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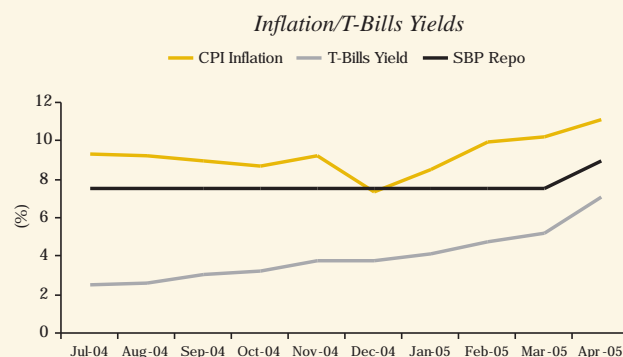
NBP Performance at a Glance

Editor's Corner

Dear Readers,

Rising inflation in the economy has exerted pressure on interest rates. The State Bank had earlier been measured in its response to higher inflation, but as inflationary pressures remained unexpectedly strong in recent months, the Central Bank became more aggressive in its stance. It raised the discount rate to 9%, constant at 7.5% since mid November 2002. The yield on treasury bills has progressively been raised to between 7.0-8.25%. Consequently banks have started increasing their lending rates.

Consumer Price Index (CPI) is now in double digits, having risen to 11.1% year-on-year by April 05, mainly driven by higher fuel prices and subsequently higher food prices. The removal of cap on fuel prices in December 2004, has resulted in its prices rising gradually thereby raising transportation costs. As the later is a major contributor in the price of food these were consequently pushed higher.



As oil prices remained high in the international market, it is anticipated that there will be no major decline in domestic fuel and consequently food costs.

The non-food component of the CPI also remained high (8.2% in March 05 year-on-year over 3.9% in March 04 year-on-year), driven primarily by the sharp rise in transport and communication and the fuel, lighting and lubricant sub-indices. The dominant contributor to the increase in CPI inflation was however, from food prices.

The easy monetary policy pursued, alongwith the oil price hike, hoarding of some essential food items had a fallout effect on inflation. These factors influencing price hike could be effectively checked by fiscal administrative measures. "Anti-inflationary policies will need to focus more on administrative and fiscal measures", says the Third Quarterly Report for the year 2004-05 on the State of Pakistan's Economy by the State Bank of Pakistan. However, "the impact of rise in aggregate demand due to easy monetary policy would be effectively curtailed through tightening of monetary policy".

Interest rates started the upward climb since mid 2004. Earlier during FY02 and FY03, when a low interest rate environment was prevailing it had contributed to increased economic activity in the country, as credit

flowing to the private sector had increased substantially. Consumer credit market grew, there was increased access of credit to agriculture and the competitiveness of Pakistani exports was boosted. Improvement in agricultural output added to the purchasing power in rural areas. By following an accommodative monetary policy, the State Bank's objective was to sustain the growth levels necessary for meaningful employment generation and poverty reduction.

Now with a changed scenario, when interest rates are going up, credit growth is likely to slow down, which would discourage the use of banking funds for speculative purposes. Consumer financing would become expensive, and as the financial costs to borrowers rises, there is a probability that there may be some slack in the demand for credit. However, care would have to be exercised that the slowdown in credit expansion to private sector for productive purposes through this tightening does not mitigate the improvement in industrial activity that has been witnessed in the recent past, when interest rates were low.

Lending rates will see an upward trend, for both corporate loans and consumer lending for home, automobiles and consumer products. Lending to the private sector has risen to Rs.362 billion (till April 16, 2005), against the full year target of Rs.350 billion. Higher interest rates would check that portion of lending not going into productive investments.

Increased credit to different sectors of the economy has improved the profitability of the banking industry alongwith an improvement in the asset quality of banks. While lending will become expensive, banks stand to gain through their investments in Treasury Bills whose rates have gone up.

Some money may move away from the stock market, as returns on deposits and national saving schemes rise. Low interest rate in the past had witnessed money moving into the stock market.

Ayesha Mahmood

Abstract of the Bulletin

Agricultural Growth and Poverty Reduction

- § With poverty prevailing in developing countries, the respective governments are increasingly focusing upon poverty reduction measures.
- § As most of the world's poor are rural based, the development of the agricultural sector is being increasingly emphasized upon by developing countries.
- § Studies in developing countries have shown the linkages between agriculture and poverty reduction.
- § The Government of Pakistan is pursuing a pro-poor growth policy, through its Poverty Reduction Strategy Programme.
- § Agricultural sector forms a part of this programme and large investments are being made to develop the agri-sector, livestock farming, fisheries, rural infrastructure, etc.
- § The Asian Development Bank has examined the relationship between agricultural growth and rural poverty, and its major findings and recommendations have been mentioned in the article.

WTO Agreement on Agriculture – Salient Features

- § The Agreement on Agriculture is an important milestone in the Multilateral Trading System.
- § As the number of quantitative restrictions, tariffs, various kinds of non-tariff barriers to protect the domestic farmers became large, agro based economies found it difficult to compete in the world market.
- § The Agreement on Agriculture has the long-term objective of establishing a fair and market oriented trading system for agriculture products.
- § The Agreement on Agriculture prohibits the use of agriculture – specific non-tariff measures. All non-tariff measures were to be converted into tariffs. Members were to bind their tariffs at a maximum level.
- § While the Agreement on Agriculture promised improvement in market access, it could not bring benefits to the developing countries. Studies show that developed countries still protect their agricultural sectors.

§ Pakistan has liberalized its agricultural sector to a fairly large extent.

§ Pakistan does not maintain any non-tariff restriction except a few.

Credit to Agriculture Sector

- § In Pakistan, agricultural credit needs are being met by the Zarai Taraqiati Bank, the commercial banks and the Punjab Provincial Cooperative Bank. Cumulatively credit disbursement to the sector has risen to over Rs.73 billion in FY04.
- § Commercial banks' lending to the agri sector surpassed ZTBL last year.
- § Credit recovery from the agricultural sector has shown an improvement in recent years.
- § Recently, the domestic private banks have stepped up their lending to the agri sector.
- § State Bank of Pakistan has developed a separate set of Prudential Regulations for agricultural financing.
- § National Bank of Pakistan is playing an increasing role in agricultural financing, with a market share of 18%.

Water Resources for Farming

- § In recent months, the severe water crisis situation facing Pakistan's agricultural sector abated, because of the rains and heavy snowfall.
- § There has been poor focus on water management, development of additional storage capacity and checking wastage.
- § The long dry spell had an adverse impact on the economy.
- § Current estimates show that there will be no water shortage during the current Kharif season.

Market Analysis

- § After seeing steep gains that took the KSE-100 Index above 10,000 points, the market corrected in March and April and lost almost one-third of its value.
- § The SECP and KSE are now tightening the market's risk management systems, and while this period of adjustment is ongoing, market trading will likely remain dull.

Agricultural Growth and Poverty Reduction

Increasing focus on poverty

With around a billion people living on only a dollar a day or less, unable to meet their basic needs of food and shelter, governments of developing countries are increasingly focusing upon poverty reduction measures. It has been recognized that reducing poverty is a big challenge. A multi-dimensional poverty reduction strategy which encompasses economic growth, human development, access to assets, empowerment of state institutions can human deprivation be checked, bringing about an improvement in the well being of large numbers.

Most of the world's poor are rural based, 85% in Uganda, 82% in Papua New Guinea, 84% in Malawi, 82% in Barkina Faso, where the concentration of population below the poverty line is also substantial.

Most of these are either engaged in their own agricultural activities or doing non-farm employment that depends in one way or another on agriculture. It is increasingly being realized by developing countries, that pro-poor policies are needed to bring about any meaningful development and structural change in the economy. Various studies have shown that among others, agricultural growth contributes towards poverty reduction. It plays a catalytic role for broad based economic growth with strong linkages to the rest of the economy.

In a paper '*Agricultural growth is the key to poverty alleviation in low income developing countries*', the authors, Per Pinstup Andersen and Rajul Pandya Lorch have stated, "very few countries have experienced rapid economic growth without agricultural growth either preceding or accompanying it". Economic growth is strongly linked to poverty reduction.

Why agricultural growth is essential

The Report has listed four reasons as to why agricultural growth must be pursued in low income developing countries; (a) to alleviate poverty through employment creation and income generation in rural areas; (b) to meet growing food needs driven by population growth and urbanisation; (c) stimulate overall economic growth (d) to conserve natural resources. When people are poor they do not

Government policies must be appropriate

have the means to intensify agriculture and are forced to misuse the natural resource base to meet basic needs.

The paper has discussed the beneficial effects that will accrue if government policies are appropriate. 'Distortions in input and output markets, assets ownership and other institutional and market distortions adverse to the poor must be minimized or removed. Access by the poor to productive resources such as land and capital needs to be enhanced. Rural infrastructure and institutions must be strengthened. Failure to invest in agricultural development will make poverty eradication an elusive goal.'

Large percentages, in some countries like Bangladesh, 85% of the poor live in rural areas. As agriculture is the predominant activity in rural areas, accelerating its growth is of significance. For instance in Bangladesh, the challenge of poverty reduction is enormous. It is more pervasive in the countryside than the cities. By all measurers, poverty in rural areas continues to be higher than urban poverty.

Two years back, the World Bank Country Director to Bangladesh in one of his speeches in the country had addressed the question of what it will take to accelerate Bangladesh's economic growth to enable it to achieve its poverty reduction objectives. The government was pursuing sound macroeconomic management policies, improving the investment climate, with more efforts needed for improving governance. While discussing the policies that were needed to make growth more pro-poor in Bangladesh, it was felt that there was a need among other factors, to accelerate economic growth in order to achieve the country's poverty reduction targets.

Accelerate growth of agriculture

Accelerating the growth of agriculture through intensification and diversification is crucial as it is the predominant activity in rural areas. The poor are predominantly landless, and an improvement in the operation in land markets is necessary to enable them to strengthen their position in the rural economy. Given poor people's limited land ownership, the continued development of livestock and fisheries is particularly important to them.

Vietnam focuses on agri related areas

Vietnam focuses upon developing infrastructure facilities in rural areas to wipe out poverty and transfer advanced technology to the farmers; comprehensively develop agriculture and make improvements in productivity and quality, develop forestry, fishery and aqua culture, increase farmers' income by developing job opportunities in rural areas, narrow the income gap between rural and urban areas and accelerate farm exports. Improved irrigation, land reclamation, increasing the number of crops annually has helped Vietnam cut rural poverty to 11% from 45.5% in 1998.

Zambia's potential for agri growth

Studies have shown that the Zambian economy has remained heavily dependent on urban-based mining. Copper's long standing dominance led to strong bias against agriculture, which undermined the sector's growth and export potential. Consequently poverty has remained concentrated within marginalized rural areas. According to the findings of a paper '*Prospects for Growth and Poverty Reduction in Zambia, 2001-2015*', besides other factors, Zambia could substantially reduce its poverty through the acceleration of agricultural growth, though limited market opportunities necessitate supporting investment in rural infrastructure. Overall, the potential of the agricultural sector depends on the government's commitment to reforms and the removal of the anti-agricultural bias created by the dominant copper sector.

In a paper, '*Will growth halve global poverty by 2015*', the authors, Lucia Hanmer, John Healy and Felix Naschold have identified major areas of policy challenges which are needed to launch countries onto a pro-poor growth path. They have discussed these as, adequate growth and efficient use of capital; importance of agricultural productivity; focus on the distributive impact of policies; and gender equality.

Agriculture can stimulate linkages between farm and non-farm sectors

Improved agricultural yields were associated with poverty reduction in South Asia and sub-Saharan Africa. This reinforces the case for a rural-based development strategy. The promotion of agriculture can stimulate linkages between farm and non-farm activities which are important for poverty reduction. Recent comparative evidence from Indian states supports this because the number of people

below the poverty line was found to be more responsive to the growth of non-farm output in those states where farm yields and rural spending levels were higher. Policies to improve incentives for both farm and non-farm enterprises in rural areas have been recognized for some time (e.g. deregulation of pricing and marketing in agriculture, better marketing opportunities, information and extension services for smallholders crops and small producers of non-farm products).

Enlarged role for formal financial institutions

Credit networks and similar measures to encourage livelihood creation in non-farm rural businesses are needed but so far few strategies for ensuring access to credit for remote rural areas and the poor seem to have worked well. An enlarged role for formal financial institutions is now seen by some as more important given the limited success in reaching the poor through micro-credit institutions and targeting. Flexible credit repayment periods and provision of crop insurance would assist the poor together with development of 'Green revolution' type higher yields for African crops like maize, sorghum and cassava.

Agriculture as pro-poor growth policy

While reducing poverty requires a multi-sectoral approach, experience of many developing countries have shown the significance of the agricultural sector as pro-poor growth policy. Some studies have compared the effects of urban and rural growth in poverty in India and shown that growth in urban incomes has no effect on rural poverty, but also only modest effect on urban poverty. On the other hand, rural growth reduces urban poverty more than does urban growth.

Rural growth reduces poverty in both urban and rural areas

The paper *Pro-Poor Growth & Livelihood Diversification* by S. Mahendra Dev has said the linkages of agricultural growth are stronger for livelihood diversification particularly in South Asia where majority of the poor live. In the 1990s poverty reduction in Bangladesh was due to rural non-farm sector growth. But the demand for this came from agricultural growth.

It has generally been shown that growth in agriculture is more beneficial to the poor than growth in other sectors. Studies have shown that rural growth in India reduced poverty in

Box Linkages between Government Spending, Growth and Poverty in Rural India

Given below are excerpts from the above Report by Shenggen Fan, Peter Hazell, Sukhadeo Thorat, which shows how different types of public investment affect agricultural growth and rural poverty.

Poverty in rural India declined substantially from the mid 1960s to the early 1980s. This has been strongly associated with agricultural growth, particularly the Green Revolution, which in turn was a response to massive public investment in agriculture and rural infrastructure. Public investment in rural areas has also benefited the poor through its impact on the growth of the rural non-farm economy, and government expenditure on rural poverty and employment programmes, which have grown rapidly, has directly benefited the rural poor.

The Report, analyses the specific roles that public investment has played in promoting agricultural growth and poverty alleviation in India. Government investments can have a direct and indirect effect on poverty. The direct effects are the benefits the poor receive from expenditure on employment and welfare programmes such as the Integrated Rural Development Programme and from various rural employment schemes that are directly targeted to the poor during drought years. The indirect effects arise when government investments in rural infrastructure, agricultural research, and the health and education of rural people stimulate agricultural and non-agricultural growth, leading to greater employment and income earning opportunities for the poor.

It has shown that targeting government expenditures simply to reduce poverty is not enough, unless accompanied by investments which increases the welfare of rural people and stimulates economic growth. There are different types of investments which this report has ranked according to their impact on growth and poverty. All of the investments considered increase agricultural productivity and also reduce poverty.

Effectiveness of different types of government expenditure in contributing to poverty alleviation are quantified.

Ranking Government Expenditures by Impact

When government expenditures are ranked according to their effectiveness, the results are striking.

1. *Government expenditure on roads* has by far the largest impact on rural poverty. If the government were to increase its investment in roads by Rs.100 billion, the incidence of rural poverty would be reduced by 0.87%. For each Rs.1 million increase in investment in roads, 165 poor people would be lifted above the poverty line. These impacts on poverty are nearly twice as large as those of the next best poverty reducer – government investment in agricultural R&D. Investment in roads also contributes importantly to productivity growth (calculated as total output minus inputs). An additional Rs.100 billion invested in roads would increase productivity growth by more than 3%, second only to investments in agricultural R&D.

Investment in roads not only reduces rural poverty through productivity growth, but also through increased non-agricultural employment opportunities and higher wages. Productivity growth accounts for 24% of the total impact on poverty, non-agricultural employment accounts for 45%, and increases in rural wages account for the remaining 31%. Of the total productivity effect on poverty,

75% arises from the direct impact of roads on incomes, while the remaining 25% arises from lower agricultural prices (15%) and increased wages (10%).

2. *Government investment in research and extension* has the second largest impact on rural poverty, but the largest impact of any investment on productivity growth. Another Rs.100 billion of investment in R&D would increase productivity growth by 6.98% and reduce the incidence of rural poverty by 0.48%. Another Rs.1 million spent on R&D would raise 91 poor people above the poverty line. R&D has a smaller impact on poverty than roads because it only affects poverty through improved productivity.
3. Third ranked is *government spending on education*. An additional Rs.1 million spent on education would raise 32 poor people above the poverty line, mostly by increasing non-farm employment opportunities and wages. Education, at least as measured here by a simple literacy ratio, has only a modest impact on agricultural growth.
4. *Government expenditures on rural development* ranks fourth in impact on poverty. Another Rs.1 million spent would raise 28 poor people above the poverty line, an impact comparable to that of additional investment in education. But unlike other investments with similar or greater effects on poverty, rural development expenditures have no discernible impact on productivity growth in agriculture, and hence they do not provide a long-term solution to the poverty problem.
5. *Government expenditure on irrigation*. Another Rs.1 million of expenditure would raise 7 poor people above the poverty line. Public irrigation investments also have the third largest impact on productivity growth; an additional Rs.1 billion would add 0.56% to the growth rate. Public irrigation plays a catalytic role in stimulating additional private investment in irrigation, but most of its impact on poverty is through the increased productivity it fosters.
6. The effects of *government expenditure on power* are relatively small and statistically insignificant from the standpoint of their effects on rural poverty and productivity growth. This may be because the government has already invested heavily in rural electrification, and the marginal returns from additional investments are now low. Today about 90% of all rural villages are electrified. But public spending on power is still a relatively large part of the government's budget (50% more than was spent on roads in 1993), and current expenditure has increased enormously since 1990. More than 90% of the effects of investment in power are derived from non-farm employment, while the remainder come from productivity increases obtained through improved irrigation as the result of electrification of pumps.

According to this research, additional government expenditures on soil and water conservation and health have small effects on rural poverty, and the impact of health spending is statistically insignificant. They also have no discernible effects on agricultural productivity growth. Their benefits lie in the improvements they bring to the quality of life in rural areas.

both rural and urban areas, while economic growth in urban areas did little to reduce rural poverty. With regard to the role of agricultural productivity in reducing poverty, studies have shown that an increase in labour productivity in agriculture reduces the number of people living on less than a dollar a day.

A paper “*Agriculture, Growth and Poverty Reduction*”, by the UK Department of International Development has explained how increased agricultural productivity reduces poverty. The four mechanisms mentioned are: -

- § direct and relatively immediate impact of improved agricultural performance on rural incomes;
- § impact of cheaper food for both urban and rural poor;
- § agriculture’s contribution to growth and the generation of economic opportunity in the non-farm sector and
- § agriculture’s fundamental role in stimulating and sustaining economic transition, as countries shift away from being primarily agricultural towards a broader base of manufacturing and services.

The four mechanisms

Poverty is predominantly a rural problem and agriculture provides livelihoods to large numbers in South Asian and Sub-Saharan Africa. Any improvement in rural incomes should have an impact on poverty. Similarly on-farm employment is important for many farmers to supplement their incomes.

Given agriculture’s dominance in the economies of both Asia and Africa, it remains the most likely source of significant growth in most developing countries. Any fluctuations in the agricultural performance are felt not only in the agricultural sector, but also in the other sectors of the economy. Empirical work has shown that the rate of growth of the non-agricultural sector depended strongly on growth in agriculture.

Finally, there is evidence to show that most countries cannot successfully industrialise without first achieving significant improvements in agricultural performance, particularly increased agricultural productivity. This holds true for Europe, North America, Japan and the emerging countries of Asia

where industrialisation has been very clearly agriculturally led.

As a significant contributor to Pakistan’s national economy, agriculture is a major element in the government’s overall strategy to reduce poverty. Nearly two-thirds of Pakistan’s population lives in rural areas and the vast majority of the rural poor are dependent on agriculture for their food and livelihood. Agricultural growth helps reduce poverty directly through an increase in farmers’ income. The indirect effect of agricultural growth on poverty reduction occurs through the spending of farmers’ income on locally produced non-agricultural goods. Through forward and backward linkages, agriculture contributes to rural economy (farm and non-farm) and creates livelihood for poor in the non-farm sector.

Agriculture – poverty linkages in Pakistan

The Government of Pakistan (GoP) is pursuing a pro-poor growth policy. The development of the agricultural sector is among the major elements of the Poverty Reduction Strategy Programme of the Government. The GoP is aiming to improve rural and agricultural infrastructure and supporting agricultural programmes that generate sustainable growth through development of high yielding varieties of improved seeds, balanced application of fertilizer, agriculture extension programme etc.

To improve agricultural productivity, the government is encouraging corporate agriculture farming, for which, the government will lease out large chunks of state owned uncultivated land to potential investors alongwith various incentives.

Concerted efforts are being made to direct increased flow of credit to the agricultural sector to adequately meet the farmers’ needs. While the Zarai Taraqiati Bank continues to play the lead role in disbursing of agricultural financing, commercial banks lending to the sector has jumped substantially.

As part of the Poverty Reduction Strategy for rural development, besides the agricultural sector, the government is focusing on developing livestock farming, fisheries, farm to market roads in rural areas, and water.

PRSP for rural sector

Water is the key engine for agricultural growth, and its shortage adds to poverty. Large investments are planned to develop additional water reservoirs, improve water conservation, and management.

An Asian Development Bank Report, '*Agricultural Growth and Rural Poverty: A Review of the Evidence*', examines the relationship between agricultural growth and rural poverty, and reaches some interesting conclusions on the structure of the sector in Pakistan and the consequent implications for poverty.

The findings of the Report show:-

- § Despite high growth rates in the agriculture sector in the 1960s, poverty increased in rural areas, as during this period the beneficiaries of agricultural subsidies and new technology were generally large farmers.
- § The 1970s witnessed a decrease in the incidence of rural poverty, largely due to private investment in agriculture and large numbers migrating to the Middle East.
- § Highest incidence of poverty is in zones that rely most on crop incomes.
- § Poverty is greater in zones where the possibility of diversifying incomes in order to manage risk is limited.
- § The rise in poverty in the 1990s seems to be a result of the increase in the number of poor in the cotton/wheat zones of southern Punjab and Sindh. Persistent drought, lack of irrigation in the regions has resulted in a decline in cotton production, the mainstay of many households.
- § For the small farmer, the possibility of overcoming poverty after a bad year declines even if it is followed by a very good year, for one good year may not be sufficient to pull them out.
- § The skewed land distribution is one of the major obstacles hindering the rapid reduction of rural poverty. Excessive land fragmentation and sub-division of land holdings has caused a persistent decline in farm size and therefore, in agricultural productivity. Small farms tend to be less diversified and so more vulnerable to poverty.

§ The highly skewed land distribution in rural Pakistan results in sharecropping which is detrimental to poverty reduction. The incidence of poverty among sharecroppers has been found to be considerably higher than those who cultivate their own land.

The major recommendations of the study are: -

- i. Agricultural growth without specific interventions targeting small farmers and rural non-farm households, may not alleviate poverty for much of the poor in rural Pakistan. An explicit strategy is needed for the development of the rural non-agriculture sector.
- ii. In view of the relatively high incidence of poverty in the cotton/wheat zones of Punjab and Sindh, a poverty reduction strategy focusing on education, skills development, job creation, and health care needs to be designed for these areas.
- iii. Transitory poverty can be reduced if policy interventions aim at levelling out income fluctuations. A reduction in chronic poverty is possible through large and sustained growth in household incomes. For the former, the availability of micro-credit would be an effective tool, while for the latter, targeted public works programmes could help reduce chronic poverty.
- iv. Poverty reduction is linked strongly to employment. Minimum wage laws need to be set for the agriculture sector and all legislation, including workers' protection and non-wage benefits, made applicable to the agriculture sector.
- v. The Government has followed an interventionist pricing policy for the agriculture sector. Although these pricing policies have been designed to favour small farmers, studies argue that they achieve the opposite. Such policies should be revised for the benefit of small farmers.
- vi. Greater efforts need to be directed towards the conservation of natural resources. One measure in this regard would be to educate and encourage farmers through incentives to move to more sustainable practices such as diversified crop rotation and the cultivation of legumes.
- vii. Finally, research on the linkages between agricultural growth, rural development, and poverty reduction requires more disaggregated data at various levels.

WTO Agreement on Agriculture - Salient Features

*Shoukat Ali Anwar Randhawa**

Protection to domestic farming rises

The Agreement on Agriculture (AoA) is considered an important milestone in the Multilateral Trading System that had started with the conclusion of General Agreement on Tariffs and Trade (GATT) in 1947. As compared to GATT rules applied to the industrial goods, the GATT disciplines had not been very strong for agricultural goods. The rules, if any were made to suit the needs and policies of the developed countries. The use of quantitative restrictions, high tariffs, various kinds of non-tariff barriers and provision of huge production and export subsidies rose to exorbitant proportions in order to protect domestic farming communities. These protective measures and support through subsidization continuously frustrated those agro-based economies that found themselves unable to compete in the world market even if they had comparative advantages in certain agricultural products.

Agreement on agriculture addresses three main areas

The AoA, termed as reform process, has the long-term objective of establishing a fair and market-oriented trading system for agricultural products. The agreement provides for implementation of the programme in an equitable way among all members of the WTO. Aspects relating to non-trade concerns including food security and need to protect the environment were given special emphasis. The agreement addresses three main areas; market access, domestic support and export competition. For improvement in market access the agreement seeks prohibition of non-tariff measures, conversion of non-tariff barriers into tariffs, binding and reduction of tariffs.

However, the agreement also provides specific safeguard measures against likely import surges in wake of liberalization. On domestic support and export competition issues, the agreement sets procedures and methods for reduction in trade distorting domestic support and export subsidies. One prominent feature of AoA is provision of Special and Differential Treatment (SDT) for developing and least developed countries under which these countries

The Agreement on agriculture

could enjoy certain flexibilities such as lower reduction commitments, longer implementation periods and recourse to a few specific domestic support measures.

The Agreement on Agriculture is considered to be a major achievement of UR. It came into force on 1 January 1995 as part of the single undertaking. The preamble to the Agreement recognizes that the agreed long-term objective of the reform process initiated by the Uruguay Round is to establish a fair and market-oriented agricultural trading system. The reform programme comprises specific commitments to reduce support and protection in the areas of domestic support, export subsidies and market access. The Agreement provides for implementation of the programme in an equitable way among all Members, by including aspects relating to non-trade concerns, including food security and the need to protect the environment.

The preamble of the Agreement promises various special and differential treatment provisions for developing and least developed countries aiming to provide significant improvement in the opportunities and terms of access for agricultural products of export interest to these countries. The Agreement on Agriculture applies to all basic and primary farm products as defined by Article 2 and Annex I of AoA. Overall it covers three areas usually known as three pillars namely; Market Access, Domestic Support and Export Competition.

Market access under AoA

The Uruguay Round resulted in a key systemic change on the market access issue for agricultural products by switching from a situation where numerous non-tariff measures obstructed agricultural trade flows to a regime of tariff-only form of protection and that too with further reduction commitments. It was expected that fundamental change would help to stimulate investment, production and trade in agriculture by making agricultural market access conditions more transparent, predictable

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and competitive, strengthening the link between national and international agricultural markets, and thus relying more prominently on the market for guiding scarce resources into their most productive uses both within the agricultural sector and economy-wide. The steps taken under AoA to achieve these objectives are briefly explained below: -

Tariffs only regime

The Agreement on Agriculture prohibits the use of agriculture-specific non-tariff measures (Article 4.2). All non-tariff measures were therefore to be converted into tariffs.

Tariff Reduction

Having found the tariff equivalent of the various import restrictions the next step was to reduce these tariffs by applying the reduction formula agreed in UR. These reductions were an average of 36% and a minimum of 15% for each tariff line over six years for developed countries and an average of 20% and a minimum of 10% for each tariff line over ten years for developing countries. However, the averages referred to here are simple averages and they were not weighted for the volume of trade. The Least Developed Countries were exempted from reduction commitments.

Binding of Tariffs

After conversion of non-tariff measures into tariffs another requirement from the Members was to bind their tariffs at a maximum level. Developing countries were given a choice to bind their unbound agricultural tariffs at a ceiling level higher than the applied rates prior to the WTO. Members were also required to present these tariff bindings in their Schedules of Commitments.

Tariff rate quotas

A tariff only situation on its own only improves transparency and does not result in better market access. As part of the tariffication package, WTO Members were required to maintain, for tariffied products, current import access opportunities at levels corresponding to those existing during the 1986-88 base period and additional market access opportunities. These market access opportunities are generally implemented in the form of tariff quotas. These tariff quotas, including the applicable tariff rates and any other conditions related to the tariff quotas, are specified in the schedules of the WTO Members concerned.

Special safe-guards

With the removal of non-tariff measures some countries were worried that they would not be able to prevent sudden surges in import volumes or falling prices of imports. To allay these concerns it was agreed that a special agricultural safeguard (SSG) could be applied to certain products. This meant an additional tariff could be charged when imports rose above a certain trigger volume or prices fell below a certain trigger price.

Domestic support under AoA

Domestic support is the term used for subsidies provided in the form of production subsidies, price support or other like measures. Some of domestic support measures are thought to be more trade distorting as compared to others. The Agreement on Agriculture provides different rules for different types of measures according to their impact on trade. Thus domestic support is further divided into three main categories. These categories are described into three coloured boxes i.e. Amber Box, Blue Box and Green Box. It is worth mentioning that the agreement itself does not use any color or the word 'box'; however subsequently for convenience these boxes have become so popular that these types of subsidies are recognized by their colours more than by respective articles of the agreement. The boxes are briefly explained below.

Amber Box

All domestic subsidies considered to be most trade distorting are included in this box. The agreement does not contain specific definition for this category of subsidies. Instead the agreement says that the domestic measures not covered under the criteria for another category of measures which have 'no or minimal trade distorting effect' (i.e. green box; explained in preceding paragraphs). The amber box support is under reduction commitments according to the AoA. The Members were required to calculate level of such support for the base period 1986-88 and then reduction commitments were to be applied according to an agreed formula. The developed countries had to reduce the base level support by 20% in six years from 1995 whereas developing countries were required to reduce this level by 13% in ten years from 1995. The level of support is measured in terms of 'Total

Aggregate Measurement of Support (AMS)'. Current total AMS for a particular year is thus the annual level of support expressed in monetary terms. For the purpose of Current Total AMS calculation, price support is generally measured by multiplying the gap between the applied administered price and a specified fixed external price by the quantity of production eligible to receive the administered price. Calculation of AMS has to be made for both product-specific support and non-product-specific support.

The agreement has allowed that if in a particular year product-specific support or non-product-specific support is below a certain level called *de minimis* then it may not be included in the calculation of AMS. The product-specific *de minimis* is 5% (for developed countries) and 10% (for developing countries) of the Member's total value of production of a basic agricultural product during a relevant year. The *de minimis* for non-product-specific support is 5% (for developed countries) and 10% (for developing countries) of the value of the Member's total agricultural production. Besides this *de minimis* allowance Article 6.2 of AoA also provides some special and differential treatment to the developing country members by allowing keeping certain types of subsidies outside the calculation of current AMS. The measures covered by this Special and Differential clause include:

§Investment subsidies which are generally available to agriculture in developing country Members

§Agricultural input subsidies generally available to low-income or resource-poor producers in developing country Members

§Domestic support to producers in developing country Members to encourage diversification from growing illicit narcotic crops.

A special kind of domestic support is exempt from reduction commitments under Article 6.5 of AoA. This covers direct payments under production-limiting programmes. This kind is called blue box subsidies.

Blue Box

Green Box

The domestic measures that are considered to have 'no' or 'at most minimal' trade distorting effect are categorized as green box subsidies. In the Annexure 2 of AoA a clearly defined criteria is given for any measures to be included in this category. Main criteria is:

- a. the support in question shall be provided through a publicly-funded government programme (including government revenue forgone) not involving transfers from consumers; and
- b. the support in question shall not have the effect of providing price support to producers.

The policy-specific criteria and conditions are also laid down in detail in the Annexure 2. These subsidies include measures such as research, pest and disease control, training services, extension & advisory services, inspection services, marketing and promotion services and infrastructural services, public stockholding for food security purposes, etc.

The use of green box subsidies is quite flexible. There is no upper ceiling for this box and any country can provide whatever quantum they want of green subsidies provided that those are in conformity with the criteria laid down in Annex 2 of AoA. *(The fluidity of green box has however been subject to criticism since it is feared that advanced countries with abundance of resources have used the definition of this category to enhance the volume of green subsidies, shifted subsidies from other boxes to this box and thus have evaded their reduction commitments in a way. For this reason there is a very vehement demand in the ongoing round of negotiations on AoA, particularly from developing countries that criteria for green box is tightened to stop its misuse)*

Green box subsidies

Export subsidies are clearly those that are contingent upon export performance. According to the Agreement on Agriculture these subsidies are:

- a. the provision by the governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a

cooperative or other association of such producers, or to a marketing board, contingent on export performance;

- b. the sale or disposal for export by governments or their agencies of non-commercial stocks of agricultural products at a price lower than the comparable price charged for the like products to buyers in the domestic market;
- c. payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived;
- d. the provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight;
- e. internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments;
- f. subsidies on agricultural products contingent on their incorporation in exported products.

Export subsidies under AoA

Problems with AoA

Dirty Tariffification

Tariff peaks and escalations

The Members were required to calculate their level of export subsidies for a base period 1986-90 and declare it in their Schedules of Commitments. The subsidies were then to be reduced by using an agreed formula. The developed countries were required to reduce these subsidies by 21% in terms of volume of subsidized exports and 36% in terms of budgetary outlays during six years. For developing countries these percentages were 14% and 24% respectively to be implemented in ten years. In all 25 Members have reduction commitments specified in their Schedules of Commitments clearly indicating the relevant products.

According to AoA no export subsidies other than specified in the Schedules of Commitments can be provided subsequently. The Article 9.4 however allows developing countries to use

the subsidies listed at (d) and (e) above without reduction commitments during the implementation period. *(The implementation period for developing countries under existing AoA had to end by December 2004. However under current negotiations developing countries are demanding that the special and differential treatment provided under Article 9.4 should continue)*

Despite the promised improvement in market access of AoA, it could not bring benefits to the developing countries and LDCs when the agreement was practically implemented. The studies and statistics show that developed countries still protect their agricultural sectors. Some concerns of developing countries are briefly given below.

While converting non-tariff barriers to tariffs, many countries especially the developed ones managed to keep tariff levels that were much higher than their non-tariff equivalents. The QUAD countries (EU, US, Canada & Japan) in particular have set some very high tariffs. An OECD study on border protection showed that actual border protection to agriculture was higher in 1996 compared to 1993 in 8 out of 10 OECD countries (treating EC as one). "This 'dirty' tariffification implies that actual tariffs at the beginning of the twenty-first century provide no less protection than did the NTBs of the late 1980s. The so-called 'binding overhang's that resulted is significant. Binding tariffs at such high levels allows countries to set the actual tariff below the ceiling but to vary it so as to stabilize the domestic market, analogous to the earlier EU system of variable import levies and export subsidies.

Tariff peaks are generally defined as occurrence of high tariffs for certain products, or groups of products, in a country's schedule of commitments while average level for majority of the products is comparatively much low. For example, 10% tariff in a schedule with 4% average and a 40% tariff in a schedule averaging at 10% may be termed as peaks. However, peaks are defined in relative context and no definite level could be assigned to a tariff to become a peak. The tariffs peaks are maintained

for certain products, obviously to provide protection for those products. Tariff peaks are most common for major agricultural products including cereals, meat, sugar, milk, butter, cheese, tobacco, cotton and fruits and vegetables; the products that are of export interest to developing countries. Many developed countries have tariff peaks exceeding 100% whereas agricultural tariffs above 100% are rare in developing countries.

Tariff escalation is defined as the setting of a tariff in such a way that it rises with the increasing transformation of a product. For example if a country allows fresh grapes at say 5 % ad valorem tariff but levies a higher tariff on preserved grapes and still higher on grape juice then the countries would be said to have maintained escalations. The presence of tariff escalations maintained by the developed countries create disincentives for setting up of agro-based processing industries thus denying them value addition in their basic primary products. An FAO study indicates that the post-Uruguay Round tariff wedges (i.e. the difference between the tariffs on processed products and a primary input commodity) in developed countries remain at an average tariff escalation of 17%.

Tariff escalation also prohibits diversification and hinders transition from primary to processed goods, which is very important for developing countries' economies, particularly as most of the value addition is created at the latter stages of production.

Pakistan has liberalized its agricultural sector to a fairly large extent. The binding level for most of agricultural products in Pakistan is 100% ad valorem while a few are bound at 150%. The maximum applied duty is however 25%. The oilseed sector faces specific duty structure instead of ad valorem tariffs. Pakistan does not maintain any non-tariff restriction except a few on moral or religious basis. Pakistan does not give any export subsidies

whereas a nominal domestic support is used. Pakistan's AMS has been negative throughout the years.

In view of the above problems in market access issue (alongwith imperfections in domestic support and export competition) the developing countries felt that the AoA still needed to be improved to create a level-playing field by all trading partners. In fact this apprehension prevailed even at the time of conclusion of AoA in Uruguay Round. Hence there was an in-built clause in AoA (Article 20) that the negotiations should continue for further reforms. Under this mandate of AoA the negotiations started in March 2000.

In the fourth Ministerial Meeting of WTO held in Doha, Qatar in November 2001, a specific and binding time frame was agreed to get the negotiating process to a meaningful end with an objective of, inter alia, substantial improvements in market access. Paragraph 13-14 of Doha Ministerial Declaration lays down programme for the negotiations on agriculture. According to Doha programme the negotiations, initiated in early 2000, were to culminate by reaching a decision on modalities for further commitments in AoA. On the basis of these modalities the Members had to submit their Schedules of Commitments at the time of fifth Ministerial Conference. The entire negotiations process was then to be completed by 1st January 2005 to become a part of the single undertaking. All these dates have been elusive so far.

However, following points have been agreed by the negotiators though the details thereof have yet to be decided.

- § The market access for the agricultural products will be enhanced both in developed and developing countries by reducing tariffs.
- § Domestic support will be reduced in such a manner that those who use more would reduce more.
- § The export subsidies would be eventually eliminated.

The AoA is open for further negotiations

Doha development agenda

Tariff escalation

Pakistan and AoA

Credit to Agriculture Sector

Rising demand for credit

The demand for agricultural credit has increased over the years, given the expansion in the size of the agricultural sector and increased usage of fertilizer, pesticides and mechanization. The credit needs are being met through Zarai Taraqiati Bank Ltd (formerly Agriculture Development Bank of Pakistan), the commercial banks and the Punjab Provincial Cooperative Bank Ltd.

Loans are disbursed for purchase of implements like tractors, tubewells, harvesters; for working capital of poultry, dairy, livestock, fisheries and for the development of new agriculture land, for purchase of tractors, building of godown/cold storage, installation of tubewells etc.

Banks are providing in addition to working capital and long term loans to farmers, also loans to the buyers of agriculture produce so that they have the liquidity at the time of harvest. It is provided both to the public and private sectors for the purchase of wheat, tobacco and occasionally for cotton and rice. It provides relief to the farmers by strengthening the market for their produce and thereby reducing the chance of any fall in prices at the time of harvest.

With an increase in the coverage of institutional finance, the ratio of credit to agricultural GDP has risen to around 7%, while the number of borrowers, both farm and non-farm, livestock, poultry, forestry, fisheries, dairy farming and

Agriculture lending picks up

others has reached 1.2 million.

Agriculture lending has picked up in recent years because of enhanced lending by commercial banks, especially the five large ones, in contrast to earlier practice, where they could not meet the targets assigned under directed credit control.

In recent years, with decline in interest rates, commercial banks had excess liquidity, which they started to lend to hitherto untapped areas, such as to the agricultural sector. With a large network of branches, their access to borrowers is much easier. This alongwith the changes brought about by the State Bank of Pakistan in expanding and enlarging the coverage of agriculture credit, has made agricultural financing more attractive for commercial banks. Commercial banks are gradually building up their lending to the agricultural sector, and last year, they surpassed Zarai Taraqiati Bank and also exceeded the target set for the year.

Active participation by commercial banks

Lending for development purposes has gone up in the last year or two, partly reflecting the rise in farm incomes, as well as better prospects for agriculture in light of increased water availability and revival of farmers confidence who are now getting a better price for their produce. While development loans were earlier the domain of ZTBL, now all banks are actively participating in this area, with a significant change in the banks' composition of development and production loan.

Production/Development Loans

(Rs. Bn)

Period		Commercial Banks	Zarai Taraqiati Bank Ltd	Punjab Provincial Cooperative Bank	Domestic Private Banks
FY02	Production Loans	15.75	22.01	4.94	0.41
	Development Loans	1.74	7.10	0.19	0.18
FY03	Production Loans	18.87	23.11	5.34	0.52
	Development Loans	3.87	6.16	0.1	0.90
FY04	Production Loans	26.82	24.53	6.16	1.54
	Development Loans	6.43	5.41	1.52	1.18

Source: SBP Annual Report 2003-04 (Volume-I)

Credit Disbursed by Agencies

(Rs. Bn)

Year	Zarai Taraqiati Bank Ltd [‡]	Taccavi (Rs. Mn)	Cooperatives	Commercial Banks	Domestic Private Banks	Total
1972-73	0.17	10.23	0.04	0.08	*	0.31
1973-74	0.42	67.50	0.14	0.28	*	0.91
1974-75	0.40	12.13	0.08	0.52	*	1.01
1975-76	0.53	25.67	0.09	0.81 ⁺	*	1.46
1976-77	0.64 [‡]	13.14	0.05	0.96 ⁺	*	1.66
1977-78	0.43 [‡]	8.80	0.21	1.28 ⁺	*	1.92
1978-79	0.42 [‡]	12.65	0.26	1.38 ⁺	*	2.07
1979-80	0.71 [‡]	9.20	0.60	1.54 ⁺	*	2.86
1980-81	1.1 [‡]	8.59	1.13	1.82 ⁺	*	4.02
1981-82	1.6 [‡]	8.48	1.10	2.44 ⁺	*	5.10
1982-83	2.3 [‡]	11.42	1.41	2.34 ⁺	*	6.07
1983-84	3.1 [‡]	7.60	1.45	3.77 ⁺	*	8.36
1984-85	4.2 [‡]	6.28	1.57	4.54 ⁺	*	10.29
1985-86	5.3 [‡]	4.62	2.05	5.32 ⁺	*	12.69
1986-87	6.0 [‡]	13.30	2.49	7.31 ⁺	*	15.85
1987-88	7.7 [‡]	9.14	3.02	5.17 ⁺	*	15.92
1988-89	8.7 [‡]	24.93	2.73	3.05 ⁺	*	14.48
1989-90	9.4 [‡]	55.58	0.81	3.63 ⁺	*	13.89
1990-91	8.3 [‡]	56.30	3.02	3.52 ⁺	*	14.91
1991-92	7.0 [‡]	56.30	3.25	4.18 ⁺	*	14.48
1992-93	8.6 [‡]	50.80	2.97	4.53 ⁺	*	16.20
1993-94	9.0 [‡]	**	2.62	4.06 ⁺	*	15.67
1994-95	14.6 [‡]	**	3.76	4.04 ⁺	*	22.37
1995-96	10.3 [‡]	**	3.80	5.04 ⁺	*	19.20
1996-97	11.7 [‡]	**	3.43	4.43 ⁺	*	19.55
1997-98	22.4 [‡]	**	4.93	6.11 ⁺	*	33.40
1998-99	30.2 [‡]	**	5.44	7.24	*	42.85
1999-00	24.4	**	5.95	9.13	*	39.69
2000-01	27.6	**	5.12	12.05	*	44.79
2001-02	29.1	**	5.13	17.49	0.58	52.31
2002-03	29.3	**	5.49 ^{††}	22.74	1.42	58.92
2003-04 ^P	29.9	**	7.68	33.25	2.73	73.60

[‡] Formally ADBP

[†] Including Agribusiness

* Not Applicable

^{††} Punjab Provincial Cooperative Bank only

** Not Available

⁺ Excluding Tobacco Marketing

Source: Pakistan Economic Survey 2003-04
Statistical Supplement

During the last four years, as the accompanying Table shows, credit disbursement to the agricultural sector rose by 64%, from Rs.45 billion in FY01 to Rs.73 billion in FY04. This was led by the big five commercial banks which showed a significant growth and overtook ZTBL in loan disbursement to the agricultural sector. In FY04, actual disbursement exceeded the target; a year earlier also 94% of the target

was met and the shortfall was due to ZTBL, as commercial banks had exceeded their target during the year.

Credit
recovery
improves

Credit recovery from the agricultural sector has shown an improvement in recent years. While the outstanding amount of agri credit has risen, the State Bank of Pakistan attributes this to 'increased pace of fresh disbursements

rather than increasing bad loans' and outstanding stock 'owes more to the accrued interest on the past due loans rather than the impact of fresh non-performing loans'.

Agricultural Credit – Target/Disbursement

(Rs.Bn)		
	FY02	FY03
Annual Target	60.0	62.7
Disbursement	52.5	58.9
Percentage of target achieved	87.5	93.9

Source: Annual Report State Bank of Pakistan 2003-04

The recovery drive launched by the financial institutions in FY01, and the State Bank's decision to discontinue the provision of concessionary credit to Agriculture Development Bank and Federal Bank for Cooperative forced both these institutions to make greater efforts on recovery to be able to maintain the same size of lending. Loan recovery by ZTBL would have been higher, but a large part of their borrowers were concentrated in areas declared by the government as calamity hit areas, for which the Bank had to reschedule its loans.

Lending by domestic private banks picks up

A recent development witnessed in agricultural lending has been the greater disbursement by domestic private banks during the first half of the current fiscal year (2004-05). They achieved 93% of their annual disbursement target compared with 49% in the first half of FY04.

Also their lending for corporate farming went up significantly. Lending to corporate farms rose from Rs.12.4 million to Rs.594 million in the corresponding period. A pronounced improvement was seen in their recovery rate which registered a 115.6% increase, against an already high recovery ratio of 98.4% in the first half of FY04.

The State Bank of Pakistan continuously monitors the flow of funds to the agriculture sector, whose demand for financing has increased with the growth in its size. Some new products for financing the agricultural sector have been introduced by the commercial banks.

The State Bank of Pakistan has developed a separate set of Prudential Regulations for agricultural financing, so providing a broader regulatory framework to the banks, within which they should be able to develop their own

Credit to Agriculture Sector

(Rs. Bn)

	Disbursement				Recovery				Net Credit				Outstanding			
	FY01	FY02	FY03	FY04	FY01	FY02	FY03	FY04	FY01	FY02	FY03	FY04	FY01	FY02	FY03	FY04
Zarai Taraqiat Bank Ltd	27.6	29.1	29.3	29.9	31.9	33.4	34.3	35.6	(-) 4.3	(-) 4.3	(-) 5.0	(-) 5.7	79.9	83.7	71.6	73.1
Commercial Banks*	12.1	17.5	22.7	33.2	10.9	14.8	19.5	24.4	1.1	2.7	3.2	8.8	10.4	13.3	16.6	25.5
Domestic Private Commercial Banks	-	0.6	1.4	2.7	-	0.5	0.5	1.5	-	0.1	0.9	1.2	-	0.7	1.6	2.9
Punjab Provincial Cooperative Bank	5.1	5.3	5.5	7.7	5.0	4.6	5.1	5.9	0.1	0.7	0.4	1.8	3.1	3.6	4.0	5.7
Total	44.8	52.5	58.9	73.5	47.8	53.3	59.4	67.4	(-) 3.0	(-) 0.8	(-) 0.5	6.1	93.4	101.4	93.7	107.2

* Includes NBP, HBL, UBL, MCB & ABL

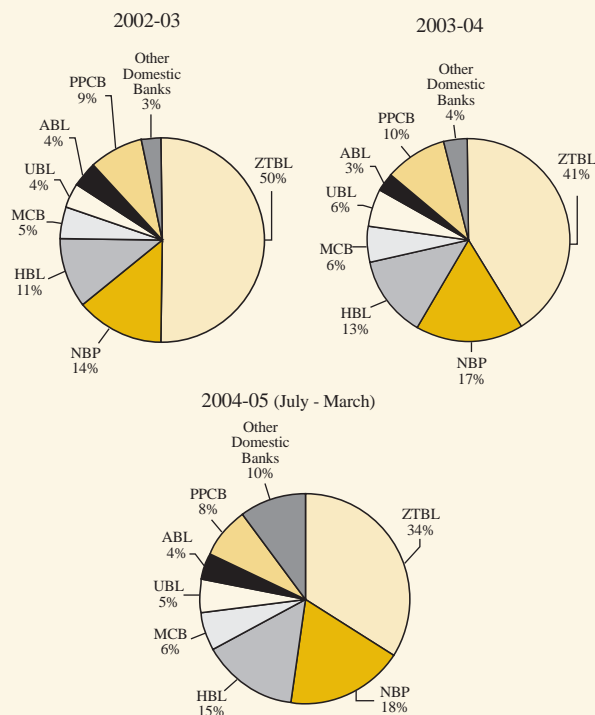
Source: Annual Reports, State Bank of Pakistan Various Issues

financing schemes for financing the agricultural sector.

NBP and agricultural credit

As far back as 1972, National Bank of Pakistan has played a leading role in the promotion of agricultural sector, when the Supervised Rural Credit Programme was initiated. There has been no looking back since. Today, this package of credit, supplies and knowledge, easily available

Lending by Financial Institutions
Market Share
(Percentage)



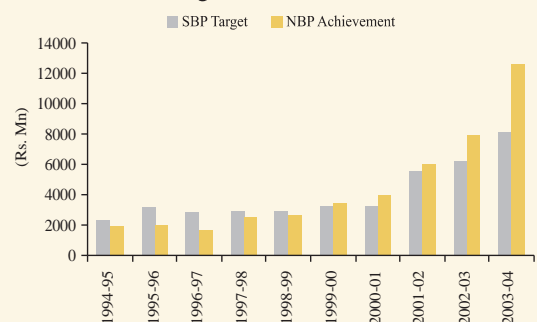
at the doorstep of the farmers has brought the Bank to the forefront in agriculture financing amongst all commercial banks operating in the country; its lending accounting for nearly 28% in total agriculture credit disbursement by commercial banks.

The Bank caters to the needs of about 0.2 million borrowers, with an average loan size of

Rs.70,000. Since FY2000, National Bank of Pakistan has progressively exceeded the target for agricultural financing given by the State Bank of Pakistan.

In FY00, for instance, NBP exceeded the SBP target by Rs.265.5 million, while in FY04, the target of Rs.15 billion for the whole year was exceeded by Rs.4.5 billion. In the first ten months of the current fiscal year the target has already been surpassed.

Target vs Achievement



National Bank of Pakistan has been nominated as the best agriculture financing institution in the banking sector by Kissan Times Agro Communications (Pvt) Limited in recognition of its outstanding services in the field of agricultural financing.

Recovery rate has significantly improved from 38% in 1998-99 to 95% in FY05. The outstanding amount has risen to nearly Rs.13.0 billion by FY05.

With increasing focus on the agricultural sector by the government, the market opportunities are growing, placing increasing demand on the institutions for financing. Given the past record of National Bank, it is expected that it will play a major role in the development of the agri sector and will in the foreseeable future emerge as the market leader in agricultural financing.

Water Resources for Farming

Increasing pressure on agriculture

Pakistan has in recent years been through a severe water crisis situation. In recent months due to timely rains and heavy snowfall water availability has improved. Earlier it had become difficult to meet the growing demand, emanating from its major user; the agricultural sector. The sector accounts for over 90% of water usage in the country. As agriculture contributes 24% of the GDP, its sustainability depends among others on timely and adequate availability of water. The increasing pressure of rising population, plus the migration that has taken place from rural to urban areas has generated enhanced demand for agricultural products, especially food grains, edible oil, milk, meat, fruits and vegetables, for cotton based materials and forestry products.

Per capita water declines

Meanwhile, available water resources are inadequate to meet the growing demands of the agricultural sector. Per capita water availability has declined over time, to 1136.5 cubic meters in FY04 from 2002.6 cubic meters in FY51 and is now only slightly above the threshold level of water scarcity i.e. 1000 cubic meters.

Water management is poor

This situation has largely resulted from poor focus on water management and development of additional storage capacity. The country's vast irrigation system comprises of three reservoirs, 19 dams and 43 main canals, totalling 57,000 kms. Much of the irrigation system is threatened by water logging and salinity, reduced water storage capacity, over exploitation of groundwater and weak water management.

Water management is poor, particularly with respect to the disposal of effluents which contaminate water resources and the use of water for irrigation purposes. Little has been done towards building additional storage facilities or conserving use of water. The two main reservoirs on the Indus, the Mangla and Tarbela dams, are losing storage capacity due to sedimentation. According to some estimates, they have already lost 20% and 43% respectively. Little attempt has been made to add new reservoirs since Tarbela was built in 1974 or manage the water resources more efficiently.

In comparison, our neighbouring countries have built more reservoirs. The country's water

problems are compounded by depleting ground water reserves and increased soil salinity. The situation has been compounded especially in the rain-fed areas by persistent drought in Thar, Cholistan, and some areas of Balochistan and Sindh. The water level in the major reservoirs had reached a critical stage. Large snowfall in the northern regions of the country this year and heavy rainfall, has raised the water level in the water reservoirs considerably and the water storage situation is now better.

Benefits of increased access to irrigation water

Adequate water availability results in increased crop yields, more cropped area, cropping intensity, crop diversification etc. Furthermore, it also provides opportunity for production of high value crops, multiple cropping and year around crop production. Consequently, there is increased income from crop production and stabilisation of farm family income. Better access to irrigation water helps in increased on-farm and off-farm employment opportunities and income.

Water resources

Pakistan's water resources consist of surface water, rainfall and ground water. Surface water resources are mainly based on the flows of the Indus River and its tributaries; where the Indus River alone provides 65% of total river flows. The months of peak flows are during the monsoon period. Rainfall in Pakistan is irregular and not enough. A large part of the rainfall floods the areas near the rivers or flows out into the sea without any economic benefit. Groundwater resources are substantial in the Indus Plain, extending from the Himalayan foothills to the Arabian Sea. There has been substantial growth of tubewells for extracting water. The number of tubewells has increased from 0.34 million in 1990-91 to 0.68 million by 2002-03. In Balochistan, large part of irrigation is based on groundwater, extracted through tubewells, dug wells, springs etc.

Dry spell affects economy

The long dry spell in the country had an adverse impact on the economy. The overall growth declined in 2000-01 with GDP growing at 1.8%, as the agricultural sector suffered a fall of 2.2%. There was a significant loss of livestock and

crops. Due to low precipitation and lack of adequate water resource management, water tables have been steadily dropping in the drought affected areas.

The recent rains have improved the water situation, alleviating the earlier concerns of not being able to meet the FY05 agri-growth target. The rains have helped improve water availability prospects and also allowed farmers to increase areas under cultivation, particularly in rain-fed areas. The overall water shortage was reduced to 36.4% for Rabi FY05 against initial estimate

Irrigation Water Situation

(Million Acre Feet)				
	Average 77-78 to 03-04	2003-04	Shortage	% Shortage
Inflow	131.185	131.062	0.123	-0.1
Canal withdrawals	98.603	97.501	1.102	-1.1

Rainfall Recorded During 03-04

(In Millimetre)		
	Monsoon Rainfall (Jul-Sep)	Winter Rainfall (Jan-Mar)
Normal	137.5	70.5
Actual	211.0	42.0
Shortage (-)/excess (+)	+73.5	-28.5
% Shortage (-)/excess (+)	+53.4	-40.4

Source: Pakistan Economic Survey 2003-04

of 44.6%. The water balance for the remaining period of Rabi FY05 has significantly increased, with a 54.2% and 67.1% increase in the water balances for Punjab and Sindh respectively from the pre-rainfall levels. Current estimates show that there will be no water shortage during the current kharif season, as there is ample water in the reservoirs which would further increase when the snow melts.

If sustainable growth in agriculture is to be achieved, Pakistan has to once again become the water surplus country it was earlier. Future water requirements have to be assessed and appropriate steps taken to meet them. Additional water could become available through water conservation, maximum utilisation of groundwater resources; change in the outdated irrigation techniques which have resulted in water logging and increased the soil salinity; and production practices would need to undergo changes. This would require growing crops suited to arid regions of Balochistan and Sindh. There is growing concern for a pricing mechanism for water, to save the underground water table in Balochistan.

Pakistan's Agricultural Sector: Key Figures

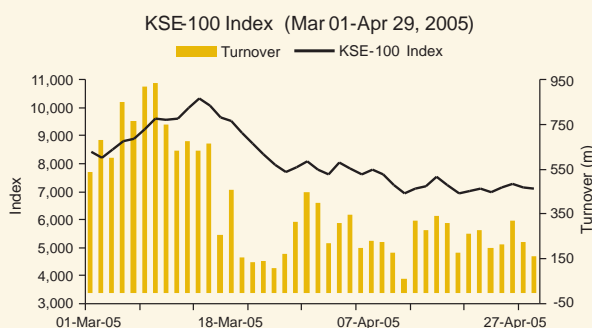
- Contribution to GDP	23.3%	Progress of Land Reforms	
- Of the total employed labour force	42.1% is employed in the agriculture sector	Area Resumed under land reforms	1.5 mn hectares
- Largest foreign exchange earner		Area Allotted	1.3 mn hectares
- Two principal crop seasons		Persons Benefited	258 thousand
Kharif – Sowing season April – June		Total Consumption of Fertilizer (2003-04)	3222.01 (000 N.tonnes)
Harvesting during Oct – Dec		Total Water Availability (2003-04)	141.64 million acre feet
eg rice, sugarcane, cotton, maize, bajra and jowar		Consumption of Pesticides	Rs. 11.2 bn
Rabi – Sowing Oct – Dec		Of Agricultural Credit advanced by Commercial Banks (%)	
Harvesting April – May		Farm Sector	79.1
eg wheat, gram, tobacco, rapeseed, barley and mustard		Production loans	84.5
Major crops	Wheat, rice cotton and sugarcane account for 91% of the value added in major crops	Development loans	15.5
Minor crops	Oilseeds, masoor, mung, mash, potatoes, onions and chillies	Non-Farm Sector	20.9
Livestock accounts for 49.1% of agricultural value added and 11.4% of GDP.		Total No. of Tubewells (000)	768.3
30-35 million rural population engaged in livestock raising.		Production of Tractors (000)	36.1
Total Cultivated Area	22.12 mn hectares	Milk production (mn tonnes)	22.9
Net Area Sown	16.07 mn hectares	Meat production (mn tonnes)	2.2
Total Cropped Area	22.94 mn hectares	Fish catch (2002) (000 tonnes)	637.8
Largest Canal Irrigation Network	16.64 mn hectares irrigated through canals	Export earnings from major agricultural commodities (2002-03) (Rs. bn)	652.3
Of total Cropped Area		Per capita availability of wheat (2003-04) (kgs/annum)	120.07
food crops 55%, cash crops 19%, pulses 6%, oilseeds 3%, vegetables 2%, fruits 3% and others 12%		Per capita availability of rice (2003-04) (kgs/annum)	10.72
Total Land Area under forest	4.04 mn hectares	Per capita availability of pulses (2003-04) (kgs/annum)	7.21
Total No. of Farms	6.6 million	Per capita availability of edible oils (2003-04) (kgs/annum)	10.24
Almost 99.99% are private farms		Per capita availability of meat (2003-04) (kgs/annum)	14.81
Size of Farm		Per capita availability of milk (2003-04) (kgs/annum)	84.79
58% are between under 0.5 – 2.0 million hectares		Per capita availability of fish (2003-04) (kgs/annum)	5.25
37% are between 2 – 10 mn hectares			
5% are between 10 – 40 mn hectares			
78% of farms are owner cultivator, 8% are owner cum tenants, 14% are tenants.			

(Source: Agricultural Statistics of Pakistan 2003-04)

Market Analysis

Market Summary

The market was becoming increasingly overheated since the start of the calendar year, but the speculative rally got out of hand in March 2005 when the KSE-100 Index gained 2043 points in just the first two weeks of the month to reach a new lifetime high of 10,303. To thoughtful investors this should have been enough warning that a sharp correction was due as such gains were unsustainable. By the latter half of March a steep reversal had set in which by the end of April had reduced the KSE-100 Index by 31% to 7105 points from the lifetime high attained in mid-March. Most of the drop in share prices occurred in March, but the market remained weak and extremely volatile in April as well and the KSE-100 Index lost 666 points over the course of April.



Crisis was averted in March

The drop was sudden when it came, and caught many investors off guard. The KSE-100 Index lost 2595 points (25%) over eight panic stricken days, before the SECP and KSE management moved in to halt the slide. They were aided in their efforts by help from some key market players. Once the market fall had begun, most of the major scrips would hit their lower limits at the start of the day, preventing investors from offloading their positions. This was a disastrous scenario for leveraged investors, and the market was extremely heavily leveraged at the time of the correction, with over Rs35b of shares being financed by the badla market in the days leading up to correction.

The situation was exacerbated by the futures market, which had begun to see greater volumes than the ready market, and was faced with the

threat of a settlement crisis as the market fell and futures investors were unable to find buyers to settle their open positions. Most of the difficulty arose in the March futures contract for OGDCL. OGDCL had led the bull run, but its share price at over Rs180 per share was almost double what could be justified by fundamentals, and when its price collapsed, there were no buyers in sight, in either the futures or the ready market. There was a very real fear of a default in the futures market, which could in turn have led to a system-wide pandemic.

The settlement crisis was alleviated by measures taken by the SECP, which eased badla restrictions and allowed additional funds to flow into the market from institutions. A consortium of institutions led by NIT- the state-owned mutual fund- agreed to provide funding and purchase OGDCL shares at a price of Rs117.5 per share in order to support the scrip, which had been in free fall otherwise. The moves were successful in that they helped to avoid any member defaults, and what had started as a technical correction did not turn into a system-wide pandemic as was feared at the time.

Phasing out of COT and start of margin finance

The sharp market correction means the SECP and KSE management have had to take a close look at the risk management system in place in the local equity markets, particularly for Futures trading. In April the SECP announced new rules for the Futures market. COT Financing, or Badla finance, as it is locally known, was to be phased out by June 2005 and replaced with margin finance, but because of market jitteriness over this phase-out, particularly in light of the fact that banks were not yet ready to fill the financing vacuum left after the end of the badla market, the SECP decided to extend the deadline till August as well as change the mode of phase-out.

The COT market, which was to be phased out by June 2005, has been extended until August 3rd, 2005. Moreover, the 7 remaining scrips

on the COT list will not be phased out one at a time, but will all undergo a reducing limit on the number of shares that can be financed through COT. The number of shares under COT finance will reduce at the rate of 12.5% per week over a period of 8 weeks starting June 8, 2005. This mechanism is designed to ensure a gradual weaning off from badla finance.

There was also concern that the mechanism for margin finance was not in place, and banks had not come forward to fill the financing gap that would be left once badla was phased out. This was a major cause of market weakness in April- the month in which heavyweight PTCL would have been phased out from COT under the original phase-out plan. The SBP, SECP and KSE management addressed this concern, and a consortium of banks have agreed to allocate Rs20b to introduce margin financing by August 26, and margin financing will be facilitated through the National Clearing House.

To reduce the chances of systemic risks in the Futures Market, the SECP has imposed a number of restrictions upon futures trading. Some of the more important new restrictions include:

1. Only those companies will be eligible for futures trading which have a free float in excess of 50m shares. This limits the Futures Market to 27 companies.
2. Members may not take up futures positions in any scrip in excess of 1% of the free float of that scrip. The KSE has requested this exposure limit be increased to 5% of free float, but till the end of April no decision had been taken on this request.
3. Margins for the Futures Market have been set at 10% for the first Rs100m (50% cash and 50% securities); 12.5% for the amount exceeding Rs100m up to Rs200m; 22.5% all cash margin for the amount exceeding Rs200m; and 30% all cash margin for the amount exceeding Rs300m. Some members of the KSE have asked that the all cash margin after Rs300m be converted into a 50% cash and 50% securities margin,

New rules for the Futures Market

but the SECP had not yet responded to this request as of the end of April either.

The Index is misleading

While the KSE-100 Index gained 65% since the start of the year to reach its high, this was far higher than most company share prices and was primarily the result of gains made by PTCL and OGDCL, which together account for about half of the weightage of the Index.

During the bull run, PTCL rose 99% and OGDCL rose 153% between the start of the year and the onset of the market correction.

Investors understandably read the index as a proxy for the market; a steeply rising index leads market participants to think the overall market is rising accordingly. This was not the case in February and March 2005 however when there was a steep rise in a few key scrips but most shares saw more moderate gains.

Going forward, it will not be as easy for the KSE-100 Index to reach the 10,000 mark because in future rallies, OGDCL, which has such a major weightage of the Index, is unlikely to see the high prices that it showed up till March. While share prices for most of the other major companies will once again reach levels attained in early March 2005, this is not likely to be the case with OGDCL, and without OGDCL, the market will not be able to reach 10,000 for quite a long time.

The market will be shaky and quick to react on negative news, but attractive valuations are opening up and investors should keep an eye out for the right time for reentry.

Some important events to pay attention to:

1. Rising interest rates - PIB yields rising in the next auction would have a negative impact on market sentiment
2. Privatization of PTCL, plus a possible IPO of UBL.
3. The 2005-06 Fiscal Budget which will be announced latest by June.

Outlook

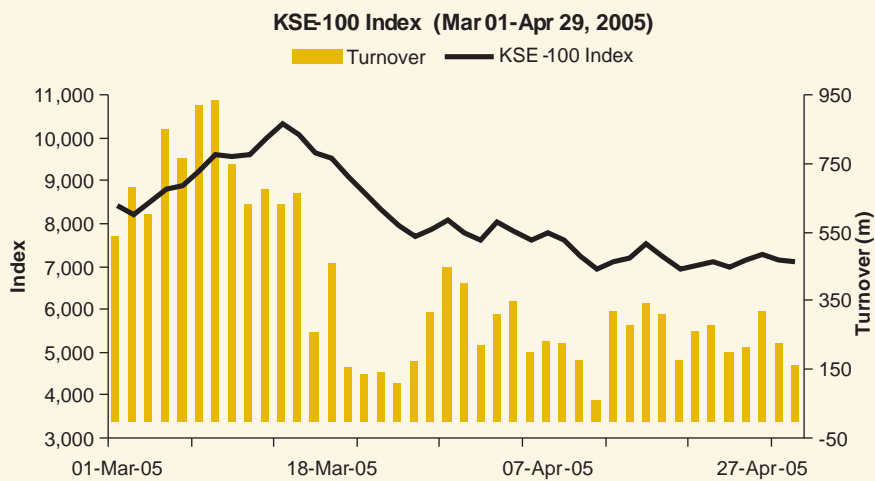
On the positive side, corporate earnings remain very strong, as witnessed by the Jan-Mar05

quarter, especially for banks; the upcoming budget will be mostly business friendly (corporate tax rates and import duties are expected to be reduced); and any progress in the privatization of PTCL will spark a rally in that scrip which could affect overall market sentiment.

These positives aside, there is some lingering weakness stemming from uncertainty over regulations and the phasing out of COT, and investor confidence will take time to build up after the recent market beating. Rising interest rates could also have an adverse effect. Following on from the increase in the SBP

Discount Rate from 7.5% to 9% in April, and the increase in T-bill yields of over 400 basis points over the last year, PIB auction yields are likely to increase next, as continued high inflation causes the government to further tighten monetary policy.

Given the mix of negative and positive factors, in our view the overriding factor will be the shaken investor sentiment, as a result of which market movements may continue to be sideways to negative for the short to medium term. The privatization of PTCL would however boost sentiment and play a stimulating role for the market.



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

NBP Performance at a Glance

(Rs. Bn)

Items	2000	2001	2002	2003	2004
Total Assets	371.6	415.1	432.8	468.9	549.7
Deposits	316.5	349.6	362.9	395.5	465.6
Advances	140.3	170.3	140.5	161.3	221.4
Investments	72.6	71.8	143.5	166.2	144.7
Shareholders' Equity	11.4	12.0	14.3	18.1	25.2
Pre-Tax Profit	1.03	3.02	6.04	9.01	12.02
After-Tax Profit	0.46	1.15	2.25	4.20	6.24
Earning Per Share (Rs.)	1.24	3.08	5.49	8.53	12.68
Return on Assets (Pre-Tax Profit) (%)	0.3	0.8	1.4	2.0	2.4
Number of Branches	1428	1245	1204	1199	1226
Number of Employees	15351	15163	12195	13272	13745

NBP Products

NBP Saiban

- § Finance available for home purchase, home construction and home improvement.
- § Period of repayment ranges between 3-20 years.
- § Loans available upto a maximum of Rs.10 million.
- § Mark-up choices available. Rate ranges between 7.5% – 9.75%.
- § Minimum approval and disbursement timing.
- § Limited to areas where there are no documentation, fee, resale and foreclosure related issues, so to protect the bank's interest.

NBP Advance Salary

- § 15 months salary in advance (certain conditions apply).
- § Minimum documentation.
- § Repayable in 5 years.
- § No processing charges; no collaterals, no guarantees, no insurance.
- § Mark-up charged at 11% per annum on reducing balance method.

NBP Cash n Gold

- § Facility of Rs.5000 against 10 gms of gold.
- § Mark-up 9% per annum.
- § No maximum limit of cash.
- § Repayable after one year.
- § Roll over facility.
- § No penalty for early repayment.

NBP Kisan Dost

- § Loans available for the farmers for production, development purposes, for purchase of tractors, for installation of tubewells, for purchase of agricultural implements, micro loans, for godown construction, for construction of fish pond, for livestock farming, for milk processing, for cold storage, bio-gas plants etc.
- § Mark-up 9% per annum.
- § Loans available at the farmer's doorsteps.
- § Agricultural experts to guide farmers.
- § Loans available against agricultural passbooks, gold ornaments and paper security.