3. Fiscal and Monetary Development

3.1. Fiscal Policy

The MTDF envisages an integrated approach to development. It requires consistency and continuity of various economic policies but, most importantly, the coordination of fiscal, monetary and exchange rate policies. High growth generates a momentum which can fuel inflation and low growth leads to shortages and smaller purchasing power. The purpose of policy coordination is to ensure development in a stable framework.

For a considerably long period in the past the country had been pursuing an expansionary fiscal policy with public expenditure persistently growing, coupled with stagnant revenue-GDP ratio. This soft fiscal option was adopted under political compulsions. Consequently the country had to live with a large fiscal deficit which peaked at 8.8 percent of GDP in 1990-91. The persistent deficit had set in a self-enforcing tendency and the public debt continued to snow-ball, with debt servicing continuously increasing. The large fiscal deficit resulted in unsustainable public debt with a huge debt service liability which left meager resources for more compelling development purposes. Besides domestic borrowing, the government had also to resort to foreign borrowing at uneconomical terms. A continuation of this reckless approach derailed macroeconomic management of the country irredeemably. It was in this background that the government started to implement stabilization and structural adjustment programmes with a focus on the fiscal sector.

Under the structural reforms programme the government undertook various initiatives in the fiscal sector which, inter alia, include overhauling of taxation system and its administration, restraint on overall expenditure and change in its composition, phasing out subsidies, privatization of public sector units, containment of fiscal deficit and debt management. The taxation system has been greatly changed with a shift from taxes on foreign trade to domestic consumption. Direct taxation base has been expanded while the rates reduced. Import tariffs have been drastically slashed. The net of General Sales Tax which is ultimately to be converted into true VAT is being expanded and is also substituting excise duty which is planned to be phased out. Many public sector units have been privatized and the proceeds used to retire public debt. This has lessened their direct burden on the budget. Tax administration is also undergoing re-orientation with a view to reducing evasion and avoidance as well as to foster confidence of the tax payers in the official tax collection machinery. Debt rescheduling on bilateral external debt was sought through the Paris Club and Debt Policy Co-ordination Office (DPCO) established to monitor the debt situation. Auditing and accounting functions have been separated. Fiscal Responsibility and Debt Limitation Law (FRDLL) has also been approved by the National Assembly. Under this law the Government is expected to eliminate revenue deficit by reducing it to zero by the end of June, 2008 and bring down its public debt ensuring that up to 30th June, 2013 it does not exceed sixty percent of the estimated GDP for that year and thereafter maintaining the total public debt below sixty percent of GDP for any given year. For this, it is to be ensured that public debt is reduced by not less than two and half percent of the GDP every year within 2003-2013. The debt-GDP ratio during 2004-05 is estimated to be at about seventy percent. Social and poverty alleviation related expenditures are also not to be reduced below four percent of GDP.

In recent years reform measures have been implemented with greater vigour and this has started showing satisfactory results although much remains to be achieved. The total revenue collections (consolidated) have improved. Ratio of total revenues to GDP increased from 14.2 percent in 2001-02 to 14.3 percent in 2003-04 and as per modified budget estimates is likely to remain at 13.0 percent during 2004-05 (due to higher GDP level this year). The tax to GDP ratio increased from 10.9 percent in 2001-02 to 11.0 percent in 2003-04 and is budgeted to remain at 10.1 percent during 2004-05. Total expenditure also increased over time in quantum but as proportion of GDP have, however, declined from 20.0 percent in 2001-02 to 17.3 percent in 2003-04 and are budgeted to be contained at 16.0 percent of GDP during 2004-05. In particular, the current expenditure declined from 16.4 percent of GDP in 2001-02 to 14.0 percent of GDP in 2003-04 and is budgeted to decline further to 13.2 percent of GDP during 2004-05. Due to fiscal space thus created, development expenditure (PSDP) was increased to 2.9 percent of GDP in 2001-02 and 2003-04 and as per modified budget estimates is to be at 3.1 percent of GDP during 2004-05. Resultantly, the overall fiscal deficit declined from 5.5 percent of GDP during 2001-02 to 2.3 percent of GDP in 2003-04 and is budgeted to be at 3.0 percent of GDP during the year 2004-05.

Total outstanding domestic public debt has declined from 43.3 percent of GDP in 1999-2000 to 35.8 percent of GDP in 2003-04. Accordingly, domestic debt servicing declined from Rs.269.2 billion to Rs.236.0 billion during the same period.

Because of crude oil price hike internationally and increased amount of subsidies to contain inflation as well as higher GDP growth rate of 8.4 percent, the fiscal position is likely to be slightly different from the one projected earlier for the year 2004-05. The total revenues are estimated to be at the same level of Rs.851.3 billion (13.0% of GDP) as budgeted for the year 2004-05(MBE) with tax revenues including surcharges to remain at Rs.662.6 billion (10.1% of GDP) and non-tax revenues to remain at Rs.188.7 billion (2.9% of GDP). Total expenditure during the year 2004-05 is estimated to remain at Rs.1061.5 billion (16.2% of GDP) against the modified budget estimates of Rs.1050.4 billion (16.0% of GDP). Overall fiscal deficit during 2004-05 is, therefore, estimated to increase from the modified budget estimates level of Rs.199.1 billion (3.0% of GDP) to Rs.210.2 billion (3.2% of GDP). Fiscal performance indicators over the recent years are given in Table 1 below:

Table 1
Major Fiscal Indicators
(At current market prices)

(Rs. Billion)

	2001-02	2003-04 (R.E.)	2004-05 (Estimates)
Total Revenues	**624.1**	**791.1**	**851.3**
- Tax Revenues	478.1	608.4	662.6
- Non-Tax Revenues	146.0	182.7	188.7
Total Expenditure	**878.2@**	**955.9**	**1061.5**
- Current Expenditure	720.2@	774.9	866.0
Of which interest payments	(279.2)	(230.2)	(246.6)
- Development Expenditure (PSDP)	126.2	160.5	202.0
- Net lending to PSES	31.8	20.5	-6.5
- Operational shortfall	-11.7	-35.4	-

	2001-02	2003-04 (R.E.)	2004-05 (Estimates)
Overall Fiscal Deficit (-)	**-242.4***	**-129.4***	**-210.2**
Primary Deficit (-)/surplus (+)	**36.8**	**100.8**	**36.4**
Revenue Deficit(-)/surplus (+)	**-96.1**	**16.2**	**-14.7**
As % of GDP (MP)			
Total Revenues	**14.2**	**14.3**	**13.0**
- Tax Revenues	10.9	11.0	10.1
- Non-Tax Revenues	3.3	3.3	2.9
Total Expenditure	**20.0**	**17.3**	**16.2**
- Current Expenditure	16.4	14.0	13.2
- Development Expenditure (PSDP)	2.9	2.9	3.1
- Net lending to PSES	0.7	0.4	-0.1
Overall Fiscal Deficit (-)	**-5.5**	**-2.3**	**-3.2**
Primary Deficit (-)/surplus (+)	**0.8**	**1.8**	**0.6**
Revenue Deficit (-)/surplus (+)	**-2.2**	**0.3**	**-0.2**
GDP (MP) Rs. Billion	**4402**	**5533**	**6548**

@ Includes one-off expenditure of Rs.52 billion (20+32) incurred on KESC.
* Includes operational shortfall.
RE: Revised Estimates.

3.2. Medium Term Development Framework 2005-10

For improving quality of life and living standard, a higher but sustainable growth rate has been targeted for which more funds are required to be generated domestically. This entails adoption of appropriate mix of policy measures in the area of revenue collection and reform in the taxation system. Prudent budgetary policy, rational management of public spending with enhanced share for social and community services and poverty related expenditures, will help to achieve economic and financial sustainability and maintain higher level of economic growth during the Medium Term Development Framework period.

Objectives

The main objectives of the Medium Term Development Framework are:

i) Achieving economic sustainability by promoting macroeconomic stability with emphasis on fiscal discipline and minimization of wastages

ii) Evolving buoyant and broad based taxation system with progressive rate structure and enlarged tax net

iii) Promoting tax efficiency and equity by realignment of tax burden across sectors

iv) Ridding the system of exemptions and SRO culture to eliminate distortions in taxation system caused by the indiscrete use of discretionary powers

v) Increasing fiscal space for development budget and its orientation to growth promotion and poverty alleviation

vi) Efficient debt management and optimal intergeneration equity

vii) Enhancing outlays for social and community services, poverty alleviation and development expenditures keeping fiscal deficit within safe limits

Targets

The following targets have been fixed to achieve the objectives:

i) Increasing Government revenues from Rs.851.3 billion in 2004-05 to Rs.1405.2 billion in 2009-10 at an annual compound growth rate of 10.5 percent (14.8% of GDP by the end of year 2009-10)

ii) Enhancing tax revenues (including surcharges) from Rs.662.6 billion in 2004-05 to Rs.1082.4 billion in 2009-10 at an annual compound growth rate of 10.3 percent (11.4% of GDP by fiscal year 2009-10), and non-tax revenues from Rs.188.7 billion in 2004-05 to Rs.322.8 billion in 2009-10 at an annual compound growth rate of 11.3 percent (3.4% of GDP by 2009-10) and thus achieve revenue surplus in the third year of the MTDF (2007-08) as envisaged under Fiscal Responsibility and Debt Limitation Law

iii) Increasing total expenditure from Rs.1061.5 billion in 2004-05 to Rs.1727.2 billion in 2009-10 at an annual compound growth rate of 10.2 percent during MTDF period (18.2% of GDP in fiscal year 2009-10)

iv) Increasing social service and poverty related expenditures

v) Increasing development expenditure (PSDP) from Rs.202 billion in 2004-05 to Rs.597.3 billion in 2009-10 at an annual compound growth rate of 24.2 percent (6.3% of GDP by 2009-10)

Strategy

For achieving the above targets the elements of the strategy will be:

i) Broadening the tax base, documentation of the economy, improving vigilance and tax facilitation for enhancing the revenue collection

ii) Ending the multiplicity of taxes

iii) Creating uniformity in tax laws throughout the country by harmonizing and rationalizing the tax and tariff rates and streamlining the taxation structure

iv) Extending GST throughout the country at retail stage

v) Promoting congenial rapport between tax payers and tax officials to improve tax compliance and reduce tax collection cost and evasion

vi) Gearing up resource mobilization efforts of the provincial governments including enactment of tax on income earned from agriculture

vii) Strengthening district taxation system

viii) Pre-payment of costly loans for reducing reliance on external borrowing (especially hard-term loans) and restraint on fresh borrowings (both domestic & external) to bring the debt – GDP ratio at sustainable level

ix) Applying strict vigilance on public spending through Budgetary Management & Control and following new budgetary techniques in accordance with New Accounting Model (NAM)

x) Maintaining current expenditure level consistent with the requirements of national security and increasing the non-debt and non-defence expenditures

xi) An early promulgation of Fiscal Responsibility and Debt Limitation Law

xii) Adopting an adequate and equitable system of user charges for public services throughout the country; and

xiii) Making public sector enterprises/corporations financially viable for eventual privatization

3.3. Reforming the CBR

Total revenues are projected to grow at an annual compound growth rate of 10.5 percent and the tax revenues at 10.3 percent during the MTDF period. However, the CBR taxes are estimated to rise at an annual compound growth rate of 11.1 percent and of these taxes, the highest growth of 12.7 percent is projected for sales tax followed by direct taxes with 12.0 percent, customs duty with 7.3 percent and central excise with 5.6 percent. A relatively higher growth projection of sales tax among the indirect taxes would be chiefly the outcome of taxation strategy of expanding the VAT variant. Similarly, high growth projection for direct taxes primarily hinges on tax reforms to enlarge the tax net, plug tax loopholes and improve tax administration. These tax reforms will be implemented by the CBR under their "Tax Administration Reform Programme (TARP)" project being funded by the World Bank at a cost of Rs.9.501 billion. These second generation reforms being undertaken by the CBR are in succession of reforms already undertaken under their programmes of "Tax Administration and Restructuring of CBR" and "Human Resource Management in CBR". Moreover, in view of sensitivity of the issue of revenue collection and its enhancement and to monitor closely the reform process of CBR and coordinate the interface between the tax payer's representatives and CBR, a high powered Cabinet Committee for Federal Revenues (CCFR) headed by Minister for Finance and including Ministers for Commerce and Privatization, Deputy Chairman Planning Commission, Secretary General Finance, Secretary Establishment Division and Secretary Revenue Division has been constituted. For resolving the problems of tax payers an independent institution of Federal Tax Ombudsman has also been established. With a view to supplementing the level of skills in CBR, government has appointed professional members from the private sector for human resource management, information management system, audit, facilitation & tax payers education and fiscal research & statistics.

The projections of CBR taxes are given in table 2 below:

Table 2
CBR Taxes during the MTDF Period
(2004-05 Prices)

(Rs. Billion)

	2001-05 Average	2004-05 (Estimates)	Projections					ACGR (%)
			2005-06	2006-07	2007-08	2008-09	2009-10	
I. Direct Taxes	**161.3**	**185.5**	**209.3**	**236.1**	**262.1**	**294.5**	**326.6**	**12.0**
II. Indirect Taxes	**332.4**	**404.5**	**440.2**	**483.4**	**539.3**	**599.7**	**670.4**	**10.6**
a) Sales Tax	208.4	252.9	275.5	307.9	351.5	400.6	460.0	12.7
b) Central Excise	45.6	45.7	47.8	50.5	53.3	56.0	60.1	5.6
c) Customs Duty	78.4	105.9	116.9	125.0	134.5	143.1	150.3	7.3
Total (I&II)	**493.7**	**590.0**	**649.5**	**719.5**	**801.4**	**894.2**	**997.0**	**11.1**
Total taxes as % of GDP	**9.3**	**9.0**	**9.3**	**9.6**	**9.9**	**10.2**	**10.5**	

Tax revenue collection by CBR during the MTDF period is projected to increase at the rate of 0.3 percent of GDP every year as a result of initiation of second generation reforms and by enhancing confidence of the tax payers on tax collection machinery by adopting more facilitative measures like the establishment of large and medium tax payer units, bringing change in duty draw back system/refund procedure, good governance and introduction of automated taxation system which will help in minimizing unnecessary personal interaction between tax payers and taxation machinery. Provincial and district governments will also make similar efforts to enhance their revenues.

Provincial Revenues

Though the enhanced share of revenues is likely to become available to the provinces from the federal divisible pool under the new National Finance Commission (NFC) award, yet they have to gear up efforts for increasing revenues for diverting more funds towards community & social services and poverty alleviation related expenditure and to meet other development needs.

Local Taxes

In accordance with devolution programme, fiscal decentralization from federal to provincial and sub-provincial/district governments is also essential. Timely and judicious flow of funds through the National Finance Commission to Provincial Finance Commissions and to District/Local Government Commissions is to be channalized. Although the district/local governments are faced with some institutional, capacity building, budgeting skill and auditing and monitoring problems, they have the capability to generate more funds with the help of community participation and taping new resources at local level for social services and development projects. They would therefore, review the local tax structure and enhance their revenue collection by diversification and improved efficiency. Physical and financial monitoring of development schemes on regular basis will not only result in their timely completion but will bring savings in expenditures too.

Though revenue deficit is projected to be eliminated by the third year of the MTDF period (2007-08), yet with a view to tackling poverty, expenditure on social and community related services will be enhanced. Development expenditure as a percentage of GDP will also increase from 3.1 percent of GDP in 2004-05 to 6.3 percent in 2009-10. The increase is warranted to finance high priority projects for expanding physical infrastructure, improving social sectors and implementing poverty alleviation related schemes. Thus expenditure-GDP ratio is projected to rise from 17.2 percent to 18.2 percent during MTDF period. Total revenue collection will however, also increase outpacing the growth in expenditure and as a result fiscal deficit will decline. It is estimated to decline from 3.8 percent of GDP during 2005-06 to 3.4 per of GDP by the end year of MTDF period, which is substantially lower than average level of previous four year's (2001-05) i.e. 4.2 percent of GDP.

Fiscal Deficit and its Financing

The deficit projected during MTDF period will be financed by external and domestic borrowings, almost in equal proportion as given in table 3 below:

Table 3
Financing of Fiscal Deficit

(Rs. Billion)

	2001-05 Average	2004-05 Estimates	Projections					Total 2005-10
			2005-06	2006-07	2007-08	2008-09	2009-10	
I Total Revenues	**751.0**	**851.3**	**935.8**	**1034.3**	**1149.5**	**1280.0**	**1405.2**	**5804.8**
II Total Expenditure	**972.6**	**1061.5**	**1201.2**	**1308.3**	**1439.5**	**1588.4**	**1727.2**	**7264.6**
III Overall Fiscal Deficit	**221.6**	**210.2**	**265.4**	**274.0**	**290.0**	**308.4**	**322.0**	**1459.8**
IV OFD Financing	**221.6**	**210.2**	**265.4**	**274.0**	**290.0**	**308.4**	**322.0**	**1459.8**
a) External Borrowing	115.7	97.4	137.0	138.7	141.2	149.4	160.0	728.4
b) Domestic Borrowing	105.9	112.8	128.4	135.3	148.8	159.0	162.0	731.4
i) Bank borrowing	20.5	60.0	45.0	45.5	48.0	48.5	50.0	237.0
ii) Non-Bank borrowing	85.4	62.8	83.4	89.8	100.8	110.5	112.0	494.4

The overall budgetary scenario (consolidated) for the Medium Term Development Framework (MTDF) is given at Annex I.

Monetary and Credit Policy

The monetary and credit policy has to be coordinated with other macroeconomic policies for promoting economic growth, price stability and poverty reduction. Its present complexion owes much to the financial reforms under implementation over the last few years. Unfortunately the monetary policy in Pakistan had long remained dormant to play its true role in macroeconomic management and was made hostage to fiscal policy to give coverage to persistent fiscal indiscipline. The bank credits had been recklessly used to win over political loyalties, and sound banking practices were compromised.

Following the nationalization of domestic banks in the 1970s and expansion of public sector development finance institutions, monetary and financial sector was controlled through direct instruments of monetary management which resulted in financial inefficiency, crowding out of the private sector, deterioration of the quality of assets and rising vulnerability of financial institutions. Realizing these weaknesses, the government initiated a broad based programme of de-regulation, privatization and financial reforms since early 1990s. With the abolition of the Pakistan Banking Council, the autonomy of the State Bank of Pakistan and privatization of the major banks, Pakistan's monetary and financial sector has entered into a new era of development in which open market operations have become the primary tool of monetary management. There is now a robust and efficient financial system in place, but the credit allocation could be more optimal.

During 2003-04, accommodating monetary policy was adopted which helped accelerate GDP growth and induce increased capacity utilization especially in the manufacturing sector. Money supply (M2) recorded an expansion of 19.62 percent (Rs.407.8 billion). This expansion was attributed to increased credit expansion of Rs.325.2 billion in the private sector and budgetary borrowing of Rs.63.7 billion.

The original Credit Plan for fiscal year 2004-05 envisaged money supply growth at 11.3 percent (Rs.280 billion) on the basis of GDP growth target of 6.6 percent and inflation rate target of 5.0 percent. But in view of developments during first half of the year and rising trend in inflation, the State Bank of Pakistan revised the Credit Plan target and shifted from accommodative to neutral and moderately tight monetary policy stance during the second half of the year to check inflationary expectation and to discourage speculative and non-productive financing while simultaneously ensuring adequate credit availability to the credit worthy institutions and individuals. Therefore, under the revised Credit Plan money supply is estimated to grow by 14.5 percent (Rs.360 billion) mainly due to higher disbursement of Rs.350 billion to the private sector instead of Rs.200 billion targeted earlier. Government sector borrowing will remain at Rs.65 billion and non-government sector at Rs.330 billion while the overall expansion of net domestic assets is projected upward at Rs.330 billion. Build up in net foreign assets is expected to remain at the original estimated level of Rs.30 billion.

3.4. Medium Term Development Framework 2005-10

During the Medium Term Development Framework, balanced monetary policy will be pursued to achieve different macroeconomic goals. The process of market-oriented monetary policy will be further improved through development of financial markets.

Sufficient bank credit would be made available to the productive sectors and for employment generating activities. Interest rates would be adjusted as and when required to tighten monetary policy to suppress inflationary tendencies. Main objectives and strategy of Monetary and Credit Policy are as under:

Objectives

i) To ensure adequate money supply to encourage economic growth, productive employment and capacity expansion

ii) To enhance competition and efficiency and ensure stability and soundness in the financial sector

iii) To meet growing credit requirements of the private sector

iv) To curb inflationary expectations

v) To improve risk management capacity of the banking sector

vi) To maintain price and exchange rate stability

vii) To coordinate with other macroeconomic policies to achieve development goals

Strategy

i) Timely adjustment in interest rates to stifle inflationary trends and to facilitate investment and growth in non-inflationary environment

ii) Strengthening of legal infrastructure and revising of banking laws and regulations and ensuring international best practices in domestic banking industry

iii) Early recovery and settlement of non-performing/stuck-up loans through vigorous efforts

iv) Consultative participation of the private sector in the process of policy change by State Bank of Pakistan

v) Restructuring and re-organization of banks and DFIs

vi) Increasing clientage by introducing diversified lending and instruments as well as promoting e-banking and sound payment systems

vii) Encouraging private sector to play a dominant role in the banking sector under the guidance of the State Bank of Pakistan and supported by the government

viii) Proactive supervision by SBP

ix) Privatization of remaining public sector banks and divestment of Government shares in privatized banks

Monetary policy management needs a forward-looking dimension due to the existence of long lags between policy actions and their intended effects on output and inflation. To meet this requirement, the SBP plans to build a macro model to make dynamic impact analysis of various policy scenarios.

Monetary Projections

During the MTDF period, monetary and credit expansion will be paced compatibly with the GDP growth and price stability targets. Accordingly, the projections of monetary expansion have been worked out on the basis of real GDP growth rate ranging from 7.0 to 8.2 percent and inflation rate decreasing from 8.0 percent to 7.0 percent. In view of the already excess liquidity in the system and expected inflation rate of about 9.7 percent during 2004-05, the money supply is projected to expand at year on year rate of 11.0 percent, 11.5 percent, 13.5 percent, 14.5 percent and 15.0 percent during the years 2005-06, 2006-07, 2007-08, 2008-09 and 2009-10 respectively. Greater increase in monetary expansion has been projected for private sector to meet its growing demand. Within the private sector, agriculture, manufacturing, exports, small and medium enterprises, information technology and housing and construction have been identified as priority areas. Projected monetary expansion during the years 2005-10 is given in Table 4 below:

Table 4
Projected Monetary Expansion during MTDF Period 2005-10

(Rs. Billion)

	2001-05 Average	Revised Credit Plan Target 2004-05	Projections					Average Annual Growth Rate (%)
			2005-06	2006-07	2007-08	2008-09	2009-10	
I. Government Sector	**16.7**	**65.0**	**50.0**	**52.0**	**55.0**	**56.0**	**58.0**	**6.6**
- Budgetary Support	20.5	60.0	45.0	45.5	48.0	48.5	50.0	6.5
- Others	-3.8	5.0	5.0	6.5	7.0	7.5	8.0	6.8
II. Non-Government Sector	**203.3**	**330.0**	**336.4**	**345.8**	**455.0**	**559.0**	**660.0**	**19.0**
- Private sector	224.0	350.0	350.0	375.0	502.2	644.0	798.0	21.5
- Others	-20.7	-20.0	-13.6	-29.2	-47.2	-85.0	-138.0	-135.1
III. Other Items (Net)	**-37.0**	**-65.0**	**-101.4**	**-44.3**	**-43.0**	**-49.0**	**-53.0**	**21.0**
IV. Net Domestic Assets (I+II+III)	**183.0**	**330.0**	**285.0**	**353.5**	**467.0**	**566.0**	**665.0**	**15.4**
V. Net Foreign Assets	**147.2**	**30.0**	**29.0**	**10.0**	**8.0**	**14.0**	**22.0**	**2.6**
VI. Monetary Expansion (IV+V)	**330.2**	**360.0**	**314.0**	**363.5**	**475.0**	**580.0**	**687.0**	**13.1**
(% Change)	(16.9)	(14.5)	(11.0)	(11.5)	(13.5)	(14.5)	(15.0)	

Inflation

Like other developing countries Pakistan has been experiencing a varying inflation rate over different periods in the past. Annual inflation rate (CPI) averaged at 3.2 percent in the 1960s, 12.5 percent in the 1970s, 7.2 percent in the 1980s and 9.7 percent in 1990s. During the last four years (2001-02 to 2004-05) its annual average has remained at 5.2 percent. A great deal of empirical research to identify its causative factors has been done but no single theory has been found to give a full explanation. As a matter of fact a host of factors have been contributing to this at different points in time. The chief factors thus identified as contributing to inflation included global inflation, jump in oil prices, public sector expenditure, increase in money supply, structural changes in aggregate demand composition, supply shocks, increase in wages, cost push and demand pull factors.

Change in prices is measured by three indices, namely Consumer Price Index (CPI), Wholesale Price Index (WPI) and Sensitive Price Indicator (SPI) (all three with Base of 2000-01=100). The CPI covers the retail prices of 375 items in 71 markets of 35 major cities and shows roughly the cost of living in urban areas. The WPI (1550 quotations) covers wholesale prices of 424 items (with 106 major items) prevailing in the 18 cities and 18 markets of the origin of commodities. The SPI covers 53 essential items, prices of which are collected from 17 urban centers.

Inflation rate, which is measured by the CPI, rose to 9.3 percent during July – April, 2004-05 as against 3.9 percent in the corresponding period last year. This is the fall out of the expansionary monetary policy pursued in the past years, supply shocks such as shortage of some food items like wheat atta, enhancement of wheat support price, higher international price of crude oil, exchange rate depreciation and rising trend of real assets prices and consequently wealth effect on aggregate demand.

Price stability would remain a top priority goal in future and efforts would be made to bring the inflation rate down to 7.0 percent by the end of MTDF. The price stability will be achieved by:

i) Maintaining high GDP growth and enhancing production of essential food items

ii) Regulating aggregate demand through a balanced mix of monetary and fiscal policies

iii) Ensuring exchange rate stability with SBP's commitment to provide foreign exchange for imports

iv) Improving the marketing and distribution system

v) Ensuring timely measures to offset any possible domestic supply deficits with expeditious imports

vi) Keeping the input costs including utility tariffs compatible with moderate inflation and neutralizing their possible effect through improvement in total factor productivity

vii) Relating wage levels, productivity and taxation

viii) Making provincial and district governments more effective and proactive in controlling hoarding and profiteering

The thrust of fiscal developments during the MTDF will be on enhancement of revenues through improved tax collection by federal, provincial and district governments by implementing second generation reforms. The monetary expansion will be commensurate with the growth momentum of the economy providing required amount of credit to private sector to serve as the engine of growth, but at the same time keeping strict vigilance on exchange rate and price stability and curbing inflationary expectations.