

## Part 2 : Chapter 17 - Pakistan

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## Chapter 17

# PAKISTAN

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### Islamic Republic of Pakistan

Area:	803,900 km <sup>2</sup>
Population:	152.53 million (June 30, 2005)
Capital:	Islamabad
Language:	Urdu, English, and four other major languages
Religion:	Islam
Government type:	Federal republic
Chief of state:	President General Pervez MUSHARRAF
Currency:	rupee (PKR) (US\$1 = Rs 59.36; FY2005 average)
Fiscal year:	July–June

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# Citizens Crossed the Line of Control in Kashmir

MOMOE MAKINO

**I**n August 2005, local body elections were held for the second time after President General Pervez Musharraf seized power in 1999. Formally, all candidates were designated as independent, nonpartisan candidates, but in fact the election was a sweeping victory for the ruling party, the Pakistan Muslim League (PML). The election proclaimed itself to be grassroots democracy in action; however, in Pakistan the local landed elite are strong powerbrokers, and so even if elections are held, votes are affected by the influence of the local landowners. These local landowners used government decentralization to increase their power, and President Musharraf's power base was also thereby strengthened.

The earthquake that struck northern Pakistan on October 8 killed more than 73,000 people. International institutions, relief agencies from multiple countries, and domestic NGOs, etc., went to the scene of the disaster, where they continue their vigorous emergency support and reconstruction efforts. The massive damage in the area of Kashmir under Pakistani administration (Azad Kashmir) led to an improvement in the relations between Pakistan and India. While bus service across the Line of Control (LoC) had been already restored in April, five checkpoints on the LoC were opened up following the earthquake so that the LoC could be crossed even on foot.

The real GDP growth rate in FY2005, at 8.4 percent, was the highest in twenty years. However, whether this growth will continue in the future remains unknown given that the savings rate is declining and that the economy is dependent on growth in agriculture. In particular, inflationary pressure which has been rising since the latter half of 2004 poses the

greatest cause for concern; an inflation rate of 9.3 percent was recorded in FY2005, whereas an inflation rate of 4.6 percent was recorded in the previous fiscal year. The budget deficit and trade deficit are also expanding, and improvement in the deficits is sought because they may exert further upward inflationary pressure. Meanwhile, it should be regarded positively that real progress has been seen in the privatization of the Karachi Electric Supply Corporation (KESC), etc.

## DOMESTIC POLITICS

### *Local Body Elections*

In August 2005, Pakistan held the local elections for the second time under the Local Government Plan 2000. The first phase of local elections was held on August 18 involving 3,032 union councils, and the second phase was held on August 25 involving 2,974 union councils. The first and second phases consisted of direct elections of union council members, the union council head (*union nazim*), and the union council deputy head (*naib union nazim*). Under the Local Government Plan 2000, the union council heads and deputy heads automatically become members of the district council and the county-level *tehsil* council, respectively. On October 6, the third phase of the local council elections took place. In the third phase, the members of the district councils and *tehsil* councils constituted the electoral college, and an indirect election was conducted in all 110 districts for the district council head (*zila nazim*), district council deputy head (*naib zila nazim*), *tehsil* council head (*tehsil nazim*), and the *tehsil* council deputy head (*naib tehsil nazim*) as well as for reserved seats in each council (33 percent for women, 5 percent for workers and farmers, and 5 percent for non-Muslims). Though the third phase was conducted relatively peacefully because of the nature of indirect elections, it was reported that at least 44 people died as a result of election-related violence in the direct elections of the first and second phases. The voting turnout in the direct elections was 47.4 percent, according to the Election Commission (EC).

Ever since President Musharraf took power through the military coup d'état in October 1999, he has made continuous efforts to gather traditionally influential persons in local areas to his side. The Local Government Plan 2000 may be considered a pillar of those efforts. Officially, the Local Government Plan 2000 was created to promote

democratization through “reform of the provincial government from the grassroots through decentralization of government” (National Reconstruction Bureau, *Local Government Plan 2000*, 2000) under President Musharraf (then chief executive) who promised to restore democracy following the coup d’etat. However in reality, in Pakistan where the landed elite have local power, it is difficult to carry out reforms at the grassroots level through promotion of decentralization, and the plan is understood to be for the purpose of strengthening President Musharraf’s power base. In and after the previous local elections which were completed in August 2001, President Musharraf had successfully created local powerbrokers loyal to the president by giving police powers and other powers to the *zila nazims*. Likewise in the elections in August 2005, the president’s power was fortified under the pretense of decentralization.

In the Local Government Plan 2000, political parties are forbidden from fielding candidates, but actually support was openly given. Because all council members are designated as independent, there are no official figures on the number of seats secured by each political party. However in Punjab and Sindh, seats were won by many candidates loyal to the PML (made up of five factions in the Pakistan-Muslim League excluding the Pakistan Muslim League Nawaz [PML-N]). According to the October 21, 2005 issue of *News*, the elected *zila nazims* in 28 out of 35 districts in Punjab and in 13 out of 23 districts in Sindh are PML supporters. In Balochistan and the North-West Frontier Province (NWFP), a good showing was made by candidates loyal to the nationalist parties and to Jamiat Ulema-e-Islam Fazl (JUI-F). The rapid progress of the National Party and the Balochistan National Party in Balochistan may be considered to be a result of dissatisfaction of the Baloch people against the central government’s policy toward Balochistan (involving management rights for Gwadar Port, gas royalties, and intra-province resource allocation). In NWFP, the Awami National Party (ANP) eroded the support of the JUI-F, the Jamaat-e-Islami (JI), and the PML-N. ANP increased its support by speaking out against the construction of the Kalabagh Dam, which is being promoted in NWFP by the central government.

The ruling PML used a variety of strategies to maintain its strength in Punjab, which is its electoral power base, and in Sindh. In Punjab, the PML used money to encourage the candidates who had been supported by the PML-N and the Pakistan People’s Party (PPP, officially known as the Pakistan People’s Party Parliamentary [PPPP]) to change their sides to PML (*Dawn*, January 1, 2006). In Sindh, the PML’s strategy was to sup-

port a traditionally powerful local politician instead of nominating its own candidate because the party's base is weak there. Moreover, the creation of new districts in Sindh in 2004 was a move to gerrymander the voting areas in favor of the PML and its ally party, the Muttahida Qaumi Movement (MQM), in order to oppose the PPP which has its electoral power base in Sindh (*Dawn*, January 1, 2005). Furthermore, in both Punjab and Sindh, the government invested money known as development funds in district governments (*Daily Times*, August 25, 2005). The opposition parties appealed to the EC, accusing the PML of illegal election practices, but they made no progress as the EC itself is of doubtful neutrality and lacks transparency.

### ***The Balochistan Problem***

Pakistan became a separate and independent state from India in the name of Islam as a symbol of the Muslim unity, but from the beginning, there were destabilizing elements, such as differences among the various ethnic groups and regions. The problem may be summarized as an ill feeling in the regions against the central government, or more specifically, against the ethnic Punjabis who hold the important posts in the central government and the military. This ill feeling was most strongly expressed when Bangladesh, formerly known as East Pakistan, became independent in 1971. In addition to that, the Baloch people's movement for self-determination and independence is fierce, and the civil war-like conflict that began in 1973 between the Pakistani military and the Baloch guerillas lasted for four years. The main current dissatisfaction of the Baloch people is that even though resources such as natural gas lie within Balochistan, the Punjabis who hold the important posts in the central government are monopolizing the profits from those resources.

Ill feelings toward the central government are nothing new, but they intensified in 2005. This was triggered by the rape in January of a female Baloch doctor in a hospital managed by Pakistan Petroleum Limited (PPL) and the fact that the investigation did not progress, as shown by the failure to arrest the military personnel who was the suspect. Nawab Akbar Bugti, who is powerful as the head of Bugti Tribe in Balochistan as well as the chief of the Jahoori Watan Party (JWP), justified the attack on the natural gas pipeline in Sui by the Baloch Liberation Army (BLA) on January 7 as "struggling for the rights of Baloch people, their honour and dignity" (*Dawn*, January 13, 2005). Attacks on government-owned facilities continued after January 7, and the Frontier Corps (FC), which is a govern-

ment paramilitary group, responded. The government was unable to arrest the military personnel who were said to be suspects, and fighting occurred continuously between the armed tribal forces and the joint FC-Defense Security Guards (DSG). Though it appeared to be only an uprising of a local tribe at first glance, the central government was forced to take serious intervention measures because the domestic gas supply was exposed to the threat of continued attacks on the pipeline facilities of Sui Southern Gas Company (SSGC) and Sui Northern Gas Pipeline Company Limited (SNGPL), in addition to attacks on the facilities of the PPL.

President Musharraf's initial policy was to suppress the Baloch tribes with force, but given the fact that similar policies previously had led to Bangladeshi independence and extension of the civil war-like conflict with Baloch guerillas, he decided to attempt a political resolution. On January 17 an emergency cabinet meeting was held, and it was decided to work on a political solution through the Parliamentary Committee on Balochistan which had already been set up in September 2004 with PML President Chaudhry Shujaat Hussain as the chairman. PML President Hussain, of whom it was said "President Pervez Musharraf has given him a free hand to resolve Balochistan's crisis through political means" (*Dawn*, March 22, 2005), had his first meeting with JWP chief Bugti on March 24. Subsequent meetings followed on March 27 and April 4, and in return for the government's withdrawal of the FC, JWP chief Bugti promised to secure the gas facilities. After this, the armed disturbance in Balochistan began to subside for a time. However since then, there have been armed clashes between the tribal forces and the FC continually, including those where the BLA has made repeated attacks on other government facilities. In December when the president was visiting Kohlu in Balochistan, rockets were launched and fighting broke out between the FC and the Marri Tribe. This is regarded as resistance from the tribe in opposition to construction of the Kalabagh Dam, which may cause water shortages in Balochistan while benefiting Punjab.

The Parliamentary Committee on Balochistan discussed concessions that could be granted to Balochistan to promote the safety of the gas facilities as well as to fundamentally resolve the problem. The committee decided on May 2 to adopt a comprehensive plan composed of eight items to benefit Balochistan. These included a development fund package of ten billion rupees for the provincial government, higher gas usage fees to be paid to the provincial government, quotas for Baloch people to be hired by the Gwadar Port facilities, and limitations on duty in the FC. However,

the level of autonomy granted to the province was not included in the comprehensive plan because, given that a revision of the Constitution would be required, agreement could not be reached within the committee. JWP chief Bugti indicated his dissatisfaction with the fact that the comprehensive plan did not include constitutional revision needed to define the level of provincial autonomy (*Dawn*, July 1, 2005). Moreover, the question remains as to how much of the comprehensive plan will actually be implemented, and even if it is implemented, it remains unknown whether it will fundamentally resolve the problems in Balochistan.

### ***Pakistan Earthquake***

On October 8, a magnitude 7.6 quake occurred with its epicenter located at a point 14 km northeast from Muzaffarabad, the capital of Azad Kashmir. It affected the areas of Kashmir administered by Pakistan and India, the Northern Areas, and NWFP. According to the government's official figures, there were 73,000 killed and more than three million left homeless. Even in Islamabad, the capital of Pakistan located 90 km from the epicenter, a building toppled and killed 76 people. The damage to Muzaffarabad and surrounding villages, as well as in Dheerkot, Bagh, and Rawalakot, was massive, and government facilities such as roads, hospitals, and schools were destroyed. Even in NWFP, Balakot and other locations suffered heavy damage. The actual extent of the damage including remote villages in all of the regions is unconfirmed, but the United Nations estimates the number killed to be over one hundred thousand. The death toll continued to rise even as international institutions and support from various countries poured into the area and emergency aid efforts such as distribution of food, blankets, and tents continued. Secondary damage was feared as winter approached the disaster area.

On October 8 when President Musharraf visited the site of the collapsed building, Margalla Towers, in Islamabad, he emphasized that, in addition to setting up the Disaster Relief Cell to coordinate assistance activities in the prime minister's secretariat and starting a president's relief fund, he had called up the air force and assistance activities have been launched swiftly in a cooperative manner. On October 9, in addition to President Musharraf's calling on other countries for assistance, Prime Minister Shaukat Aziz announced that the cabinet had decided to pay 100,000 rupees in condolence money to the family of each earthquake victim. On the other hand, it was reported daily that relief supplies were not reaching the victims, and delays in the government's response



became apparent. While the government asserted the necessity of cooperation in assistance efforts, the distrust of the government's ability to coordinate efforts and the distrust of how the assistance funds would be used resulted in each group conducting assistance without any coordination. A variety of factors probably contributed to the slow response, including the fact that infrastructure was destroyed, many remote villages were difficult to reach, relief supplies were lacking, and the military which was supposed to be involved in relief efforts had suffered damage itself. The opposition party Muttahida Majlis-e-Amal (MMA) (a political alliance of six religious political parties) and the Alliance for the Restoration of Democracy (ARD) (an alliance of the political parties PPP and PML-N) criticized the government's delayed response and lack of coordination ability. Meanwhile, given the large scope of the damage, some opposition parties decided that it was not politically wise to continue blaming the government. At an emergency meeting of the National Security Council (NSC) on the October 12, the MMA, which had boycotted past meetings saying that the NSC positioned the parliament under the military, permitted the participation of NWFP Chief Minister Akram Khan Durrani for the first time. This may indicate such a political decision on the part of the MMA.

Compared to the government, assistance from NGOs was swift. Among the NGOs which energetically undertook relief efforts, there are organizations with relations with militant groups, such as the outlawed Lashkar-e-Taiba (LT), which changed its name to Jamaat-ud Dawa (JD), as well as JI-related groups. The delay in the government's response opened up room for activities by banned groups. While denying that illegitimate groups were conducting relief activities in the disaster area, the president announced on October 20 that, given the current condition of massive damage, "[I] would not deny anyone who is doing some relief work for the people in their hour of trial" (*News*, October 21, 2005).

## ECONOMY

### *Overview of FY2005*

Pakistan's real GDP growth rate in FY2005 (July 2004 to June 2005), at 8.4 percent, was the highest growth rate in 20 years (*Economic Survey*, 2005). The GDP per capita was US\$736. The growth rate in each sector was: agriculture 7.5 percent, industry 10.2 percent, and services 7.9 per-

cent (Table 17.1). The outstanding feature of FY2005 was that, in addition to the continuation of growth in the industrial sector from the previous fiscal year, the agricultural sector broke out of its four-year slump to record growth that exceeded the target goal, thereby contributing greatly to the high growth rate. The growth in agriculture was greatly boosted by the fact that the major crops, which account for 37.1 percent of agriculture value-added, recorded growth of 17.3 percent. Among the major crops, startling growth was seen in cotton (45.5 percent increase in yield YOY) and wheat (8.3 percent increase in yield YOY). The increases in these two crops were due largely to favorable weather, in addition to the better machinery and agricultural chemicals available due to increased agricultural credit and the high government support price. Conversely, this also indicates the fragility of Pakistan's economy, which is at the mercy of the weather. The industrial sector powered Pakistan's economy with growth in large-scale manufacturing (15.4 percent YOY) in continuation from last year. Textiles, which accounted for 32.6 percent of the large-scale manufacturing value-added, displayed high growth (24.7 percent YOY). The growth in textiles is likely to affect the purchasing power of all Pakistanis, both directly because it accounts for over 50 percent of the employment in manufacturing, and indirectly because it has spillover effects on employment in related industries. Growth in automobiles (32.6 percent YOY) and electronic equipment (44.8 percent YOY) was driven by expansion of consumer demand, and although this consumer demand was backed by an increase in consumer financing, the textile sector probably played a role as well. Reflecting the growth in large-scale manufacturing, the retail and wholesale sectors (12.0 percent YOY) continued to perform favorably in continuation from the previous fiscal year.

As seen above, the three sectors posted remarkable growth in FY2005, but it is necessary to remember that the growth was driven by the demand side. Looking at real GDP from the consumption side, the growth in private consumption, which was 8.2 percent in the previous year, was 16.8 percent in FY2005 and accounted for 76.8 percent of the real GDP. Though growth in total investment (16.8 percent YOY) maintained a level similar to the previous year (17.3 percent YOY), a factor for concern is the fact that the savings rate (15.1 percent) necessary to maintain such investment in the future fell significantly below the previous year's savings rate (18.7 percent). Moreover, from the supply-side point of view, the sectors that drove growth were limited to major crops in agriculture and textiles in manufacturing. Compared to the previous year when more diverse sec-

Table 17.1. Real Growth Rates of Major Industries in Past Two Fiscal Years

	(%)	
	2003/04	2004/05
Real GDP growth rate	6.4	8.4
Agriculture	2.2	7.5
Major crops	1.9	17.3
Livestock	2.8	2.3
Industry	12.0	10.2
Manufacturing	14.1	12.5
Large-scale manufacturing	18.2	15.4
Construction	-6.9	6.2
Electric power and gas supply	21.1	2.1
Services	6.0	7.9
Retail/wholesale	8.1	12.0
Transportation/communications	5.5	5.6
Public services/military	4.2	-0.8

Source: State Bank of Pakistan, *Annual Report 2004/05*.

tors contributed to the growth, the production base seems to be shrinking, and this is not a pleasant fact for Pakistan, which is endeavoring to diversify its production base.

In foreign trade, exports amounted to US\$14.45 billion, an increase of 16 percent YOY, and textiles, which made up 62.0 percent of total exports, contributed significantly, displaying an increase of 16.9 percent YOY. While there were negative factors such as the imposition of a 13 percent antidumping tax on bed wears by EU in continuation from March 2004, the phaseout of the Multifibre Arrangement (MFA) in January 2005 seems to have worked in Pakistan's favor. Growth in exports was firm, but because imports amounted to US\$18.965 billion, an increase of 38.0 percent YOY, the trade deficit greatly exceeded the target of US\$3 billion to reach US\$4.515 billion, putting the current account balance for FY2005 in the red for the first time in five years. Deterioration of the trade balance and the current account balance is not seen as a problem because behind the increase in imports was, in addition to the increase in the international oil price, the growth in imports of machinery and raw materials, which is seen as a positive sign for domestic manufacturing henceforth. (State Bank of Pakistan, *Annual Report 2004–2005*, 2005). However, there is a problem with the classification of statistics in this regard; it is pointed out that automobiles, cellular phones, and other durable consumer goods

are handled as capital goods, and these amount to 25 percent of the items classified as imported machinery (*Business Recorder*, December 8, 2005). So, straightforward optimism needs to be tempered.

While the current account deficit is worsening, capital accounts changed from a US\$1.33 billion deficit in the previous year to a US\$570 million surplus. Factors behind this include the first issue of US\$600 million worth of Islamic bonds (Sukuk) in the international capital market on January 18, receipts accompanying the privatization of Habib Bank, the increase in direct investment (FDI) in the oil and gas sector and the telecom sector (60.4 percent increase YOY), and low-interest loans from the World Bank and ADB. While the growth in FDI is a positive development, the absolute value is still just US\$1.525 billion and the recipients of the investment are extremely limited, with 65 percent of FDI going to 18 companies in the telecom, finance, and oil and gas sectors. So, further promotion and diversification of FDI is required.

### ***Economy in the First Half of FY2006***

It can be predicted from an overview of the economy in the first half of FY2006 that, compared to the striking growth displayed in FY2005, growth in FY2006 is likely to decelerate. For instance, growth of large-scale manufacturing during July–October in FY2006 (at 8.7 percent) was sluggish compared to the same period in the previous year (which saw growth of 24.9 percent). Moreover, not only were cotton and sugar cane, which are the main crops in the rainy season (*khariif*), below the target level, but they also were decreased by 11.0 percent and 12.7 percent, respectively, compared to yields in the previous year. This can be said to reveal the fragility of Pakistan's economy, which relies on the extremely limited sectors of textiles and major crops.

Moreover, the trade deficit grew. The trade deficit in the first half of FY2006 was US\$5.581 billion, and not only did this significantly exceed the US\$2.396 billion in the same period of the previous fiscal year, but it already exceeded the total trade deficit of the previous fiscal year. Behind that is the ongoing rise in the international oil price, demand for machinery and raw materials for manufacturing, and imports of disaster relief supplies. Because the effect of exogenous factors such as the oil price and the earthquake disaster is large, it is difficult to respond with policy measures, but if the current account deficit continues, as a result, it will produce inflationary pressure, which is the greatest fear of the domestic economy. Then the government will no longer be able to optimistically say

“the increase in imports is primarily due to the manufacturing industry’s increased demand for machinery.”

While the deterioration in the current account balance is conspicuous, the large improvement in capital accounts is compensating for that, and so the international account balance is improving overall. The increase in FDI is a positive factor in the improvement of capital accounts, but caution is necessary when including the international aid for the earthquake. In time, loans will increase Pakistan’s foreign debt burden and even grant aid does not continue indefinitely, so they should not be considered to represent a fundamental improvement in capital accounts.

### *Progress of Privatization*

In 2005, the auctioning of state-operated companies, which had been considered problematic, was implemented, and even progressed to the actual transfer of ownership. The fact that actual transfer of ownership was achieved has great significance. The reason is because even if tangled issues of domestic rights in state-operated companies are overcome and an auction takes place, cancellations are not rare as negotiations following the auction often reach an impasse due to incomplete documentation for the auction, etc., and the deadline often passes without payment. Pakistan graduated from the IMF’s Poverty Reduction and Growth Facility (PRGF) in December 2004, and among the economic issues in Pakistan, the IMF had expressed concerns with the slowness of progress in privatization. Hence, the year 2005 was the first year that the government’s stance toward privatization was tested. The greatest result may be the privatization of KESC. On February 4, the auction of KESC, which had initially been planned for 2004, took place, and 73 percent of KESC’s stock was successfully bid on by a joint venture of the Kanooz Al Watan Group of Saudi Arabia and Siemens Pakistan for 20.24 billion rupees. However, the deal was cancelled when payment did not arrive by the deadline, and so privatization was postponed. On August 22, Hassan Associates, the second highest bidder at the first auction, agreed to pay 20.24 billion rupees, and on November 29, KESC was transferred to a joint venture of Hassan Associates and Saudi Arabian Al-Jomaih Holding Company.

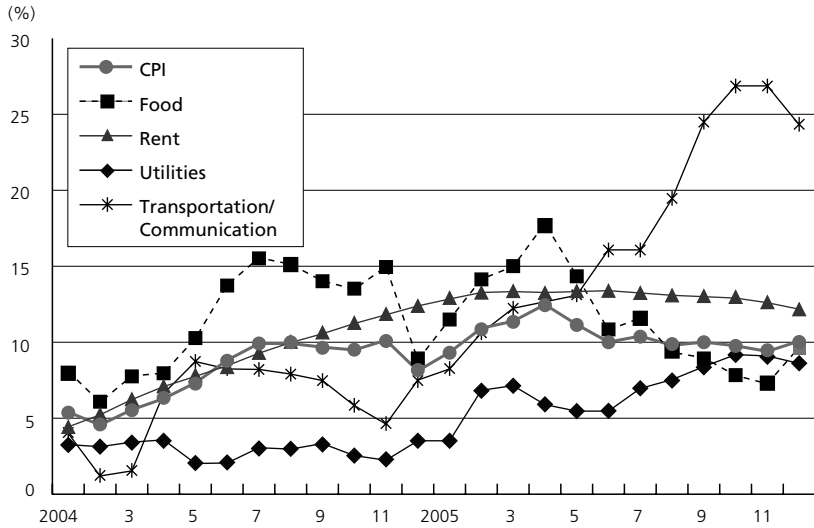
In June, an auction of 26 percent of the stock of Pakistan Telecommunications Company Limited (PTCL) took place, and it was the largest transaction ever in terms of monetary amount. The auction, which initially had been planned for June 10, was postponed until June 18 due to resistance from PTCL’s labor union. Etisalat, a company from the

United Arab Emirates (UAE) bid successfully on 26 percent of PTCL's stock and management rights for 155.158 billion rupees. However, negotiations following the auction reached an impasse and payment was not made on time. On October 29, Pakistan's Privatization Committee (PC) announced that the privatization process would start afresh. Anxiety caused by the setback in the largest privatization transaction to date had an impact on the stock price index, known as KSE-100, of the Karachi Stock Exchange (KSE) (*Business Recorder*, September 23 and 28, 2005). The government, which was planning on the payment from Etisalat for two-thirds of the FDI target amount for FY2006 (*Dawn*, October 17, 2005), was strongly determined to complete this privatization deal. Negotiations continued between PC and Etisalat even after the announcement to start afresh, and on December 20, agreement was reached on the sale at the original bid price. The actual payment is still pending, and so all eyes are likely to be watching to see if it is actualized.

### ***The Rising Rate of Inflation***

The largest problem for the economy in 2005 was the rising rate of inflation. The rise in the consumer price index (CPI) in FY2005 was 9.3 percent, which greatly surpassed the 4.6 percent of the previous year and the 5 percent inflation target. Initially, inflationary pressure was expected to decline due to the bumper crop of wheat as well as the stringent monetary policy of the State Bank of Pakistan (SBP) implemented since July 2004 which specifically included the Treasury Bill (TB) rate hike. However, inflation actually rose due to factors such as higher food and oil prices, an increase in loans from commercial banks, worsening of the trade deficit, and higher asset prices. SBP announced its intention to continue its stringent monetary policy (SBP, *Policy Statement*, 2005), and so it raised the TB rate, which led to the progressive raising of the export refinance rate from 3.5 percent at the end of 2004 to 7.5 percent in July 2005. Moreover on April 11, SBP raised the discount rate, which it had frozen since lowering it to 7.5 percent in November 2002, to 9 percent. To restrain the rising food prices that made up 40 percent of the CPI basket, the government permitted tariff-free imports on wheat and unrefined and refined sugar on July 1 and permitted tariff-free imports of unrefined and refined sugar from India on August 2. As a result, the rise in the CPI peaked at 12.6 percent (YOY) in April, then declined to 9.6 percent (YOY) in November 2005 (Figure 17.1). However, inflationary pressure continues in the form of increased domestic demand and higher international oil prices.

Figure 17.1. Inflation Rate Trends (YOY)



Sources: State Bank of Pakistan, *Statistical Bulletin*, various issues.

Note: The CPI basket share for FY2005 is: food 40.3%, rent 23.4%, utilities 7.3%, and transportation/communication 7.3%.

Meanwhile, while real interest rates are near zero, borrowing by the large-scale manufacturing sector is beginning to decline (SBP, *First Quarterly Report 2005–2006*, 2005). Further tightening of monetary policy will reduce the incentive to invest in growth industries, and so SBP is faced with a difficult steering task.

### *Worsening of the Budget Deficit*

The tax receipts collected by the Central Board of Revenue (CBR) in FY2005, at 591.1 billion rupees, exceeded the target for three consecutive years, but government expenditures increased even more, creating a budget deficit equivalent to 3.3 percent of the GDP, which outstrips the previous year's 3.0 percent. The fact that tax receipts exceeded the target tends to be regarded as a positive thing, but it should not be taken as such. Viewed as a percentage of GDP, tax receipts were 10.6 percent, which is lower than the 11.6 percent of the previous year. The main factor in higher tax receipts is most likely the unexpectedly high economic growth and the dramatic increase in imports, rather than any effect of tax reforms implemented starting in November 2001. This trend continued in the first half of FY2006. Tax receipts in the first half of FY2006 achieved

their target and posted growth of 21.6 percent compared to the same period in the previous year. However, that was primarily the result of higher receipts of customs taxes due to the increase in imports. Conventional budget policy where the budget deficit is offset by a reduction of development expenditures is not a wise policy for sustainable economic growth. Fundamental resolution of the problem should be achieved by increasing tax receipts, and particularly by expanding the taxpayer base. In addition to the fact that income taxpayers in Pakistan are 1.5 percent of the total population, the figure for corporate tax is reported as 31 percent of the registered corporate taxpayers (SBP, *Annual Report 2004–2005*, 2005). Since tax receipts as a percentage of GDP are 20.4 percent on average in developing countries (IMF, *Government Finance Statistics*, 2005), expansion of the taxpayer base is an important issue for Pakistan where the percentage is low. There has been a visible tendency in Pakistan hitherto to rely on indirect taxes like customs tax because such taxes are easy to collect. However, the tariff rate will unavoidably decline as trade deregulation progresses, and so Pakistan must switch to direct taxes as a source of tax revenue. Moreover, taxpayers' incentive to pay has been eroded up to now by the fact that bribery of tax officials is known to be commonplace and the fact that there is bias and a lack of fairness in the levying of taxes, as seen in the under-taxation of the agricultural sector, which accounts for approximately 25 percent of the GDP, and the service sector, which accounts for approximately 50 percent of the GDP. Reform of the agricultural sector is probably difficult because of vested interests of landed elite. Since reform of the service sector is not even being discussed, ultimately it depends on how seriously the government will engage in tax reform. Government expenditures are expected to increase through 2006 due to emergency aid expenditures and reconstruction expenditures following the earthquake (Asian Development Bank and World Bank, *Preliminary Damage and Needs Assessment*, 2005). Since an increase in the budget deficit will place upward pressure on interest rates, there is a risk that the already declining incentive to invest will decline even further.

## FOREIGN RELATIONS

### *Relations with India*

Relations between Pakistan and India in 2005 followed the direction set in 2004 when the first summit meeting in two and a half years was held, and



improvements on a number of points were witnessed. The greatest achievement was the start of regular bus service connecting Muzaffarabad, the capital of the portion of Kashmir under Pakistan's administration (Azad Kashmir) and Srinagar, the capital of the portion of Kashmir under India's administration (Jammu and Kashmir). The significance of this is that it is the first bus service for private citizens to cross the Line of Control (LoC), a line which is based on the ceasefire line prescribed by UN arbitration in 1949 following the first Indo-Pakistani War. Starting bus service between Muzaffarabad and Srinagar had been mentioned ever since India proposed the Confidence Building Measures (CBMs) on October 22, 2003. However, actualizing it was said to be impossible because the question of what sort of passports bus passengers should carry had been considered very sensitive as it implied the determination of the border in disputed Kashmir. At the first meeting concerning bus service held in New Delhi on December 7–8, 2004, India asserted that passengers living on the Indian side of the LoC should carry Indian passports, and passengers living on the Pakistani side of the LoC should carry Pakistani passports, but Pakistan could not accept this because it does not recognize the LoC as a national border. Meanwhile Pakistan, refusing to recognize the implications of bus service for clarifying the national border, insisted that passengers should be limited to residents of Kashmir, who should carry permits issued by the United Nations or the local authorities; however, India was unable to accept the granting of special status solely to the residents of Kashmir. The problem was resolved through mutual concessions on February 16, 2005, when Indian Foreign Minister Natwar Singh visited Islamabad and met with Pakistan Federal Foreign Minister Khurshid Kasuri. In short, it was decided that the passengers would not be limited to residents of Kashmir and passengers should carry the "LoC Crossing Permit" issued by local government with no reference to nationality, thus solving the matter without touching on the problem of the national border. In this way, both parties agreed to start bus service on April 7. The agreement between the foreign ministers was welcomed by the people of both Pakistan and India, and particularly by the Kashmir people whose families were divided by the LoC. But from a few quarters there was strong criticism. JI Chief and MMA President Qazi Hussain Ahmed stated, "The agreement is a ploy to ignore the Kashmir problem" (*Dawn*, February 18, 2005), emphasizing that the resolution of the Kashmir problem should not be postponed. Moreover, militant organizations such as Hizbul Mujahideen (HM), which has its base of

operations in Azad Kashmir and aims to return Kashmir to Pakistan, threatened to attack buses in protest. If such attacks had actually occurred, they would have unavoidably resulted in a sudden souring of the relationship between India and Pakistan. Despite the antagonism, buses from both sides crossed the LoC on April 7 as scheduled.

On April 16, President Musharraf visited India to further promote CBMs more concretely. On April 18, President Musharraf and Indian Prime Minister Manmohan Singh issued a joint communiqué declaring that “the peace process is now irreversible” (*News*, April 19, 2005), and they vowed that they would not allow terrorism to stop it. The joint communiqué covered many topics, including the continuation of talks on Kashmir, increase of bus and train service, restart of the operations of Pakistan’s and India’s consulates in Mumbai and Karachi respectively, cooperation on development of the Iran-Pakistan-India (IPI) gas pipeline, activation of the Joint Economic Commission, and holding of meetings of the Joint Business Council. While these certainly are good outcomes, the fact that there were no references to Kashmir, and specifically to the border problem which is the core issue of dispute between India and Pakistan, caused divided reactions domestically. Those who agreed with the outcome considered President Musharraf’s “think outside the box” approach necessary to peacefully resolve the Kashmir issue. On the other hand, stern criticism appeared in an article entitled “Farewell to Kashmir” (*Dawn*, April 24, 2005) which pointed out that although Pakistan has insisted heretofore on a local referendum by Kashmir residents based on a 1949 UN recommendation and has put this argument as a core item in Pakistan-India negotiations, there was weakness in the president’s negotiations this time because he did not make any reference to this. The joint communiqué also made no reference to the Baglihar problem discussed below, and so it cannot be denied that negotiations on matters that are difficult to resolve seem to have been avoided.

The earthquake on October 8 in Azad Kashmir had a positive effect on Pakistan-India relations. On the day, Indian Prime Minister Singh telephoned President Musharraf, and together with expressing his condolences for the massive damage across Kashmir in both the area administered by Pakistan and that administered by India, offered emergency assistance. Specifically, according to the announcement of India’s Ministry of External Affairs, on October 10, relief supplies and helicopters were offered. The relief supplies were approved by the Pakistani government, and on October 12, the first shipment of supplies, including blankets and

tents, arrived. This was the first case of disaster aid since the third Indo-Pakistani War in 1971. Meanwhile, the helicopters were initially declined due to the militarily delicate nature of accepting them, but after the Pakistan government was criticized by domestic public opinion, it conveyed its intention on October 17 to accept the helicopters but without Indian military pilots. This was unacceptable to the Indian government, and in the end Pakistan did not receive the helicopters. The unbending attitude of the Pakistani government was criticized at home and abroad as the demand for helicopters was huge because they were the only means of delivering assistance to remote disaster areas and there were many regions of Kashmir that could be more easily accessed from the Indian side.

On the other hand, it should be appreciated that the following specific improvements were seen in matters related to Kashmir. On October 19, in order to allow contact between families that were divided by the LoC, telephone lines which had been forbidden since the intensification of militant activities in Kashmir in 1989 were reconnected. After President Musharraf announced on October 18 his willingness to open the LoC, a meeting of high-level foreign affairs officials was held on October 29, and agreement was reached to open five checkpoints on the LoC with the primary purpose of allowing relief efforts and divided families to pass through. After this agreement, the Rawalakot-Poonch crossing point was the first checkpoint opened, on November 7, and the remaining four were opened after that. At first, no private citizens passed through because more than 10 days were required to receive a crossing permit, and passage was limited to the transport of relief supplies. However on November 19, 24 residents from the Indian side of Kashmir passed over the LoC at the Chakothi-Uri crossing point. This was the first case of passage by private citizens on foot since the prototype of the control line was drawn in 1949.

While there was no progress on the central issue of the national boundary line, the relationship between India and Pakistan with regard to Kashmir did show visible progress in terms of the importance placed on CBMs involving personal exchanges, and this should be regarded as a positive development. Meanwhile, the biggest dispute between Pakistan and India throughout 2005 was the water supply problem, which is one of the issues of economic interest that lie behind the national border problem, and it remains unresolved. Pakistan has insisted that India halt construction on the Baglihar Hydropower Dam on the Chenab River in Indian Kashmir which has been underway since 1992. The grounds for this are that the dam violates the 1960 Indus Waters Treaty signed with the medi-

ation of the World Bank because it would reduce the water that flows to Pakistan. India, on the other hand, claims that the dam will have no effect on the amount of water that flows to Pakistan and shows no sign of stopping construction. For an agricultural country like Pakistan, the amount of water particularly during the dry season is a matter of vital importance because it determines the growth of the agricultural sector. After the water and power secretary level talks held January 4 to 6 stalled, on January 18 Pakistan's Ministry of Foreign Affairs formally requested arbitration by the World Bank based on the above treaty. On May 11, the World Bank appointed Swiss professor and civil engineer Raymond Lafitte as the arbitrator, with the agreement of both countries. The final resolution will be in 2006 or thereafter, but a peaceful resolution through arbitration can be anticipated.

The fact that Pakistan's economy depends on water resources from Indian Kashmir complicates the Kashmir problem, and promotion of two-way economic interdependence rather than one-way dependence would most likely be effective for the countries' collective security. A concrete example is the actualization of the IPI Gas Pipeline Project. The actualization of the IPI Gas Pipeline Project is desirable for both countries, which are said to require secure energy resources in order to maintain economic growth. While India is responsible for avoiding disputes with Pakistan, which the pipeline passes through, Pakistan is responsible for ensuring the security of the pipeline in order to get the US\$6 hundred million annually in passage fees. Pakistan signed a memorandum with Iran on July 7 concerning the start of the construction of the IPI Gas Pipeline and reached agreement with India on December 17 that construction would start by mid-2007. The United States is opposed to the IPI Gas Pipeline Project on the grounds that it would increase the profit of Iran, which is pursuing development of nuclear weapons. There are also likely to be difficulties in completing the project, including the raising of the estimated US\$7.2 billion in expenses. However, such infrastructure would be unthinkable if the relationship between Pakistan and India were strained, and it is desirable that active talks continue between the two countries.

### ***Pakistan Earthquake and International Assistance***

Following the earthquake, other countries including India and international institutions offered assistance, and Pakistan and international society started cooperation in emergency aid and reconstruction aid. The UN Under-Secretary-General for Humanitarian Affairs and Emergency Relief

Coordinator Jan Egeland, who visited the disaster area on October 13 and 14, called for further assistance from other countries and for cooperation between Pakistan and India. UN Secretary-General Kofi Annan, seeing that the reaction of international society was slow, called on other countries on October 19 for emergency assistance and for attendance at the ministerial donors' conference to be held in Geneva on October 26. At the conference, Secretary-General Annan called for the cooperation of international society such as that seen after the Indian Ocean tsunami, saying, "More than three million men, women, and children are homeless." "The Himalayan winter approaches." Aid "to prevent a second shockwave of deaths" is "a race against time" (UN Office of the Spokesman, October 26, 2005). At that conference, international society pledged the provision of new funds in the amount of US\$580 million. The UN's target for emergency aid was US\$550 million, so the amount appears to have exceeded the target, but a mere 20 percent of that was provided in cash. Rather than reconstruction, the assistance that was required at that point was emergency items such as food, medical care for the injured, shelter, and protection against the cold, and implementation of emergency aid by the United Nations was also delayed due to lack of funds. So, it must be said that the conference ended in failure.

On November 17, UN Secretary-General Annan visited Pakistan to attend the International Donors' Conference (held in Islamabad). On November 18, the UN Secretary-General visited the disaster area together with President Musharraf, and he emphasized that the situation was as severe as in the case of the Indian Ocean tsunami (*Dawn*, November 19, 2005). Prior to the Donors' Conference, President Musharraf guaranteed that the usage of the aid funds would be transparent. At the Donors' Conference on November 19, international society pledged donations amounting to a total of US\$5.827 billion. Because US\$3.5 billion was considered necessary for reconstruction and US\$1.7 billion for emergency assistance, Prime Minister Aziz said this is "a very successful day for Pakistan" (*Dawn*, November 20, 2005). The cumulative donations pledged by the major countries and international organizations are shown on Table 17.2. In addition to this, India declared a donation of US\$2.5 million. It may be said that this meeting ended successfully. Even so, because the government's reconstruction plan is for three years and full reconstruction will probably require years longer, international society should work to ensure that the damage from the disaster and the lessons learned are not forgotten.

**Table 17.2. Pledges Announced at the Donors' Conference  
(cumulative amount)**

	(US\$ million)	
<i>Countries/International Organizations<sup>1)</sup></i>	<i>Total Amount</i>	<i>Loan Amount</i>
Asian Development Bank	1,000	920
World Bank	1,000	1,000
Saudi Arabia	573	320
United States	510	0
Islamic Development Bank <sup>2)</sup>	501	500
IMF	375	375
China	326	300
Iran	200	20
Turkey	150	0
France	124	94
United Kingdom	120	0
Japan	120	100
EC	110	0
Germany	100	0
United Arab Emirates	100	0
Kuwait	100	0

*Source:* Government of Pakistan, *Pledges for Reconstruction and Rehabilitation*.

*Notes:* 1) Countries and international organizations that announced pledges of US\$100 million or more.

2) Islamic Development Bank is headquartered in Jeddah, Saudi Arabia, and is funded by the Organization of Islamic Conferences (OIC).

Among the donations, those from Islamic countries and related organizations are prominent in comparison to their economic strength; however, the United States and European countries are still large donors, and it is said that their donations may soften the anti-Western feelings among Pakistani people (*Dawn*, November 12, 2005). Based on a request by the United Nations, the North Atlantic Treaty Organization (NATO) decided to cooperate in an airlift of relief supplies together with the United Nations High Commissioner for Refugees (UNHCR), and on October 21, the NATO airlift planes arrived in Islamabad. The Pakistan government decided on October 22 to allow NATO activities in the disaster area. In reaction, complaints were raised by the opposition parties such as MMA and ARD, with MMA Secretary General Maulana Fazal-ur-Rahman stating, "If American forces have come here, they should be sent back and the same should be done for NATO forces" (*Dawn*, October 29, 2005). However, despite the strong anti-American sentiment heretofore, this was

not enough to move public opinion because the damage was massive. Assistance activities by the United States and NATO in Pakistan may have been the most effective of all the activities in the “war on terror” because part of the disaster region included the NWFP, the area where anti-American sentiment runs the highest, and assistance activities there are said to have led to a diminishment of anti-American sentiment, which is the underpinning for terrorism.

## ISSUES IN 2006

The following issues should be raised concerning the emergency assistance and the reconstruction activities following the earthquake. First is to ensure the transparency of the usage of aid funds. Pakistan is ranked 144th out of 158 countries in the Corruption Perceptions Index 2005 of Transparency International, and problems have already been reported where the perceived lack of transparency is preventing cooperation in assistance activities. Second is to grasp the need for aid and to make certain the aid gets to the victims. Already the problem of fake victims has been pointed out, and there are reports that high-quality, foreign-made blankets are being sold in the markets. Job creation is generally anticipated in the reconstruction process which will involve public works, etc., and there are calls to give priority in hiring to disaster victims. Third is the measure for education and orphans of the disaster. In Pakistan where the literacy rate is low, raising the level of education is necessary also for sustained growth, and since the schools themselves in the disaster region were damaged, immediate reconstruction is required. For disaster orphans, coordinated support is needed from the national government and from local communities, including for the construction of orphanages, as adoption has already been forbidden so that orphans are not sold to child traffickers or exploited as child labor. Efficient and effective implementation of these activities of assistance and reconstruction is necessary so that there is no room for groups with ties to militant groups, etc., and to guarantee the stability of the Musharraf administration.

In Pakistan where imports are expected to increase due to demand for relief supplies, it is feared that the already sizable trade deficit will deteriorate even further. Moreover, there is high potential for the budget deficit to worsen given the massive expenditures for reconstruction assistance that are likely. Both are cause for concern with regard to inflationary pres-

sure, which remains high, and thus a strong commitment by the government to tax reform and privatization is required so as not to reduce the investment incentive of industry overall.

In Pakistan's relationship with India where positive movement was seen following the disaster, it is important to further promote concrete realization of CBMs. A direct solution to the Kashmir issue will certainly be difficult. Although it may seem long and slow, the sure path to peaceful coexistence most likely lies in the strengthening of the interdependence of both countries through specific economic and personal connections such as trade, the IPI Pipeline, an increase in the means of transportation between the two countries, and so forth.



## IMPORTANT DATES IN 2005

### January

- 1: Muttahida Majlis-e-Amal (MMA) and the Alliance for the Restoration of Democracy (ARD) held a protest rally against President Musharraf's dual office as the Chief of Army Staff.
- 7: Natural gas pipeline exploded in Sui in Balochistan Province (BP). Thereafter, tribal militants and the Frontier Corps clashed. (–11th)
- 8: Japan's Minister of Economy, Trade, and Industry Nakagawa came and agreed to restart annual loans of US\$500 million after seven-year gap.
- 14: The BP government requested the federal government to protect the natural gas facilities in the Sui area.
- 17: Kyrgyz President Askar Akaev came.
- 18: First issue of Islamic bonds (US\$600 million worth).  
- Pakistan's Ministry of Foreign Affairs formally requested arbitration by the World Bank on the Baglihar Dam construction problem (in dispute with India).
- 24–27: Pakistan Prime Minister Aziz visited Belgium.
- 25: PML President Chaudhry Shujaat Hussain met with Pakistan Oppressed Nations Movement Chief Sardar Ataullah Mengal to resolve the BP problem.
- 27: Prime Minister Aziz visited Switzerland to attend the World Economic Forum (28–30th).

### February

- 1: State Bank of Pakistan (SBP) raised the export refinance rate (ERR) to 4 percent.
- 3: The Karachi Stock Exchange's (KSE) stock price index, KSE-100, rose to 7,014.71.
- 4: Seventy-three percent of Karachi Electric Supply Corporation's (KESC) stock was successfully bid on by a joint venture of the Kanooz Group of Saudi Arabia and Siemens Pakistan for 20.24 billion rupees.
- 6–8: World Bank President James D. Wolfensohn came and on the 8th pledged aid of US\$1 billion annually.
- 7–9: Sir Lankan President Chandrika Bandaranaike Kumaratunga came and on the 9th signed a bilateral FTA.
- 10: Shadi Kaur Dam in BP collapsed; the death toll exceeded 250 persons.  
- Former prime minister Benazir Bhutto and former prime minister Nawaz Sharif met (in Jeddah).
- 15–17: Indian Foreign Minister Natwar Singh came and on the 16th decided to start bus service in April between Muzaffarabad and Srinagar.
- 15–18: Malaysian Prime Minister Abdullah Ahmad Badawi came.
- 15–23: Pakistan Foreign Minister Kasuri visited Japan.

- 22–24: Prime Minister Aziz visited Iran.
- 23: KSE-100 hit 8,180.79.
- 28: Meeting of National Security Council held. MMA Secretary General Rahman and NWFP Chief Minister Durrani were not in attendance.

### **March**

- 1: SBP raised the ERR to 4.5 percent.
- 6–8: President Musharraf visited Uzbekistan and Kyrgyzstan.
- 8: KSE-100 hit 9,218.68.
- 12: President Musharraf appointed Naval Commander (retired) Khalilur Rehman as governor of NWFP.
- 14–15: Prime Minister Aziz visited Oman.
- 15: KSE-100 rose to 10,303.13 and thereafter fell sharply, closing at 7,770.33 on March 31.
- 16–17: US Secretary of State Condoleezza Rice came.
- 19: Explosion at shrine in BP; the death toll was over 40 persons.
- 22: Afghan President Hamid Karzai came.
- 24: PML President Hussain met with Jahoori Watan Party (JWP) President Bugti of BP. Subsequent meetings followed on March 27 and April 4.
- 25: The US government sent notification of its decision to sell F-16 fighter jets.

### **April**

- 1: SBP raised the ERR to 5 percent.
- 5–7: Chinese Prime Minister Wen Jiabao came.
- 6–7: Japan's Minister of Foreign Affairs Machimura came to attend the Foreign Ministers' Meeting of the Asia Cooperation Dialogue (ACD).
- 7: Bus service began for the first time in 60 years between Muzaffarabad and Srinagar.
- 11: SBP raised the discount rate from 7.5 percent to 9 percent.
- 12: The Economic Coordination Committee (ECC) permitted free inter-province movement of wheat.
- 12–13: Azerbaijan President Ilham Aliyev came.
- 13: Pakistan's Supreme Court dismissed the revision of the 17th Constitution and all formal objections against President Musharraf's dual office as the chief of army staff.  
- US Secretary of Defense Donald Rumsfeld came.
- 16–18: President Musharraf visited India.
- 18–24: President Musharraf visited the Philippines and Indonesia and on the 24th attended the Asian-African Conference.
- 19: KSE-100 fell to 6,952.72.
- 30–May 1: Japanese Prime Minister Koizumi came.

## May

- 1: SBP raised the ERR to 6.5 percent.
- 2: The Parliamentary Committee on Balochistan chaired by PML President Hussain adopted a comprehensive plan to benefit BP.
- 4: Al Qaeda No. 3, Abu Faraj Al Libbi, was arrested as the ringleader in the attempted assassination of President Musharraf and sent to the United States on May 31.
- 5–12: Prime Minister Aziz made a visit to four Southeast Asian countries.
- 7: President Musharraf appointed Iftikhar Mohammad Chaudhry as the 20th Chief Justice of the Supreme Court.
- 11: Pakistan and India agreed to bus service between Lahore and Amritsar and between Lahore and Nankana Sahib.
- 13: Formal announcement was made that the FTA with Sri Lanka will become effective June 12.
- 17: Federal Information Minister Sheikh Rashid suggested that President Musharraf will continue beyond his term limit in 2007.  
- A *fatwa* (an interpretation of Islamic law) forbidding suicide bombing was officially issued by 58 religious scholars.
- 19: President of Palestinian National Authority Mahmud Abbas came.
- 27: Suicide bombing at a shrine in Islamabad; at least 22 dead.
- 30–June 5: Indian Bharatiya Janata Party (BJP) President Lal Kishanchand Advani came.
- 31: Attock Oil Group successfully bid on 51 percent of stock of the National Refinery Limited (NRL) for 16.415 billion rupees.
- 31–June 3: Prime Minister Aziz visited Turkey.

## June

- 2: Leaders of the All Parties Hurriyat Conference (APHC) made their visit to Pakistan using the Srinagar-Muzaffarabad bus for the first time.
- 4: Pakistan Ministry of Finance released its FY2005 Economic Survey. The real GDP growth rate was 8.4 percent.
- 4–5: President Musharraf visited United Arab Emirates (UAE) and Qatar.
- 6: Prime Minister Aziz, serving simultaneously as minister of finance, released the budget plan for FY2006. The budget increased 21.7 percent YOY to 1.098 trillion rupees. The development budget increased 35.0 percent YOY to 272 billion rupees. Defense spending increased 15.0 percent YOY (3.3 percent in revised figures) to 223.5 billion rupees.
- 8: NSC meeting held. The two MMA members were absent.  
- Foreign Minister Kasuri visited the United States.
- 12–19: President Musharraf visited Australia, New Zealand, and Thailand.
- 18: Etisalat of UAE successfully bid on 26 percent of the stock of Pakistan Telecommunications Company Limited (PTCL) for US\$2.598 billion.
- 25–26: President Musharraf visited Saudi Arabia.

- 29: The Asian Development Bank (ADB) agreed to provide aid of US\$3.6 billion over three years from 2006.

## July

- 1: ECC permitted duty-free import of wheat, unrefined sugar, and refined sugar.
- 1–13: Flooding in Punjab and NWFP due to heavy rains. Flooding also occurred in Sindh on July 9.
- 1: SBP raised the ERR to 7.5 percent.
- 4–6: Prime Minister Aziz visited Kazakhstan, attended the Shanghai Cooperation Organization (SCO) summit meeting as an observer, met with Indian Foreign Minister Natwar Singh on the 5th, and met with Chinese President Hu Jintao on the 6th.
- 5: Attempted shooting at car carrying the Pakistan Ambassador to Iraq, Younis Khan. The ambassador decided to temporarily retreat to Anman.
- 7: Pakistan signed memorandum with Iran concerning the IPI (Iran, Pakistan, India) Gas Pipeline.
- 10–16: Prime Minister Aziz visited Germany and Italy.
- 11: The MMA submitted the Hasba Bill to the NWFP Assembly. Opponents to the bill criticized it, saying it would talibanize the NWFP. The bill was approved on July 14. President Musharraf lodged an objection with the Supreme Court.
- 13: Train collision accident occurred in Sindh, killing at least 136.
- 14: Following the identification of the bombers in the July 7 suicide bombing in London, President Musharraf promised cooperation with the investigation in a telephone conversation with British Prime Minister Blair.  
- In North Waziristan, US allied forces stationed in Afghanistan killed 24 militants.
- 17: In North Waziristan, Pakistan forces fought militant groups. Seventeen foreign militants were killed.
- 19–22: Police rounded up clerics and students at mosques and madrassahs. Over 200 persons suspected of having ties to militant groups were arrested.  
- Decision was made to raise the rate of return for the National Savings Scheme (NSS) from 4 percent to 5 percent (effective retroactively from July 1).
- 21: Federal Commerce Minister Humayun Akhtar Khan announced the FY2006 trade policy. Targets are US\$17 billion for exports and US\$21.8 billion for imports.
- 24: Prime Minister Aziz visited Afghanistan.
- 29: President Musharraf announced that all foreign students enrolled at madrassahs in Pakistan, estimated at 1,400 students, will be forced to leave.

## August

- 1: Pakistan declared a seven-day mourning period upon the death of Saudi Arabia King Fahd. President Musharraf attended the funeral on August 2 (in Riyadh).
  - Supreme Court began screening the constitutionality of the Hasba Bill and issued a written judgment that it was unconstitutional on August 31.
- 2: ECC decided to allow duty-free imports of unrefined and refined sugar from India.
- 8–11: Prime Minister Aziz visited Japan, met with Japanese Prime Minister Koizumi on August 10, and signed a yen loan agreement for US\$146 million and a grant aid agreement for US\$22.8 million.
- 11–13: Prime Minister Aziz visited Hong Kong.
- 11: Pakistan conducted test launch of nuclear-capable ground-launched cruise missile, Hatf VII.
- 15–17: World Bank President Wolfowitz came and pledged to increase financing to US\$1.5 billion per year.
- 18: The first phase of local body elections took place.
- 22: After Kanooz Group declined to purchase KESC following its successful bid, Pakistan's Hassan Associates agreed to purchase KESC for 20.24 billion rupees.
- 25: The second phase of local body elections took place.

## September

- 1: Foreign Minister Kasuri met with Israel Foreign Minister Silvan Shalom. This was the first official meeting between the two countries.
- 8: NSC met. The two MMA members were absent.
- 11–19: President Musharraf visited the United States, met with US Secretary of State Rice on September 12, and met with President Bush on the 13th. He gave a speech at the 60th UN General Assembly on the 14th and met with Indian Prime Minister Singh on the 15th.
- 20: KSE-100 hit 8,066.17.
- 23: Ittehad Tanzeemat Madaris Deenia (ITMD) agreed to register 9,000 madrassahs.
  - President Musharraf appointed Deputy Chief of Naval Staff, Vice-Admiral Mohammad Afzal Tahir, as the Chief of Naval Staff.
- 28–30: Prime Minister Aziz visited South Korea.
- 29: Fighting began between government forces and Al Qaeda militants in North Waziristan. As of October 6, at least 49 militants and 8 members of the government forces including an army major had died. Subsequent fighting continued.
- 30–October 3: Prime Minister Aziz visited Malaysia. He attended the World Islamic Economic Forum on October 1.

## October

- 2–4: Indian Foreign Minister Natwar Singh came, agreed with Foreign Minister Kasuri on advance notification for the testing of ballistic missiles, and signed a memorandum for the establishment of a communication link between the Maritime Security Agency and Indian Coast Guards.
- 6: Final phase of local body elections took place.
- 8: A magnitude 7.6 earthquake occurred in northern Pakistan. According to official government figures, the death toll was 73,000.
- 12: Relief supplies airlifted from India.
  - NSC met. NWFP Chief Minister Durrani attended. MMA Secretary General Rahman was absent.
- 20–21: Turkish Prime Minister Recep Tayyip Erdogan came and pledged US\$150 million in earthquake aid.
- 26: Ministerial Donors' Conference held by UN for earthquake assistance (in Geneva). Donations of US\$580 million were pledged.
- 26–27: Prime Minister Aziz visited Russia to attend the SCO summit.
- 29: Pakistan and India agreed to open the LoC at five checkpoints to allow families affected by the earthquake to come and go.
  - Regarding privatization of PTCL, Etisalat was unable to make payment by the deadline, and so privatization started afresh.

## November

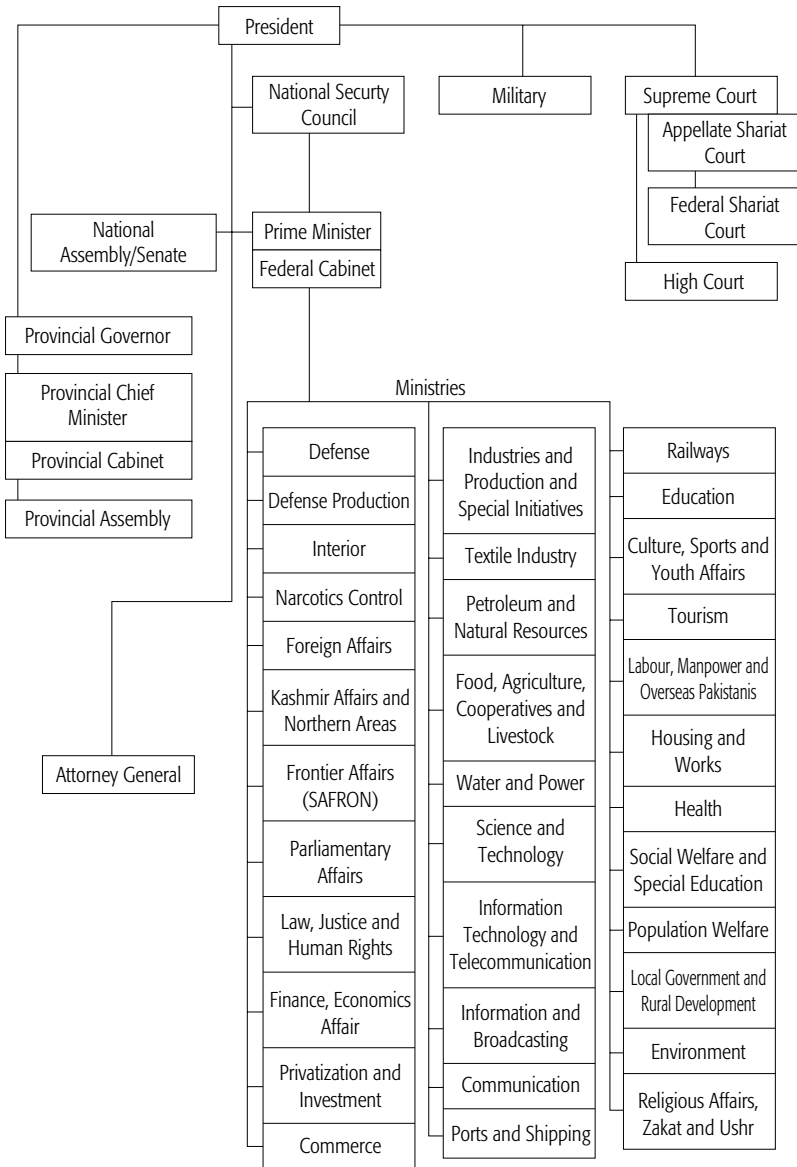
- 4: President Musharraf announced that the purchase of F-16 fighter jets will be postponed due to the need for earthquake relief and reconstruction.
- 7: Based on the agreement of October 29, the LoC was opened at the Rawalakot-Poonch crossing point.
- 12: Prime Minister Aziz visited Bangladesh, attended the 13th South Asian Association for Regional Cooperation (SAARC) Summit on the 12th and 13th, and met with Indian Prime Minister Singh on the 12th.
- 17: UN Secretary-General Annan came and went to the disaster area with President Musharraf on the 18th.
- 19: International Donors' Conference (Islamabad). Donations of US\$5.827 billion were pledged.
  - The first crossing of the LoC on foot took place by residents of Indian Kashmir at the Chakothe-Uri crossing point.
- 22: Australian Prime Minister John Howard came.
  - KSE-100 reached 9,006.26.
- 24: Indonesian President Susilo Bambang Yudhoyono came.
  - Prime Minister Aziz visited Malta to attend the Commonwealth Summit (25–27th).
- 29: The government sold KESC.

## *December*

- 1: Government forces attacked North Waziristan. Al Qaeda Operational Commander Hamza Rabia was killed.
- 3–8: President Musharraf made a visit to gulf countries, and attended the Organization of Islamic Conferences (OIC) summit (held on 7th and 8th in Mecca).
  - Dr. Shamshad Akhtar was appointed as Governor of SBP, the first woman to hold that position.
- 5–7: Prime Minister of Norway Jens Stoltenberg came.
- 9: The PML forward bloc demanded the resignation of PML President Hussain and Punjab Chief Minister Chaudhry Pervez Elahi.
- 10: Pakistan and India agreed to restart ferry service between Karachi and Mumbai for the first time in 30 years.
- 11: The first bus from Amritsar arrived in Lahore.
- 14: A missile was fired during President Musharraf's visit to Kohlu in BP.
- 17: Pakistan and India agreed to start construction of the IPI Pipeline (US\$7 billion) which is to be operational by mid-2007.
- 18: The Frontier Corps set out to suppress the Marri Tribe which is repeatedly conducting rocket attacks in Kohlu.
- 19: In a meeting with President Musharraf, opposition to the Kalabagh Dam was voiced by Shind's parliamentarians belonging to the ruling PML.
- 20: The government and Etisalat agreed to the purchase of PTCL for the initially agreed amount of US\$2.598 billion.
  - US Vice President Dick Cheney came.
- 22: A rally against the construction of the Kalabagh Dam was held in Karachi. President Musharraf made speech in Sukkur to persuade support for dam.
- 25: Natural gas fields discovered in BP.
- 27: UAE President Sheikh Khalifa bin Zayed Al-Nahyan came.
- 28: Ground-breaking ceremony held for the Chashma II Nuclear Power Plant.
- 31: The government decided to proceed with the construction of the Kalabagh Dam.

# APPENDIX 17.1 STATE ORGANIZATION CHART

(as of December 31, 2005)





## APPENDIX 17.2: KEY GOVERNMENT FIGURES

(as of December 31, 2005)

### **PRESIDENT**

Pervez Musharraf, Chief of Army Staff

### **NATIONAL SECURITY COUNCIL (NSC)**

*Chairman (Gen):* Pervez Musharraf President-cum-Chief of Army Staff

*Secretary:* Tariq Aziz

*Members:*

Shaukat Aziz (PML-Q)<sup>1</sup>, Prime Minister

Muhammad Mian Soomro (PML-Q), Senate Chairman

Maulana Fazal-ur-Rahman (MMA)<sup>2</sup>, Opposition Leader in National Assembly

Ch. Amir Hussain (PML-Q), National Assembly Speaker

Ch. Pervaiz Ellahi (PML-Q), Chief Minister of Punjab

Dr. Arbab Ghulam Rahim (NA)<sup>3</sup>, Chief Minister of Sindh

Akram Khan Durrani (MMA), Chief Minister of NWFP

Jam Muhammad Yousaf (PML-Q), Chief Minister of Balochistan

(Gen) Ehsanul Haq Chairman, Joint Chief of Staff Committee

(Gen) Ahsan Saleem Hayat, Vice Chief of Army Staff

(Adm) Muhammad Afzal Tahir, Chief of Naval Staff

(Mar) Kaleem Saadat, Chief of Air Staff

### **FEDERAL MINISTERS**

*Prime Minister (-cum-Minister for Finance) :* Shaukat Aziz (PML-Q)

*Defense (Senior Minister):* Rao Sikandar Iqbal (PPPP-P)<sup>4</sup>

*Information and Broadcasting:* Sheikh Rashid Ahmad (PML-Q)

*Commerce:* Humayoon Akhtar Khan (PML-Q)

*Culture, Sports and Youth Affairs:* Muhammad Ajmal Khan (FATA Independent)<sup>5</sup>

*Education:* Lt Gen (R) Javed Ashraf (PML-Q)

*Industries and Production and Special Initiatives:* Jehangir Khan Tareen (PML-Q)

*Labour, Manpower and Overseas Pakistanis:* Ghulam Sarwar Khan (PML-Q)

*Foreign Affairs:* Mian Khursheed Mehmood Kasuri (PML-Q)

*Health :* Muhammad Nasir Khan (PML-Q)

*Interior:* Aftab Ahmed Khan Sherpao (PPP-S)<sup>6</sup>

*Petroleum and Natural Resources:* Amanullah Khan Jadoon (PML-Q)

*Food, Agriculture, Cooperatives and Livestock:* Sikandar Hayat Khan

Bosan (PML-Q)  
*Water and Power* : Liaqat Ali Jatoi (PML-Q)  
*Information Technology and Telecommunication*: Awais Ahmed Khan Leghari (NA)  
*Railways*: Mian Shamim Haidar (PML-Q)  
*Religious Affairs, Zakat and Usbr*: Muhammad Ijaz ul Haq (PML-Z)<sup>7</sup>  
*Privatization and Investment*: Dr. Abdul Hafeez Shaikh (PML-Q)  
*Housing and Works* : Syed Safwanullah (MQM)<sup>8</sup>  
*Communication*: Muhammad Shamim Siddiqui (MQM)  
*Local Government and Rural Development*: Justice (R) Abdul Razzaq Thahim (PML-F)<sup>9</sup>  
*Kashmir Affairs and Northern Areas*: Makhdoom Syed Faisal Saleh Hayat (PPPP-P)  
*Social Welfare and Special Education*: Zobaida Jalal (PML-Q)  
*Science and Technology*: Chaudhry Nauraz Shakoore Khan (PPPP-P)  
*Frontier Affairs (SAFRON)*: Sardar Yar Muhammad Rind (NA)  
*Narcotic Control*: Ghaus Bakhsh Khan Mahar (PML-Q)  
*Ports and Shipping* : Baber Khan Ghauri (MQM)  
*Tourism*: Dr. Ghazi Gulab Jamal Syiad (FATA Independent)  
*Defense Production*: Major (R) Habibullah Warraich (PML-Q)  
*Textile Industry*: Mushtaq Ali Cheema (PML-Q)  
*Population Welfare*: Choudhry Shahbaz Hussain (PML-Q)  
*Parliamentary Affairs*: Dr. Sher Afgan Khan Niazi (PPPP-P)  
*Law, Justice, and Human Rights*: Muhammad Wasi Zafar (PML-Q)  
*Environment* : Major (R) Tahir Iqbal (PML-Q)

## MINISTERS OF STATE

*Commerce*: Hamid Yar Hiraj (PML-Q)  
*Communications*: Muhammad Shahid Jamil Qureshi (PML-Q)  
*Culture, Sports, and Youth Affairs*: Muhammad Ali Durrani (NA)  
*Defense*: Zahid Hamid (PML-Q)  
*Economic Affairs*: Hina Rabbani Khar (PML-Q)  
*Education*: Ghulam Bibi Bharwana (PML-Q)  
*Environment*: Malik Amin Aslam Khan (PML-Q)  
*Finance*: Omar Ayub Khan (PML-Q)  
*Food, Agriculture, and Livestock*: Muhammad Ali Malkani (PML-Q)  
*Foreign Affairs*: Makhdoom Khusro Bakhtiar (PML-Q)  
*Health*: Begum Shahnaz Shaikh (PML-Q)  
*Housing and Works*: Sardar Muhammad Asif Nakai (PML-Q)  
*Industries, Production, and Special Initiatives*: Ali Nawaz Khan Maher (Independent)  
*Information and Broadcasting*: Anisa Zeb Tahirkheli (PPP-S)

*Information Technology and Telecommunications:* Ali Asjad Malhi  
(PML-Q)

*Interior:* Dr. Shahzad Waseem (PML-Q)

*Law, Justice, and Human Rights:* Ch. Shahid Akram Bhinder (PML-Q)

*Local Government and Rural Development:* Ch. Zafar Iqbal Warraich  
(PML-Q)

*Overseas Pakistanis:* Tariq Azim Khan (PML-Q)

*Parliamentary Affairs:* Muhammad Raza Hayat Harraj (PPPP-P)

*Petroleum and Natural Resources:* Mir Muhammad Naseer Khan Mengal  
(PML-Q)

*Privatization and Investment:* Umar Ahmad Ghuman (PML-Q)

*Railways:* Ishaq Khan Khakwani (PML-Q)

*Religious Affairs and Zakat and Usbr:* Dr. Aamer Liaquat Hussain  
(MQM)

*Tourism:* Sumaira Malik (NA)

*Water and Power:* Amir Muqam (MMA)

## **ADVISORS TO THE PRIME MINISTER**

*Foreign Affairs, Law, Justice and Human Rights (Status of Senior  
Federal Minister):* Syed Sharifuddin Pirzada

*Finance (Status of Federal Minister):* Dr. Salman Shah

*Women Development (Status of Federal Minister):* Nilofer Bakhtiar

## **PROVINCIAL GOVERNORS**

Punjab: Lt Gen (R) Khalid Maqbool

Sindh: Dr. Ishrat-ul-Ilbad

NWFP: Khalil-ur-Rehman

Balochistan: Awais Ghani

## **MILITARY TOP OFFICIALS<sup>10</sup>**

*Director-General of the Inter Services Intelligence (ISI):* Lt Gen Pervez  
Kiani

*Notes:* 1. PML-Q (Pakistan Muslim League Quaid-e-Azam); 2. MMA (Muttahida Majlis-e-Amal); 3. NA (National Alliance); 4. PPPP-P (Pakistan People's Party Parliamentary Patriots); 5. FATA Independent, reserved seats for Federally Administered Tribal Areas; 6. PPP-S (Pakistan People's Party Sherpao); 7. PML-Z (Pakistan Muslim League Zia-ul-Haq); 8. MQM (Muttahida Qaumi Movement); 9. PML-F (Pakistan Muslim League Functional); 10. See NSC for the Chiefs of Army, Naval, and Air Staff.

## APPENDIX 17.3: MAJOR STATISTICS

### 1. General<sup>a)</sup>

	2000/1	2001/2	2002/3	2003/4	2004/5 <sup>b)</sup>
Population (million persons)	140.47	145.96	146.75	149.65	152.53
Labor force (million persons)	41.20	41.84	43.18	44.12	46.82
Increase in consumer price index (%)	4.41	3.54	3.10	4.57	9.27
Unemployment rates (%)	6.00	7.82	7.80	8.27	7.69
Exchange rates (US\$1=Pakistan rupee)	58.44	61.43	58.50	57.57	59.36

Sources: Government of Pakistan, Finance Division, *Economic Survey 2004/05*; State Bank of Pakistan, *Statistical Bulletin, January 2006*.

Note: a) The fiscal year is July 1 to June 30, and this applies throughout herein. Figures for the population and labor force are as of June 30 each year, and other figures are averages for each fiscal year; b) Provisional.

### 2. Gross Domestic Product by Type of Expenditure (at current prices)

	(Million Pakistan rupee)				
	2000/1	2001/2	2002/3	2003/4 <sup>a)</sup>	2004/5 <sup>b)</sup>
Consumption expenditure	3,491,436	3,667,351	3,886,846	4,515,363	5,748,308
Government	327,562	388,446	428,689	462,462	512,926
Private	3,163,874	3,278,905	3,548,157	4,052,901	5,235,382
Gross domestic fixed capital formation	659,325	680,373	736,433	864,701	999,306
Change in stock	56,200	58,000	80,629	94,294	103,299
Exports of goods and services	617,148	677,855	815,158	883,704	1,001,011
Imports of goods and services	661,455	681,880	786,224	825,399	1,304,334
Gross domestic product (GDP)	4,162,654	4,401,699	4,822,842	5,532,663	6,547,590

Source: Government of Pakistan, Finance Division, *Economic Survey 2004/05*.

Note: a) Revised; b) Provisional.

### 3. Gross Domestic Product by Industries (at factor cost / at constant 1999/2000 prices)

	(Million Pakistan rupee)				
	2000/1	2001/2	2002/3	2003/4 <sup>a)</sup>	2004/5 <sup>b)</sup>
Agriculture, livestock, forestry & fishery	903,499	904,433	941,942	962,527	1,034,292
Mining & quarrying	47,561	51,031	59,266	61,509	64,609
Manufacturing	571,357	596,841	638,044	727,733	818,448
Construction	87,846	89,241	92,789	86,402	91,783
Electricity & gas distribution	120,465	112,026	98,932	119,809	122,358
Transport & communication	422,195	427,296	445,552	470,015	496,171
Wholesale & retail trade	649,564	667,615	707,665	764,688	856,531
Finance, insurance & real estate	227,048	250,365	252,547	262,736	296,767
Public administration & defence	225,152	240,585	259,148	269,959	267,750
Services	339,437	366,285	389,067	409,166	431,141
Gross domestic product (GDP)	3,594,124	3,705,718	3,884,952	4,134,544	4,479,850
GDP growth (%)	1.84	3.10	4.84	6.42	8.35
Net factor income from abroad	-47,285	22,594	127,050	90,721	86,135
Gross national product (GNP)	3,546,839	3,728,312	4,012,002	4,225,265	4,565,985

Source: Same as Table 2.

Note: a) Revised; b) Provisional.

### 4. Foreign Trade by Country and Region

	(Million Pakistan rupee)							
	2001/2		2002/3		2003/4		2004/5 <sup>b)</sup>	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
OECD	323,105	213,870	362,675	239,315	407,696	311,545	495,424	419,586
USA	138,789	41,156	153,061	42,985	169,512	76,513	204,214	92,813
Japan	10,250	31,825	8,312	47,012	7,759	53,913	9,743	86,046
Others	174,066	140,889	201,302	149,318	230,425	181,119	281,467	240,727
OIC	107,702	228,467	145,462	251,459	146,770	302,567	167,535	381,597
SAARC	14,024	15,231	15,655	13,573	22,689	27,833	37,910	39,270
ASEAN	15,146	74,252	18,917	87,153	19,144	99,659	15,600	109,246
Others	100,970	102,810	109,585	122,872	112,737	156,221	137,619	273,381
Total <sup>a)</sup>	560,947	634,630	652,294	714,372	709,036	897,825	854,088	1,223,080

Source: Same as Table 1.

Note: a) Excluding reexport/reimport; b) Provisional.

## 5. Balance of Payments

	(US\$ million)				
	2000/1	2001/2	2002/3	2003/4	2004/5
Trade balance	-1,269	-294	-359	-1,279	-4,515
Exports, fob	8,933	9,140	10,974	12,459	14,450
Imports, fob	10,202	9,434	11,333	13,738	18,965
Services and income	-3,142	-2,617	-2,213	-3,523	-5,710
Current transfers	4,737	5,744	6,642	6,613	8,666
Current account	326	2,833	4,070	1,811	-1,559
Capital account	-643	-1,107	713	-1,679	1,082
Direct investment	286	483	771	906	1,459
Portfolio investment	-141	-491	-239	314	620
Others	-788	-1,099	181	-2,899	-997
Change in reserves (- = increase)	-1,001	-2,792	-5,926	-299	612
Net errors and omissions	626	928	523	222	-80

Source: State Bank of Pakistan, *Handbook of Statistics on Pakistan Economy 2005*.

## 6. Public Finance

	(Million Pakistan rupee)				
	2000/1	2001/2	2002/3	2003/4	2004/5*
Federal and provincial government revenue	553,000	624,100	720,800	791,100	851,300
Federal and provincial government expenditure	717,900	826,250	898,200	955,800	1,050,400
Federal and provincial government overall deficit	179,700	190,450	180,600	129,300	199,100
Deficit financing					
Borrowing from abroad	120,700	83,100	113,000	-6,600	74,500
Borrowing from domestic non-banks	92,000	85,000	119,500	61,000	49,500
Borrowing from domestic banks	-33,000	14,000	-55,600	63,700	60,000
Privatization	-	8,350	3,700	11,200	15,000

Source: Same as Table 2.

Note \* Provisional.

