not fully captured since weights assigned to this sector were fixed more than 20 years back.

Year	Cellular Phone Subscribers
FY1996	68,038
FY1997	135,027
FY1998	196,096
FY1999	265,612
FY2000	306,493
FY2001	742,606
FY2002	1,238,602
FY2003	2,344,799
September 2003	2,800,000

Sources: 1) Pakistan Telecommunication Authority (as reported in Daily Times of 17 December 2003).
2) Pakistan Electronic Media Regulatory Authority.

stability, the annual inflation rate, while higher than last year, is likely to be about 4.0 percent,

Robust growth in exports, as well as high level of remittances (despite some decline) in the first quarter of FY2004, point to a comfortable balance of payments position for the whole year. With global recovery gaining momentum and domestic economic upturn continuing, both exports and imports are expected to maintain a double-digit growth during the year. We expect the current account for the year to remain in surplus, although the magnitude of the surplus will be lower than last year.

II. ECONOMIC POLICIES AND REFORMS

The economic and governance reform program initiated by the Musharraf Government in 2000 has been more or less fully adopted and pursued by the elected Government, which assumed power last year. Developments during the first 3-4 months of FY2004 in the area of debt management, privatization, and performance of PSEs are discussed below.

Management of Public Debt: Successive governments in Pakistan during the 1980s and 1990s demonstrated a lack of fiscal responsibility. As a result, outstanding public debt increased from 66 percent of GDP in 1980 to 102 percent in 1999. It increased further to 110 percent of GDP by end of FY2001, reflecting mostly the impact of the sharp depreciation of the currency on the Rupee value of external debt. Since 1999, the Government has prepared and implemented a comprehensive debt reduction strategy by undertaking fiscal adjustment and paying off expensive outstanding liabilities. In addition, appreciation of the Rupee against U.S. Dollar has also contributed to containment of public debt, which had declined to 90 percent of GDP by 30 June 2003. As part of its debt reduction strategy, the Government is continuing with its policy of reducing the fiscal deficit and it plans to make a before-time repayment during FY2004 of U.S.$1 billion of relatively high interest debt owed to the World Bank and the Asian Development Bank.

To assure continuity of fiscal discipline, the Finance Minister in his budget speech last year announced Government's commitment to get a fiscal responsibility law enacted by the Parliament. A draft of the law was put on the website of the Ministry of Finance to solicit comments from interested individuals and institutions before its submission to the National Assembly. On 11 October 2003, the Government submitted the draft of the **Fiscal Responsibility Bill** to the National Assembly for approval. When passed by the National Assembly and the Senate and signed by the President, the law will bind the Government to:

- Eliminate revenue deficit by 30 June 2007.[7]
- Reduce the outstanding public debt to 60 percent of GDP by 30 June 2012.
- Reduce the outstanding public debt by at least 2.5 percent of GDP in every year, while ensuring that social and poverty related expenditures are not reduced below four percent of GDP.
- Not issue guarantees, including those on rupee borrowing by PSEs, minimum rates of return, output purchase agreements, and all other claims and commitments for any amount exceeding two percent of GDP.

According to the proposed Fiscal Responsibility Law, the Government can deviate from the above targets only on grounds of unforeseen demand on its resources due to national security or national calamity, which is to be determined by the National Assembly. To ensure transparency of its performance in the area of debt management, the Government will be required to submit annual and mid-year reports on public debt to the National Assembly.

The Government has also set up the Debt Policy Coordination Office (DPCO) envisaged in the draft law. DPCO is headed by the Economic Advisor to the Government and is to prepare a 10-year debt reduction path to be followed by the Government.

As a result of debt reduction strategy pursued by the Government in the past three years, public debt declined from 110 percent of GDP in FY2001 to 90 percent in FY2003.

The Government on 11 October 2003 submitted the draft of the Fiscal Responsibility Bill to the National Assembly for approval.

7. This means that there will be no borrowing to finance current expenditure.

Line losses of WAPDA remained more or less unchanged in the first quarter of FY2004 and those of KESC were two percentage points higher than the target for the quarter.

Performance of PSEs: The Government has been placing on the website of the Ministry of Finance since last year the actual performance of important PSEs against the agreed quarterly financial improvement plans for those PSEs. This has made the Government's management of PSEs more transparent. There was a substantial improvement in the first quarter of FY2004 in the cash flow of the Water and Power Development Authority (WAPDA), the Karachi Electric Supply Corporation (KESC), Pakistan Railways, and Pakistan Steel Mills, as is reflected in larger revenue surpluses or lower deficits (see table 9). WAPDA, for which financial performance data is available for the last two years, showed a sharp improvement in FY2003 also. However, from the information placed on the website, it is clear the improvement in the cash flow of WAPDA was mostly due to exogenous factors like increased availability of water and resulting higher generation of hydel electricity. Total transmission and delivery losses remained more or less unchanged and collection of bills worsened in the case of WAPDA. Line losses of KESC (41.7 percent) in the first quarter of FY2004 were also two percentage points higher than the target for the quarter.

Table-9: Performance of Public Sector Enterprises

	July - June		(%) Change	July - September		(%) Change
	FY2002	FY2003		FY2003	FY2004	
WAPDA						
Operational Performance						
Electricity Units Generated (gwh)	60,849	64,038	5.2	18,204	19,668	8.0
Share of Thermal (%)	68.7	65.1		49.9	46.0	
Electricity Units Purchased (gwh)	23,242	22,106	-4.9	4,750	3,885	-18.2
Total T&D Losses (%)	25.8	25.9		25.6	25.6	
Total Receivables (% of billing)	27.1	27.7		23.7	28.8	
Financial Performance						
Revenue Receipts	177,409	208,116	17.3	52,116	53,404	2.5
Current Expenditure	178,649	203,379	13.8	42,050	39,469	-6.1
Net Cash Available	-1240	4,737		10,066	13,935	38.4
KESC						
Revenue Receipts		38,847		9,103	10,659	17.1
Current Expenditure		43,772		7,455	8,113	8.8
Net Cash Available		-4,925		1,648	2,546	54.5
Pakistan Railways						
Revenue Receipts		14,424		3,374	3,327	-1.4
Current Expenditure		20,375		4,168	4,103	-1.6
Net Cash Available		-5,951		-794	-776	
Pakistan Steel Mill						
Revenue Receipts		22,805		5,097	5,592	9.7
Current Expenditure		21,582		5,092	4,799	-5.8
Net Cash Available		1,223		5	793	

Source: Website of Ministry of Finance.

The Pakistan Railways marginally reduced its revenue deficit in the first quarter of FY2004; the improvement in its financial performance was due to decline in expenditure resulting from lower POL expenditure and containment of expenditure on salaries. There has been a major downsizing of employment since December 2002. The total number of employees declined from 94,000 at the end of December 2002 to 86,710 by June 2003 and further to 85,614 by September. The Pakistan Steel Mill (PSM) was also able to sharply increase its revenue surplus in the first quarter, which at Rs 793 million was almost two-thirds of the total surplus in FY2003. PSM substantially increased production and sale of most products and also reduced its wage bill.

Privatization: The process of privatization, which had accelerated in FY2003, continued in the first five months of FY2004. The Privatization Commission (PC) continued to make increasing use of the stock market for selling government shares in various public sector enterprises, which has the added advantage of deepening and strengthening the stock market, as well as broadening the ownership of corporate shares. PC offered 2.5 percent shares (107.5 million shares) of the Oil and Gas Development Corporation (OGDC) at a price of Rs 32 per share, i.e., at a large premium on their par value. The offer had a green shoe option for the sale of another 2.5 percent shares. With a total subscription of Rs 24.0 billion, the issue was oversubscribed to the tune of seven times. Using the green shoe option, PC will be able to sell 5 percent of OGDC shares for Rs 6,800 million, making the transaction the biggest sale of shares of a PSE through initial public offer (IPO). PC also made public offer of 13.1 million shares of the National Bank of Pakistan for Rs 604 million, for which the subscription was twice the offered amount. This was the third such offer of NBP shares in the last two years, and as a result the government would have divested about 20 percent of the equity of NBP at the completion of this transaction. In addition, PC offered for sale three public sector enterprises (PSEs) and received bids amounting to Rs 1,650 million, which have been submitted to the Cabinet Committee on Privatization for approval. In all, privatization transactions worth Rs 8,967 million are in the final stages of completion, of which stock market transactions accounted for Rs 7,404 million.

The Privatization Commission continued to make increasing use of the stock market for selling government shares in various public sector enterprises.

Privatization proceedings for a number of other PSEs, namely Pakistan State Oil (PSO), KESC, Faisalabad Electric Supply Company, Jamshoro Power Company, and Habib Bank Limited, are at different stages of implementation. In case of PSO, formalities have been completed and announcement of final bidding date is awaited. PC has received five EOIs from strategic investors for the sale of 73 percent of the equity of KESC. The Data Room for Habib Bank Limited was opened for six pre-qualified parties on 3 September to start due diligence, and bidding date is expected to be announced shortly.

Privatization transactions worth Rs 8,967 million are in final stages of completion.

As a percentage of GDP, the pro-poor expenditure increased from 3.7 percent in FY2002 to 3.9 percent in FY2003.

III. POVERTY REDUCTION

Poverty alleviation is the key objective of the Pakistan Government's economic policies. Under its poverty reduction strategy the Government is committed to increasing poverty reducing public expenditure as a percentage of GDP.[8] To assess the impact of poverty reducing public expenditures and policies, the Government monitors a number of intermediate human development indicators related to education, health and population planning. In this section, we analyze poverty reducing public expenditures, and intermediate human development indicators related to health[9] based on data released since the last Economic Update.

Pro-poor Public Expenditures: The pro-poor expenditures incurred in FY2003, at Rs 158.0 billion, were 18.3 percent higher than FY2002 (see table 10), although it fell marginally short of the budget target of Rs 161.0 billion.[10] As a percentage of the GDP, the pro-poor expenditures increased from 3.7 percent in FY2002 to 3.9 percent in FY2003. Their

Table-10: I-PRSP Budgetary Expenditure (Rs Million)

	FY2002	FY2003	(%) Change
Roads, Highways & Bridges	6,340	10,791	70.2
Water Supply & Sanitation	4,644	3,263	-29.7
Education	66,290	71,057	7.2
Health	19,211	21,212	10.4
Population Planning	1,331	3,103	133.1
Social Security & Social Welfare	3,664	1,319	-64.0
Natural Calamities & Other Disasters	189	424	124.3
Irrigation	10,133	16,864	66.4
Land Reclamation	1,838	1,820	-1.0
Rural Development	12,325	18,279	48.3
Food Subsidies	5,513	7,615	38.1
Food Support Program	2,017	2,236	10.9
Grand Total	**133,495**	**157,983**	**18.3**
I-PRSP Expenditure as % of Total Public Expenditure	**16.2**	**17.6**	
I-PRSP Expenditure as % of GDP	**3.7**	**3.9**	

Sources: (1) I-PRSP Fourth Quarter/ Full Year Progress Report FY 2001-02. Finance Division, GOP.
(2) PRSP Full Year Report FY 2002-03. PRSP Secretariat, Finance Division, GoP. September 2003

8. Under the I-PRSP, poverty reducing expenditures include: education, health, water supply and sanitation, population planning, land reclamation, rural development, irrigation, roads and bridges, social security and social welfare, relief in natural calamities and disasters, food subsidies, and food support program.
9. The PRSP Progress Report for FY2003 posted on the Ministry of Finance website, for some reason, does not give numbers on intermediate human development indicators related to education. Therefore only health indicators are discussed in this section.
10. The poverty related public expenditure for the first quarter of FY2004 is not yet available.

share in total public expenditure also increased from 16.2 percent to 17.6 percent.

Of the 12 sectors identified for pro-poor expenditure, we consider education, health, population planning, social security and social welfare, water supply and sanitation (WS&S), and rural development as the core areas. Expenditure in these sectors taken together registered an increase of only 10.0 percent in FY2003 compared with the previous year. Of individual sectors, expenditure on rural development and family planning showed substantial increases, while increases in expenditure on education and health were much smaller than the increase in total poverty reducing expenditure. Expenditure on water supply and sanitation (WSS) declined by 29.7 percent. Under devolution the responsibility for WSS is with the tehsil governments, and the decline may be because of inadequate implementation capacity at tehsil level, and lack of clarity in relation between district and tehsil governments, as well as between concerned provincial departments and tehsil governments.

Within the education sector, in FY2003 there was a discernable shift in expenditure from primary and secondary education to university and professional education. Expenditure on primary education declined by 4.4 percent and that on secondary education increased by only 4.1 percent. On the other hand, expenditure on general college and university education increased by 51.2 percent and that on professional education by 15.4 percent. While large increase in expenditure on higher education is a positive development, it should not come at the expense of spending on primary and secondary education, as basic education indicators for the poor, who benefit the most from primary and secondary education provided by the public sector, are extremely low and need considerable improvement.

In the health sector, there was a much larger increase in expenditure on basic health facilities and preventive measures (21.8 percent) than on general hospitals and clinics (8.1 percent). Expenditure on family planning more than doubled to Rs 3.1 billion.

Expenditure on primary education declined by 4.4 percent.

Among non-budgetary income transfer programs, disbursement of Zakat, at Rs 8.0 billion, in FY2003 was 52.4 percent higher compared with FY2002. Priority was given to rehabilitating the poor on a permanent basis through one-time rehabilitation grants to help them set up their own small-scale businesses. There was a more than three-fold increase in disbursement under this head, and its share in total Zakat disbursement increased to 60.7 percent from 29.3 percent last year. On the other hand, disbursement of subsistence grants declined by 10.1 percent and its share decreased from 49.5 percent to 35.3 percent.

Disbursement of micro credit through Khushali Bank (KB), Pakistan Poverty Alleviation Fund (PPAF), and Zari Taraqqiati (Agricultural Development) Bank (ZTB), taken together, increased by 140.0 percent to Rs 2,518 million in FY2003. The largest increase was seen in disbursements by KB, which increased by 149.4 percent to Rs 980 million. However, PPAF remained the biggest source of micro-credit, accounting for almost three-fifths of the total disbursement.

Disbursement of micro credit increased by 140 percent to Rs 2,518 million in FY2003.

Besides the Zakat Fund and micro credit, the Government finances small public works under the Khushal Pakistan Program (KPP). Public works, administered by local governments, provide gainful employment to the poor, besides creating essential infrastructure (farm-to-market roads, water supply schemes, repair of schools, etc.) in rural and low-income urban areas. Under KPP the Government provided temporary employment to 80,758 persons --

About 19.7 million persons, or about 41.2 percent of those below poverty line were helped through the Government supported social safety net.

a sharp decline from 347,384 temporary jobs generated in FY2002.

Total number of beneficiaries of Zakat Fund, food support program,[11] and micro credit increased from 2.9 million in FY2002 to 3.1 million in FY2003. Assuming that each beneficiary represents one poor family consisting of 6-7 members, about 19.7 million persons, or about 41.2 percent of those below poverty line were helped through the Government supported social safety net.[12]

Intermediate Human Development Indicators: Changes in intermediate health indicators in FY2003 present a mixed picture, with improvement in some and deterioration in others (see table 11). There was an increase in the proportion of population covered by lady health workers (LHWs) and in utilization rate of hospitals. Similarly, first level health care facilities (FLCFs) not experiencing stock-outs of any of five essential supplies (ORS, cotrimoxazole, foalte tablets, chloroquine, and syringes), and their percentage with

Table-11: Intermediate Health Indicators

	FY2002	FY2003	(%) Change
Utilization Rate of Hospitals*	201	210	4.5
Proportion of Population Covered by LHWs (Rural only - %)	41	44	7.3
Immunization Coverage of Children and Pregnant Mothers DPT III (%)	80	69	-13.8
Immunization Coverage of Children and Pregnant Mothers TT II (%)	60	48	-20.0
Births Attended by Skilled Birth Attendants (%)	13	14	7.7
Number of Skilled Female Birth Attendants (Progressive Totals)	96,354	96,354	0.0
FLCFs not Experiencing Stock-outs of Any of Five Key Supplies (%)	28	35	25.0
FLCFs Meeting Staff Norms (%)	34	30	-11.8
Availability of Contraceptives at FLCFs (%)	83	85	2.4

FLCFs = First Level Health Care Facilities.
LHWs = Lady Health Workers
* Number of patients treated per facility per day

Source: Website of Ministry of Finance.

11. Under the food support program households with monthly income of Rs 2,000 or less are given Rs 2,000 in two biannual installments.
12. The actual numbers could be less as many families may have benefited from more than one of these programs.

supplies of contraceptives also increased. On the other hand, immunization coverage of children and pregnant mothers declined sharply and so did the percentage of FLCFs meeting staffing norms. Deterioration in some intermediate health indicators, despite increases in expenditure, reflects poorly on the effectiveness of expenditure and highlights the need for improving governance of the health sector.

Deterioration in some intermediate health indicators, despite increases in expenditure, highlights the need for improving governance of the health sector.

Conclusion: The Government's poverty related expenditure increased by 0.2 percentage points of GDP in FY2003, as agreed with the IMF under the Poverty Reduction and Growth Facility (PRGF). If this upward trend in the pro-poor expenditure is maintained, the target of 4.0 percent of GDP in FY2004 agreed with the IMF under PRGF is likely to be exceeded. However, within the overall I-PRSP expenditure, expenditure in some core sectors like primary and secondary education and WSS has either stagnated or declined substantially, which is of concern from the perspective of poverty reduction.