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### ORGANIC GROWTH

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For the past few decades countries around the world have been following an industrial growth paradigm. Pakistan by and large followed in the same footsteps and focused on industrial growth at the cost of agriculture. Even with a weak agriculture sector, Pakistan gave indirect subsidies to the industrial sector by keeping prices of agriculture commodities down. Given the recent price surge and change in the world commodity markets, a change in policy is necessary. The government needs to refocus on the agriculture sector, by rationalizing support price mechanism and stimulating growth through import substitution and exports.

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## A MATTER OF NUMBERS

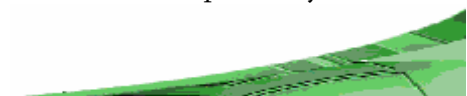
Pakistan is primarily an agriculture based country, but has generally remained food deficit with excess requirements being met through imports. This exposes the country to both internal and external factors resulting in domestic price shocks. Given its weak economy and growing population, Pakistan can ill afford not to maintain a secure and consistent food supply chain.

The history of the agriculture sector has been a history of neglect by the government. In years past Pakistan's budget has been skewed towards promoting the manufacturing sector vis-à-vis indirect subsidies and other schemes to stimulate business. With such heavy emphasis on the development of manufacturing sector, the government was not able to give appropriate focus to the agriculture sector. This has directly affected approximately 70% of Pakistan's population that lives in rural areas and depends on agriculture for sustenance. To top it all, rural areas have seen a surge in population growth which has further added to the woes of rural people who are unable to find labor. For, there is not enough job creation since the population is growing faster relative to growth in the sector.

On the whole the government's policies have been directed towards stimulating a manufacturing sector, often overlooking the agriculture sector. Due to these policies the pace of industrialization has been massive since independence when Pakistan had virtually no industrial base. During the 1950s manufacturing sector increased by 16% annually. In the first half of 1960s it increased by 11% slowing to 7% in the second half. Growth rate of manufacturing slowed to 2.3% during the Bhutto regime, due to nationalization; however, it bounced back in subsequent fiscal years, remaining 5.4% until 1992. Nevertheless this expansion in the manufacturing sector has come at the cost of the agriculture sector.

For instance, trade restrictions on agriculture merchandise and fixed procurement prices by the government have ensured a lower price than prevailing in international markets. These policies acted like indirect subsidies for the manufacturing sector, lowering cost of raw materials. Secondary industries benefited in particular as they could buy these raw materials for lower rates compared to international prices. Enormous fiscal subsidies and economic rents are involved in the sale of commodities at below market rates. Issue prices do not cover the full cost to the government of storage, handling and procurement.

Moreover not only is the manufacturing sector being subsidized by the agriculture sector, but consumers are also often given subsidies at cost of farmers. For example many flour mills





operate only in the November-April period using only government supplied wheat. This essentially means that the rural producers are subsidizing the urban consumers.

In addition to providing indirect subsidies, farmers are also hit by operations in parallel markets. By creating a price differential between international and domestic prices, the government unwittingly encourages cross border smuggling and also provides arbitrage opportunities for hoarders who have an incentive to deliberately hold back supply in an attempt to sell it later at higher prices. For example in case of wheat, the hoarders identifying the price differential have been hoarding vast quantities of wheat hoping to sell it in the future at higher prices. Despite strict bans by the government on wheat exports, smugglers have collaborated with hoarders and sold wheat, particularly across the border, making abnormal trading profits. In both cases farmers lose out as they can only sell crops at procurement prices even though prices around the world have risen drastically.

## WORLD PRICES

World food prices have gone up consistently in the past few years, with some varieties of wheat jumping by as much as 25% in a day. Similarly oil prices have also reached new highs this year, having risen by nearly 63% since May 2006 and showing little signs of slowing down.

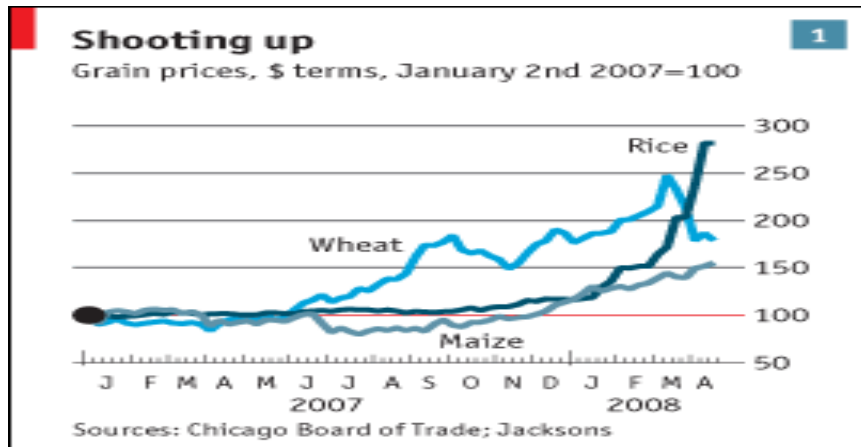


Figure 1 - World Food Prices

Sustained increases in food and oil prices in the international markets have resulted in supply disruptions and market inefficiencies in our domestic market. Subsequently inflation has assumed high numbers as CPI inflation reached a thirteen year high at 14.12% in March. Food inflation for the same period was 20.16%. However, even though food prices have gone





up in the country, farmers have not been able to sell at these price levels, as explained earlier. Furthermore, farmers have had to endure high input prices due to inflation, e.g. heavy diesel oil price crossed PKR 50 per liter. Facing these costs the natural step would be to increase crop prices, yet they have to sell at government's procurement price which is hardly enough for farmers to meet their costs, thereby worsening their financial conditions. This essentially means that procurement prices, which should be protecting farmers from price shocks, are in effect playing the role of a price ceiling for the farmers while domestic market prices rise in tandem with international commodity prices.

The government needs to link farmers directly with end consumers, allowing them to sell at markets rates and remove as many middlemen as possible. This move will directly impact their earning and help bring down poverty.

Hence due to the current government policy of procurement prices, farmers receive less than favorable prices, while middlemen receive the lion's share of profit.

### **Bottom-Up Approach**

An inspiring working example, where a more direct link has been established with the farmer is that of the White Revolution, Nestle being one of its pioneers. In the span of just a few years Pakistan has gone from being a milk deficient country to almost self sufficient, becoming the fourth largest milk producer in the world with an estimated 33 billion liters of annual milk production, from approximately 50 million animals.

The real benefit of this revolution has gone directly to poor farmers, without middlemen taking rent or obscuring market conditions. This is because, due to the perishable nature of the product, companies have bought milk directly from farmers, in the process paying them prevailing market rates. This has been encouraging for farmers, while helping to alleviate hardship in rural areas.

Although Pakistan's dairy sector appears impressive in terms of livestock numbers and milk production, a huge room for expansion exists as the gap between potential yield and actual yield is large. Comparing milk yields across the world, one New Zealand dairy animal produces as much milk as three dairy animals in Pakistan; while one American dairy animal produces as much as seven Pakistani dairy animals. This dramatic difference in milk yield is due to many reasons including genetic, technological, administration etc. However, these reasons are known to us, thereby leaving considerable room for improvement.





Thus the government can increase milk production many fold by implementing and administering the right policies. Government spending in this sector, which has shown more potential for growth than any other industry in the agriculture sector will provide a higher return for investment.

## SECURE FOOD SUPPLY CHAIN

Taking into account the government's successful policies in developing the milk sector, a similar initiative needs to be employed to the agriculture sector as a whole. This will secure the country's food supply chain, alleviating price pressures and lessening poverty in the process.

### Government support program

In theory, by setting domestic procurement prices and volumes, the government's agriculture policy objective is to formulate a policy which balances the interest of producers and consumers. On the producer side, the government looks to increase production yield of farms and provide price stability. On the other side, the government looks to bestow food security to consumers. However, procurement prices considerably below international prices and a ban of movement of commodities between provinces essentially means farmers are subsidizing consumers.

To emulate successes of the White Revolution, the government needs to rationalize commodity prices and establish more direct links with the primary producer. By offering a higher price to farmers, there will be incentive for them to increase production and help reduce the occurrence of production shortfalls, which is the root cause for price increases. To protect the consumers on the other hand, the government must rationalize its current subsidy programs, introducing targeted subsidies.

In addition, a number of measures and policy decisions can be put into place to combat production short falls. Such as, allowing the private sector to import commodities when supply is low. This policy will help stabilize market prices at no cost to the government, as deficit commodities will be imported. Also the government can maintain a separate security stock with a view to regulate the market. This strategic stockpile can be used to smooth out market irregularities and protect both producers and consumers from price shocks.





These policies will help Pakistan move towards realizing self sufficiency, which is the first step in establishing a secure food supply chain.

### **Import Substitution**

As mentioned above Pakistan has regularly imported commodities to meet production short falls. However, some of these commodities are not crops of first choice; therefore, they are not grown in abundance within the country. Consequently importing them is taxing for the exchequer, examples include oilseeds, pulses and tea. Even though these commodities are not grown commonly they still enjoy high demand from Pakistani consumers.

Consumption of cooking oil is approximately two million tons annually, out of which roughly 70% is imported. Similarly pulses account for nearly a million tons of imports with more or less half imported, while tea is entirely imported from abroad. These represent a sizeable part of the import bill. With such high demand for these commodities and increasing population, demand is set to increase further, worsening trade deficit. Therefore it is in the country's best interest to develop and facilitate the production of these commodities and stop imports from mounting. Even though previous governments have been aware of the need to substitute these commodities, not enough action has been taken by them. As an example, the National Tea Research Station (NTRS) was established in 1986, but no sizeable cultivation of the crop has taken place thus far.

The government needs to carry out large-scale productivity enhancement programs and focus on import substitution. These programs need to be extensive and detailed to ensure effective implementation and sustained growth. To begin with, the programs should educate farmers about non-traditional crops providing them with information, incentives and support, so as to motivate them to switch to crops which we are currently importing in large quantities. For example, helping cultivate palm trees in the coastal areas of Sindh and Balochistan have proven successful in the past where almost a thousand acres were cultivated by 2004. Also a large support system should be established for successful execution of the plan, for instance, setting up research centers to better monitor rainfall patterns, soil testing to establish appropriateness of land for cultivation, water management, providing fertilizer, infrastructure development and technology transfers to say the least.

By replacing imported commodities with locally grown crops, Pakistan will lessen its trade deficit and also ensure food security. Moreover it will spur economic growth. With rising international competition, where manufacturing export led growth is becoming more and





more difficult, may be it is time to focus on import substitution via growth in agriculture sector.

### **Export Led Growth – Untapped Potential**

Once a consistent domestic supply has been ensured, the government can switch focus in the long run towards promoting exports of these commodities which have a huge untapped potential.

Traditionally Pakistan has employed a reactive export policy for commodities, with exports restrained only to surplus harvests. During years of shortfall, government policies were restrictive employing tariffs, quotas and other policy instruments to limit exports. However, this strategy has been counterproductive for Pakistan's exports and their reputation abroad. This is because maintaining a constant presence through delivery of consistent commodity supply is essential for penetrating international markets. Therefore, Pakistan's appearance needs to be refurbished.

Innovative new strategies should be developed to meet consumer demands and tastes abroad. A widely used example is of Kinno, which contains many seeds despite being of superior quality; therefore, a program was launched to produce a seedless variety for export. In order to meet international standards, wide-ranging quality checks need to be put into place for homogenous good quality products. Also aggressive export promotion and marketing programs need to be established to endorse Pakistani products.

## **CONCLUSION**

The agriculture sector has been neglected for decades. However the current government has recognized the conundrum facing the sector, refocusing its attention towards its progress. Finance Minister Ishaq Dar stated: '*...agricultural resources should be developed sensibly. The farm surpluses for exports required competitive prices and efficient development and utilization of existing resources.*' Thus, the government will focus on 'agriculture manufacturing' providing the private sector with fiscal stimulus, eventually achieving mechanization of farms to increase the existing low agricultural productivity.

Agriculture for the moment is under the spotlight, which is a welcome relief. Only time will tell, if the government is able to bring in the much needed development.





## Economic Snapshot

Fiscal year 07-08															
	Units	Feb	March	April	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
<u>Inflation</u>															
Headline Inflation	%	7.39	7.67	6.9	7.4	7.0	6.4	6.5	8.4	9.3	8.7	8.8	11.9	11.3	14.1
Core inflation	%	5.72	5.42	5.2	4.7	5.1	6.0	6.0	6.1	6.5	6.9	7.2	7.8	8.1	9.3
Food inflation	%	9.99	10.74	9.4	11.3	9.7	8.5	8.6	13	14.7	12.5	12.2	18.2	16	20.6
Non-food inflation	%	5.59	5.54	5.2	4.7	5.1	4.9	4.9	5	5.4	5.9	6.3	7.3	7.8	9.4
<u>T-bill (Wgt Avg)</u>															
3 month	%	8.64	8.65	8.69	8.69	8.69	8.69	9.05	9.05	9.05	9.05	9.09	9.09	9.38	9.59
6 month	%	8.81	8.82	8.9	8.9	8.9	8.9	9.12	9.12	9.12	9.21	9.29	9.29	9.61	9.86
12 month	%	9.01	9.01	9.08	9.10	9.16	9.16	9.39	9.39	9.39	9.4	9.49	9.44	9.87	10.13
<u>External Sector</u>															
Export	Mln US\$	1,421	1,536	1,446	1,540	1,583	1,434	1,475	1,463	1,593	1,524	1,500	1,634	1,591	1,816
Import	Mln US\$	2,103	2,070	2,159	2,190	2,373	2,423	2,206	2,150	2,555	2,864	2,910	3,316	2,909	3,458
Trade balance	Mln US\$	(682)	(534)	(713)	(650)	(790)	(989)	(731)	(687)	(962)	(1340)	(1410)	(1637)	(1637)	(1637)
<u>Remittances</u>	Mln US\$	457	520	513	537	505	495	489	516	580	505	479	557	502	602
<u>Forex Reserves</u>	Mln US\$	13,378	13,624	13,661	13,778	15,182	15,723	16,106	16,145	16,354	15,807	15,589	14,657	14,031	13,232





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