RESTRICTED

Report No. SA-15a

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CURRENT ECONOMIC POSITION AND PROSPECTS OF PAKISTAN

(in four volumes)

VOLUME I

THE MAIN REPORT

July 17, 1970

South Asia Department

CURRENCY EQUIVALENTS

Rs. 4.762	=	US$ 1.00
Rs. 1.00	=	US$ 0.21
Rs. 1.0 million	=	US$ 210,000
Rs. 1.0 billion	=	US$ 210 million

This report is based on the findings of an Economic Mission which visited Pakistan in March-April 1970. The Mission was composed of the following members:

Manfred G. Blobel	-	Chief of Mission
Robert J. Maubouche	-	Deputy Chief
Hendrik van der Heijden	-	Deputy Chief
Tsuneo Nakauchi	-	General Economist
Richard J. Niebuhr	-	General Economist
J. Hanns Pichler	-	General Economist
Willem L. van der Valk	-	General Economist
Per Eklund	-	Fiscal Economist
Michel E. A. Hervé	-	Agriculture Specialist
Richard C. Taylor	-	Foodgrain Specialist
Michael Herve (UNESCO)	-	Manpower/Education Specialist
David I. Miller	-	Family Planning Specialist
Warren Robinson (Consultant)	-	Family Planning Specialist
Risto Harma	-	Agricultural Economist
Miss Geraldine M. Prefontaine	-	Mission Secretary, Pakistan
Mrs. Olga P. Snow	-	Mission Secretary, Washington

The Mission was also assisted by:

Harold G. Brandreth	-	Transport Economist
Michael R. Lav	-	Transport Economist
James J. Fish	-	Power Specialist

CURRENT ECONOMIC POSITION AND PROSPECTS OF PAKISTAN

TABLE OF CONTENTS

VOLUME I: MAIN REPORT

Page No.

* * * * *

BASIC DATA

Area:

	Total (square miles)	Cultivated Area as % of Total
Pakistan	365,503	30.4
West Pakistan	310,376	24.5
East Pakistan	55,127	63.6

Population (1969/70 estimates)

	Total	Density per Square Mile
Pakistan	132 million	
West Pakistan	61 million	200
East Pakistan	71 million	1,290
Rate of Growth (1969/70)	2.8 percent	

Political Status: Member of U.N., Commonwealth, RCD (Regional Cooperation for Development; Pakistan, Iran and Turkey)

Gross National Product at Current Market Prices (1969/70): US$16,419 million

Real rate of Growth	1959/60 - 1964/65	= 5.5%
	1964/65 - 1969/70	= 5.7%
	1959/60 - 1969/70	= 5.6%
Per Capita GNP in	1969/70	= US$124 (at official parity rate)

Gross Domestic Product at Constant Factor Cost (1959/60 prices):

	1959/60	1969/70
Total	$6.6 billion	$11.4 billion
Of which, in percent:		
Agriculture, Fishing, Forestry	53.2	44.9
Mining and Quarrying	0.2	0.3
Manufacturing	9.3	12.2
Construction	2.1	5.5
Transportation and Communication	5.9	6.6
Public Administration, Defense	4.2	6.5
Other Economic Sectors	25.0	24.1

Percent of GNP at Market Prices	1964/65	1969/70
Gross Investment	18.3	13.5
Gross Savings	11.8	9.9
Balance of Payments Current Account Deficit	6.5	3.6
Government Taxation Receipts	8.4	8.9

Resource Gap; Percent of Investment	
1964/65	35.5
1969/70	27/4
Average Third Plan	29.9

Money and Credit (Rs. Million)

Conversion: 1 Pakistan rupee = US$0.21
(Par Value): 1 US dollar = Rs. 4.76

Relationship to large monetary or customs area: member of sterling area.

	At Feb. 28 1970	Percentage of change Feb. 1969 - Feb. 1970
Total Monetary Assets	19,479	+ 8.0
Scheduled Banks' Credit to Private Sector	10,904	+ 4.6
Claims on Government	9,951	+ 7.6
General Wholesale Price Index		+ 2.8

Government Operations (Rs. Million)	1964/65	1969/70	Annual Rate of Change 1964/65-1969/70
Revenue Receipts	5,621	9,412	+ 10.9
Non Development Expenditures	3,988	6,660	+ 10.8
Revenue Surplus	1,633	2,752	+ 11.0
Capital Expenditures	3,668	7,261	+ 14.8

	1960/61	1969/70	Annual Rate of Change 1960/61-1969/70
External assistance to public sector of which	1032	2833	+ 11.9
Commodity aid	505	928	+ 7.0
PL 480	160	476	+ 12.9
Project and technical assistance	367	1429	+ 16.3

External Public Debt (US $ Million)	As of June 30, 1969
Total external public debt	3,647
Net of undisbursed	2,549
Total annual debt service (1968/69)	153
Of which:	
amortization	94
interest	59
Debt service as % of foreign exchange earnings	17.7

Balance of Payments (Rs. Million)	1960/61	1969/70	Annual Rate of Change 1960/61-1969/70
Total merchandise exports	1,877	3,304	+ 6.5
Invisible receipts	409	1,090	+ 11.5
Total foreign exchange earnings	2,286	4,394	+ 7.5
Total imports c.i.f.	3,431	6,338	+ 7
Invisible payments (incl. interest payments on official debt)	382	1,380	+ 15.3
Current account deficit	1,527	3,324	+ 9

	Second Plan	Third Plan
Commodity concentration of export (raw jute and raw cotton)	44%	39%
Official exchange reserves (March 1970)	US $ 342 million	
Net use of IMF Credit	US $ 77 million	

SUMMARY AND CONCLUSIONS

(i) Since Pakistan's present Administration under President Yahya Khan came to power in March 1969, its foremost objective has been to create in the country conditions conducive to the emergence of a new and viable order compatible with preservation of the unity of the country. This is essentially a political process, involving the creation of a political structure to serve as the channel for reaching a new national consensus. The Government's over-riding concern has been with this political task.

(ii) At the time this report is being written, the Government is still considering how to give concrete shape to its economic and social objectives, the means by which to achieve them, and how to raise the resources required. These are complex issues, and the difficulties of resolving them have delayed completion of the Fourth Five-Year Plan due to be launched on July 1, 1970. They have also effected preparation of the Annual Plan and the Budget for 1970/71 which were announced only at the very end of June, too late to be taken into account in this report. Thus, in looking to the future, this report is essentially concerned with elucidating issues and identifying constraints standing in the way towards their resolution.

Recent Economic Developments and Policies

(iii) Pakistan's economic performance in 1969/70 -- the terminal year of the country's Third Five-Year Development Plan -- did not remain unaffected by the political and social disturbances that took place in early 1969 and by subsequent events. The picture that emerges suggests a low level of general economic activity, and the present official estimates, which put growth of GNP in 1969/70 at 5.1 percent are probably too optimistic. Agriculture is the only major sector -- apart from public administration and defense -- which expanded faster than in 1968/69, thanks mainly to its recovery in East Pakistan from a weather-induced slump the year before. In all other sectors, the pace of growth slowed down, in some cases, such as manufacturing, to a considerable extent.

(iv) Particularly weak spots in economic performance were investment and exports. Preliminary estimates indicate that fixed capital formation in current prices was lower than in the previous year. In view of rising costs, particularly on account of higher duties, investment in real terms must have declined considerably. Basically, this continuing decline reflects the continuing severe resource constraint under which the economy has labored over the last several years. However, political uncertainties were no doubt a contributing factor.

(v) For a larger part of 1969/70, exports were actually moving below the level of previous years. However, they recovered towards the end of the year, and present estimates suggest that over the twelve-month period they will be marginally higher than last year. This sharp decline in the rate of growth had its origin not in manufactures which in fact continued to rise substantially, but in primary commodities. Especially exports of cotton and jute fell markedly. Here, speculation was probably a contributing factor, but mainly their poor performance reflects the lack of proper attention by Government, in the form of supporting programs and policies as well as in assuring remunerative prices.

(vi) Balance of payments developments generally underscore the low level of activity last year. It now appears that imports declined, too, and particularly heavily in East Pakistan. Were it not for a small decline in disbursements of external assistance, receipts would have balanced payments. As it is, it appears that Pakistan will sustain a small loss in net exchange assets. However, this is unlikely to exceed the SDR's accruing to Pakistan during the year, so that net assets will remain roughly at US $300 million, equivalent to about 2½ months' exchange payments and four months' non-aid financed payments.

(vii) The principal objective of the Budget for 1969/70 was to assure the continuity of Government operations within a framework of economic stability. On the whole, the budget was conservative and the policy measures developed in response to the disturbances were in the right direction. Whether on the tax, or on the expenditure side, these measures were a reflection of the Government's desire to develop -- in steps -- more appropriate fiscal policies. These measures were taken partly with a view to compensating for the inelasticity of Pakistan's tax structure with respect to increases in production and incomes, but also prompted by the slack in Government revenues resulting from sluggish developments of production and incomes.

(viii) Present estimates suggest that total revenue receipts of the Government, Central and Provincial, in 1969/70 will be Rs. 1,000-1,100 million, or about 13 percent higher than in 1968/69. Yet such is the degree of financial stringency in the public sector that even revenue increases of this magnitude provided little room for maneuver, in particular for giving significant effect to a redirection of Government spending. Thus it is now estimated that of the total increase in revenue roughly two-thirds will have gone into provisions for additional non-development outlays, largely to maintain current services in the face of higher salaries, defense outlays (up nearly Rs. 300 million, mainly because of increased pay), and interest payments (up Rs. 120 million). As a result, the revenue surplus did not increase very much. In addition, disbursements of external assistance to the public sector declined. In sum, resources were available only for a small increase -- about Rs. 200 million -- in public Plan development outlays, barely sufficient to maintain expenditures in real terms. This made it possible to provide for some increase in spending on social development, but not, it now appears, to raise development expenditures in East Pakistan.

(ix) On the whole, while 1969/70 saw some action being taken towards improvement of the fiscal situation and movement in new directions, it was not a year of decisive fiscal reform. Nor can it be said that the Government made full and effective use of fiscal policy in bolstering the level of economic activity. As early as August 1969, pressures for action grew, as there were no signs of a dramatic resurgence of private investment and exports as well as imports remained below last year's level. After assessing the situation, the Government took action to raise total effective demand in the economy. In November 1969 additional expenditure appropriations amounting to Rs. 430 million were decided upon, equivalent to 7 percent of expected revenues. These appropriations probably proved useful in keeping a number of projects and programs going, whose local currency requirements had been under-estimated in the Budget, but their impact on the economy as a whole must be regarded as negligible.

Review of Third Plan Performance

(x) It is not an easy task, looking back over the past five years, to evaluate the accomplishments and weaknesses of Pakistan's Third Plan period 1965-1970. Clearly, if Plan targets were taken as the basis, the large shortfalls that occurred would indicate that performance was highly unsatisfactory: GNP growth 5.7 percent against 6.5 percent; a sharp decline in the investment level to about 13 percent, against the planned increase to 20 percent by 1969/70; public development outlays 30 percent short of the target in current prices and considerably more in real terms; widening, instead of narrowing, of inter-regional and inter-personal income disparities, combined with stagnation, against the planned major advance, in social services; marginal savings, instead of being considerably above the average rate, significantly below; towards the end of the Plan period, even exports, that had so far done well, got into difficulties, while the level of debt service was becoming a matter of serious concern to the Government and those providing assistance.

(xi) Yet clearly, judgements on performance must take into account the circumstances which, over the last five years, were difficult for those managing Pakistan's economy. There was the war with India, with its immediate effects and the quantum jump in military outlays. There were two poor harvests in succession, with their disruptive impact. And there were the shortfalls in the amount and the worsening terms of external assistance, which contributed to the stringency of resources. In these circumstances, it was a task of formidable dimensions to maintain the momentum of economic and social development. Clearly, too, the Government took measures to protect economic growth. Incentives and resources were shifted to agriculture, which promised the greatest productive return, and away from manufacturing, previously the main engine of growth. Measures were taken to raise additional revenue, and adjustments were made in favor of manufactures for export, so as to protect export growth.

(xii) In quantitative terms, accomplishments are quite impressive. GNP grew quite respectably, despite the declining investment rate in West Pakistan. Development outlays rose in East Pakistan. Revenue measures raised double the amount of Rs. 3,000 million set as the goal. Cumulative exchange earnings are estimated at 90-95 percent of the target which was considered ambitious when the Plan was launched. Yet, in each of these cases a qualification is called for. In the case of economic growth, reservations center on its distribution, inter-regionally and inter-personally. In the field of public finance, the resources raised proved inadequate in the face of a very inelastic tax structure and sharply rising claims for defense and debt service which made orderly execution of programs and projects very difficult. In the case of exchange earnings, most of the increase was pre-empted by much higher military imports and fast rising debt service payments.

(xiii) In sum, one looks back with some ambivalence at the Third Plan period and its accomplishments. However, the essential purpose of any review of past performance is to assess the size of the future task of providing the country with effective management of its economy in pursuit of its economic and social objectives. Examining performance with this purpose in mind, one cannot but be critical. Perhaps, the critical shortcoming in the way the

Government dealt with its problems in the Third Plan period was that the action taken -- whether in devising means of achieving stated objectives, or in scaling down objectives that had proved unattainable -- was never quite enough to put development on a reasonably secure basis and thereby to get away from ad hoc adjustments, with their unsettling effects on both the private and public sector. Creation of such a basis has now become indispensable, if the Government is to cope effectively with the difficult problems of economic management that lie ahead. Thus, the accent now has to be on basic reform in a number of important fields.

The Regional Disparity Problem

(xiv) There is no question that the disparity in economic growth between Pakistan's two wings has widened during the Third Plan period. Estimates indicate that West Pakistan's growth rate (at 6 percent per annum) was some 50 percent higher than that of the East (4 percent per annum). With so much more rapid growth in the West, most of the increase in GDP was generated in West Pakistan and East Pakistan's share in the total product of Pakistan declined from 43.8 percent in 1964/65 to 40.6 percent in 1969/70. That disparity has since become, if not the principal, then at least the most hotly debated economic and political issue confronting the authorities.

(xv) However, while disparity is an unquestionable fact, it is not altogether clear that as such it can serve as a very useful analytical tool in efforts to develop a constructive approach to the problems of East Pakistan. In essence, these lie in very slow growth in the East and the fact that it has so far not been possible to develop a strategy that in the circumstances of East Pakistan has proved effective in producing growth at a pace significantly above the increase in population. Efforts in this direction have probably been hampered by concentration on nation-wide economic policies which did not take sufficient account of the significant differences that exist between East and West Pakistan. In the context of national policies strongly oriented towards using the private sector as the main engine of growth, West Pakistan's comparative advantages tended to become accentuated.

(xvi) In short, a regional approach designed to adapt the general strategy to regional conditions did not emerge. Thus, the very large allocation for private investment in East Pakistan was supported by only very limited fiscal incentives which proved ineffective in raising investment anywhere near the planned level. Nor was it ever quite clear that heavy reliance on the private sector was regarded as desirable by the authorities of East Pakistan, particularly if it involved giving entrepreneurs from West Pakistan a large role in the economy of the East wing. Moreover, similar efforts to give East Pakistan's economy a major push through a larger increase in public development outlays did not prove as effective as had been hoped. It could, of course, be argued that in view of the very limited capital stock in the Province in the mid-1960's, particularly in infrastructure, doubling public development outlays in the period of the Third Plan over the level of the Second Plan was not sufficient to provide the push that was needed. Yet, while it is undoubtedly true that investment in East Pakistan needs to be stepped up greatly if the basis is to be created for sustained rapid growth in the longer run, within the span of any single Plan period growth must come mostly from existing assets.

(xvii) It is here, in the failure so far of existing assets to yield more output, that the main explanation lies for East Pakistan's continuing slow growth over the last five years; and it is on this area that efforts must concentrate in the Fourth Plan period if growth is to accelerate as it must. This applies particularly to agriculture which, as the source of 60 percent of East Pakistan's regional product, holds the key to the over-all pace of economic growth in the Province. Some advance was made made in this direction over the last few years, but in the absence of high-yielding varieties suitable for a substantial part of the cultivated acreage, the possibilities were too limited to lead to a decisive breakthrough. Such possibilities now appear to exist and, if exploited to the full by a concentrated effort in terms of programs and policies, could enable East Pakistan to overcome the near-stagnation of its economy. To develop an effective strategy for agriculture, to create the conditions in which the private sector can play a substantial role in the economy, and to design a public development program that in terms of size and composition maximizes the realization of growth possibilities in the short run, while also laying the basis for future growth, are tasks which will put the ingenuity of Pakistan's planners to a severe test, in which this must succeed if the Government is to meet one of the principal challenges -- if not the principal challenge -- it is confronting today.

The Social Problem

(xviii) Over the past ten years or so, Pakistan's development policies have put primary emphasis on programs designed to achieve a high rate of economic growth through large investments in infrastructure and in the directly productive sectors of the economy. In view of Pakistan's poverty at the beginning of this decade -- which still persists -- emphasis on rapid growth of production was appropriate because, above all, Pakistan needed to generate additional resources in support of economic and social development over the longer term. Fairly rapid growth of the economy was indeed obtained and per capita income rose by some 2-2.5 percent per annum, but there has been a discrepancy between observable improvement in the standard of living of the great majority of the population, which remains one of the lowest in the world, and the widely acclaimed achievements of Pakistan in general economic growth.

(xix) Most of the benefits of economic progress went to a small minority of larger farmers and industrialists, while the emerging middle class -- the Civil Service, the Army and white-collar workers -- received most of the benefits from the modest social programs. This was so because of the large incentives and generous subsidies that were made available to larger farmers and industrialists as an inducement to save and invest. As a result, the tax structure was eroded and the Government deprived of resources that might otherwise have been available for social programs. In fact, the regressiveness of Pakistan's taxation structure -- personal income taxation is hardly significant in Pakistan and collections compare unfavorably with many countries of Latin America -- made the after-tax income distribution even more skewed. Finally, the stress in expenditure programs on relatively high-cost public housing, medium- and higher-level education and on urban health facilities meant that most of the poorer sections of Pakistan's population benefitted only marginally from the meagre social development programs.

(xx) In 1969, dissatisfaction with the Government's neglect of the social aspects of development was violently expressed; clearly the policies of the past decade could not be continued. A number of measures were taken, including a sizeable wage increase for unskilled industrial workers under legislation introducing a system of minimum wages, and a new labor policy was announced. Proposals were made for a new educational policy, the 1969/70 Budget introduced some tightening of the generous system of income tax concessions, and there was recognition of the need to devote more resources to social development in the Fourth Plan. Proposals now being discussed center around four possible lines of attack on the problems of social justice: first, measures to curtail private control over property, including nationalization of industry and banking institutions; second, a push towards greater direct taxation; third, the establishment of specific targets for mass consumption and for employment; fourth, substantial increases in outlays on social programs. However, no firm comprehensive program has yet emerged which is hardly surprising, considering how profound a shift in emphasis in Government policy is involved. An added difficulty has been concern that too much of a shift towards social objectives might take place, to the detriment of economic growth.

(xxi) For a country at Pakistan's level of poverty pursuit of economic growth must remain the principal objective of policy. However, the assumption of a sharp conflict between economic growth and social justice is clearly debatable. There is scope for measures in favor of greater social justice that would not detract from the objective of economic growth. Measures designed to facilitate the entry of new entrepreneurs into manufacturing would not only meet social needs, but would also be desirable from the economic point of view. Clearly, too, there is not only scope, but also a pressing economic need for raising the productivity of smaller farmers who are the mainstay of agriculture in East and West Pakistan, and in the West must be brought into the orbit of the "Green Revolution" if rapid growth of output is to be sustained.

(xxii) Similarly, as regards taxation there does not seem to be any conflict between the requirements of social justice and those of economic growth. Both point to the urgent need for making direct taxation a major integral part of the Government's revenue system. These measures could go far in raising resources for development, while also introducing more equity into the social framework of Pakistan. Finally, as regards social programs as such, there are large areas where social and economic objectives coincide. This is so in education where the present system provides a very weak basis for achieving improvements in productivity in the long run. To a considerable extent, it also applies to health programs, particularly in the rural areas where health standards are low.

(xxiii) If greater emphasis on social programs is to serve the purpose of increasing social justice, the programs will have to be designed to ensure that they benefit the low-income groups. Also, effective implementation will require administrative reform. In part, this is a matter of raising the administrative and executive capability of the departments and agencies concerned. In addition, it will also be necessary to integrate Central and Provincial programs with those operated by local government bodies.

The Internal Resource Problem

(xxiv) In the Third Five-Year Plan period, Pakistan has not done well in the mobilization of domestic resources. In 1964/65 domestic savings stood at 11.8 percent of GNP, which, with a sizeable inflow of external assistance, permitted an investment rate of 18.3 percent. Public savings reached 1.8 percent of GNP which together with a high level of private savings and external resource inflows ensured a high rate of investment, both public and private. The picture changed radically in the Third Plan. Public savings declined to 1.4 percent of GNP. In contrast to the situation in the first half of the 1960's, foreign savings no longer compensated for low domestic, and particularly public savings, as they fell from 6.6 percent of GNP in 1964/65 to an estimated 3.7 percent in 1969/70, and the public resource position became critical. Inadequate revenue, shortfalls in external assistance including PL 480, in combination with high defense spending and increasing allocations to the Indus Basin works, led to shortfalls in operating expenditure, particularly in the social sectors, in public savings and therefore also in Plan expenditure.

(xxv) Fiscal performance has been far from satisfactory. The ratio of tax proceeds to GNP was only 8.4 percent in 1964/65, and - although new measures were taken on a substantial scale - it reached only 8.9 percent in 1969/70, a figure that is very low, both in terms of Pakistan's needs and in comparison with other countries. On the basis of international comparisons, Pakistan's ratio of taxes to GNP should at least amount to 15 percent. The structure of taxation remains inelastic with respect to growth in incomes and production and contains many elements of inequity, as witnessed by the sharp relative drop in personal income taxation and the preponderance of indirect taxes in total Government revenues. In the face of these shortcomings in revenue performance, expenditures on defense remained high through the entire Plan period and consistently accounted for some 40 percent of non-developmental expenditure. Defense expenditure now absorbs 3.4 percent of GDP, up one point from where it was just before the India/Pakistan war.

(xxvi) To make up for low revenues and high defense expenditures, the rate of growth of current expenditures other than defense was consistently kept low so as to enable development expenditures to rise from some Rs. 4 billion in 1964/65 to Rs. 6 billion in 1969/70. While the rationale for this policy was understandable, it appears to have been pushed further than was consistent with efficient use of resources. It led to inadequate provision for current expenditures, which against the background of rising capital expenditures meant that newly created facilities could either not be staffed adequately or not be maintained properly. The consequences were poor utilization of installed capacity as well as wastage of resources resulting from a reduction in the useful life of assets, which contributed to raising the cost of investment in Pakistan.

(xxvii) There is, undoubtedly, much scope in Pakistan for mobilizing additional resources through new revenue measures, through raising the efficiency of the public undertakings, through raising the current surplus of public utilities such as WAPDA in West and East Pakistan - where rates of financial return are unusually low - while keeping in check growth of non-essential current expenditures. There is also great need for such measures, not only to provide the public sector with resources commensurate with its role in Pakistan's economic and social development which, in the light of recent events will perforce have to expand, but also to make taxation an instrument for the gradual redistribution of income which is needed if social progress is to become a reality. At the same time, measures are needed to stimulate private savings through a more active use of interest policy and other measures. In addition, opening up new areas of investment to the private sector would help considerably.

The External Resource Problem

(xxviii) Developments in Pakistan's balance of payments during the Third Plan period present a very mixed picture. It now appears that Pakistan comes very close to reaching its target of aggregate export earnings over the five-year period, at 90-95 percent of the amount projected originally. This represents a considerable achievement. In respect of merchandise exports, it was made possible by rapid growth of manufactures. In contrast, exports of primary commodities more or less stagnated at a level somewhat below that of 1964/65. The cause of the poor performance of primary exports lay on the supply side where output did not grow fast enough to provide for the rapidly increasing off-take of manufacturing and expand sales abroad. This situation reflects the unfavorable treatment accorded export agriculture in the Government's exchange policy, combined with the failure to develop comprehensive programs for the promotion of agricultural production for export, particularly cotton and jute. The effects of past neglect began to make themselves felt strongly in 1969/70. Although speculation was probably a contributing factor to the slump of primary exports that year, the basic problem was insufficient supplies, to which attention now needs to be given as a matter of urgency.

(xxix) The problems of economic management on the export side were dwarfed by those on the payments side. A rough indication of the dimensions of these problems is given by the fact that the amount of exchange actually available for financing normal imports fell short by about US $1,500 million, or 30 percent, of the projections. This shortfall arose in roughly equal proportions out of a deficiency in disbursements of external assistance and out of additional claims on exchange resources associated with military purchases, food imports and somewhat larger debt service payments than projected. It would probably have been possible to deal with either of these shortfalls, without significantly disrupting the orderly advance of the economy, but in combination they proved a problem that could not be handled without affecting the economy severely.

(xxx) In an effort to ease the immediate difficulties, Pakistan resorted to more borrowing abroad on hard terms than was prudent, so that debt service obligations rose sharply, causing considerable concern to the Government and those providing assistance. Not surprisingly, either, ad hoc adjustments of the import regime were used for dealing with the immediate balance of payments situation. The problem is that, in managing the country's exchange resources, the Government never went beyond short-term expedients, and ad hoc adjustments, including increases in the effective cost of exchange but also through an elaborate system of quantitative restrictions, became almost the chief instrument for keeping payments in line with receipts and for allocating available resources among various users. Moreover, throughout this period the Government was unable to resolve the conflict between the principal objective of its development strategy -- the achievement of growth through better utilization of existing capacity rather than through additions to capital stock -- and an exchange policy that, through adjustments in the effective rupee cost of imports and through quantitative restrictions, threw the major burden of adjustment to the short-fall in resources onto imports of raw materials rather than capital goods. Neither of these aspects of Government policy made it easier for the economy to adjust itself, in reasonably efficient fashion, to the sharp change in external circumstances.

Development Strategies

(xxxi) As regards the future management of the economy, probably the foremost problem is that of mobilizing additional resources, domestic as well as foreign, to support the substantial expansion of public sector activities that is called for and to meet the requirements of the economy in general for strengthening the base for economic advance. One obvious conclusion is that measures directed towards mobilizing resources -- domestically, in the form of public revenues as well as total savings, externally in the form of exchange earnings -- must loom large in any program of action designed to break through the constrictions that have thwarted so many of the aspirations enunciated for the Third Plan period.

(xxxii) The other, perhaps less obvious conclusion, relates to economic growth as an objective of policy. An acceleration of growth is, in any event, imperative in East Pakistan if frustrations of long standing are to be alleviated. Furthermore, there is a strong case for seeking rapid economic growth in conjunction with the compulsion for a massive effort to mobilize additional resources, because it is much more difficult to obtain more resources out of a given income than out of increments to income. It is this consideration that argues strongly for strong efforts to keep regional income in West Pakistan growing rapidly -- quite apart from the fact that, comparisions with East Pakistan aside, West Pakistan is still far too poor to be able to afford relaxation of efforts to maintain growth at a fast pace. The essential argument for fast growth in West Pakistan is that it is there that most of the resources will have to be generated -- in the form of public revenues, savings and exchange earnings -- which will be needed, in the context of net transfers from abroad at best a remaining constant, for effecting the shift in emphasis in investment towards East Pakistan.

(xxxiii) Concern over Pakistan's social problems will have to be translated into ameliorative action. This need not mean massive diversion of resources to non-economic ends. To provide opportunities in future is not only a social but also an economic need in important areas of economic activity, particularly in agriculture, and must constitute an important objective of economic policy. At the same time, however, social services, particularly in education, health and housing, will need to be expanded greatly, and claims on resources for these purposes will be very substantially larger than they have been in the past, circumscribing the scope for increasing investment in more directly productive activities.

(xxxiv) Compulsions for increasing the investment rate in East Pakistan raise difficult problems for the management of the economy of Pakistan as a whole. Some of them are obvious -- East Pakistan's present capital stock in infrastructure is very small -- in absolute terms and even more so in relation to the region's difficult physical environment; much of the investment will, therefore, have to go into improving the infrastructure: that is, it will create conditions conducive to future growth, but it will not produce growth by itself. It is, therefore, quite likely that, with a rising share of total investment going to East Pakistan, investment on the whole will take longer in contributing to economic growth. Several implications follow. As far as East Pakistan is concerned, great care will have to be taken in composing the investment program to balance short- and long-term considerations. As for Pakistan as a whole, the aim should be to raise investment in East Pakistan within the context of a rising over-all investment rate, that is to try to avoid a further decline in the investment rate in West Pakistan which has already fallen from above 20 percent to around 15 percent over the past 5 years.

(xxxv) Among the problems that are perhaps less obvious, the most important are those that derive from the fact that the regional economies of East and West Pakistan are not contiguous and -- because of the difficulties and cost of transport and communications -- do not form part of a genuinely integrated economy. A shift in investment towards East Pakistan would undoubtedly be facilitated by promoting regional specialization, particularly in manufacturing, and the expansion of inter-wing trade to which it could give rise, would make it possible to supplement net transfers through external trade -- where by all indications the resource position will remain very tight -- by net transfers through inter-wing trade. Such objectives would obviously have to be reflected in the regional pattern of investment.

(xxxvi) In this context, one further point about the pattern of investment may be worth making. It relates particularly to West Pakistan. If the process of transition referred to above is to proceed with a minimum of economic disruption, West Pakistan's economy will have to generate over the next several years very substantial surpluses of commodities for shipment abroad as well as to East Pakistan. It is doubtful whether this could be achieved if private investment there in real terms were kept below the level of the past five years, as proposed.

(xxxvii) There is one final point that needs to be made quite explicit. Even more so than usual within a five-year time horizon, the desired rate of economic growth and desired rate of investment are essentially two separate objectives. In terms of economic management, they have to be tackled as such. This means that economic growth has to be obtained very largely by means of making more productive use of existing assets, and economic policies and programs intended to promote growth will have to be focussed accordingly. There are ample opportunities for Pakistan to do this.

A Possible Economic Framework

(xxxviii). The Government is now under strong compulsions to re-order the objectives of Pakistan's economic and social development. Under any circumstances, such re-ordering of objectives would have entailed profound changes in the structure of economic policies and programs; against the background of the stringent resource constraint under which Pakistan labored through the end of its Third Plan period, dramatic changes will be needed. Prolonged debate about the allocation of resources as between East and West Pakistan has delayed thorough examination of the macro-economic framework within which to formulate policies. Therefore, little in the way of concrete policies has yet been made explicit. Consequently, it is not possible now, on the basis of an evaluation of a framework of policies already decided upon, to assess the likely course of economic developments over the next five years. However, it may be useful to outline what now seem to be the major elements of an effective strategy.

(xxxix). The first such element is continuing pursuit of rapid economic growth which in the circumstances will have to come chiefly from better utilization of existing assets. Acceleration of growth is, in any case, of foremost importance for East Pakistan. However, within the resource constraint of the economy as a whole, continuing rapid growth is also indispensable in West Pakistan if it is to be able to serve as the main source for generating the additional revenues, savings and exchange earnings required to support the greatly expanded development effort that is needed economically and politically.

(xxxx). The second element is the investment rate which must rise above its present low level if Pakistan is to be able to sustain economic growth at a pace sufficiently higher than that of population to produce visible improvements in living standards. To this end, Pakistan must achieve a marginal savings rate of at least 19 percent - 22 percent in the West and 15 percent in the East -, as compared to 6-7 percent in recent years. Moreover, major action is required to raise the share of revenue in GDP, to which end additional resources through new measures will be needed in the order of Rs. 10 billion, one and a half times the amount actually raised during the last five years. Yet even with such efforts the investment rate could only be raised to 14.5 percent of GDP by 1974/75. Moreover, even such limited improvement is fragilely based, as it would practically be wiped out if the amounts and terms of external assistance were not improved sufficiently to maintain the net transfer of resources from abroad at the present level of US$500-550 million a year.

(xxxxi). The third element concerns the regional division of investment resources. The obvious need here is to raise the investment rate in East Pakistan above its present low level of about 10 percent. Within the continuing overall resource constraint this could be achieved by depressing the investment level, but such a course of action would be inconsistent with the overall need to use growth in West Pakistan as the main source of additional resources for development. However, this consequence can only be avoided if inter-wing trade is developed into an important instrument of policy, designed to play a substantial role in transferring resources to East Pakistan.

(xxxxii). Altogether, it might be possible for Pakistan to achieve total investment in the order of Rs. 65,000 million over the next five years, as compared to Rs. 47,000 million in 1965-70 and to raise total development outlays close to Rs. 70,000 million. However, it cannot be stressed too strongly that the magnitudes suggested here have little basis within the present framework of policies and achievement of anything like the objectives set forth here - in terms of economic growth, recovery of investment and the shift in the allocation of resources towards East Pakistan - is crucially dependent upon action in the realm of policy.

(xxxxiii). However, while this task is essentially the Government's, there is a significant contribution that those providing assistance to Pakistan can make. This applies, above all, to need to so adjust aid policies that the absolute decline in the net amount of resources transferred from abroad, that would follow from continuing assistance in present amounts and on current terms, does not occur and that net transfers are, at least, kept at their present level of US$500-550 million a year. However, it also applies to the composition of assistance. Unless an increasing share of this assistance can be made available either to finance local currency expenditures or for non-project purposes, the scope for Pakistan to use its existing assets more productively or to shift the regional allocation of investment resources towards East Pakistan (where most projects will have a high local currency content) will be circumscribed severely. This is particularly important in the immediate future, since structural rigidities - in the economy and in the aid pipeline - present strong obstacles to changing the pattern of resource allocation, regionally as well as sectorally.

CURRENT ECONOMIC POSITION AND PROSPECTS OF PAKISTAN

I. INTRODUCTION

1. In late 1968, an outburst of demonstrations and strikes broke the state of political stability, social calm and orderly economic progress that had characterized the decade since Ayub Khan came to power in 1958. From isolated incidents, disturbances spread quickly. In the West, they were largely confined to urban centers, but in East Pakistan they engulfed practically the whole region. As disorder spread, its intensity increased, culminating in eruptions of violence which at their peak in February/March, 1969, rendered the authorities incapable in parts of the country of maintaining a semblance of law and order, especially in the East wing. Confronted with such widespread and strong repudiation of his regime and unable any longer to exercise effective authority over the country, Ayub Khan resigned from the Presidency in early March. Martial law was declared and a Martial Law Administration set up, headed by General Yahya Khan who soon thereafter also assumed the Presidency.

2. Much has since been said and written, both inside and outside Pakistan, about the causes of these events, and there is no need here to trace in detail the actual course of events and to analyze the various forces at work. Suffice it to identify the principal factors involved. Numerically certainly the weightiest, and in its impact on developments during these critical months around the turn of the year probably the decisive factor was East Pakistan where political frustration - over the lack of control by East Pakistanis over the affairs of the Province, let alone influence commensurate with their share in total population on matters of national policy - went hand in hand with economic discontent - over the persistent absence of visible economic progress, in contrast to the rapid strides of West Pakistan, which was seen as a clear indication of the Central Government's bias in favor of the West and disinterest in the fortunes of the East wing. In West Pakistan, discontent with the political order centered on the lack of political rights, the dominance of Punjabis in political and bureaucratic matters, and the concentration of economic power. On the purely economic front, there were the urban workers, particularly in West Pakistan, who sought redress against an economic system that forced them to work at declining real wages and failed to produce adequate expansion in employment opportunities, while extending generous privileges to established entrepreneurs. Finally, there were those - mainly intellectuals and students - who protested against the lack of freedom.

3. These various forces combined into a formidable alliance, challenging all the major pillars of the established order. The political system was challenged for its authoritarian nature and failure to respond to popular aspirations, particularly as regards East Pakistan. The economic system came under attack for its failure to distribute equitably the fruits of economic advance, between regions and persons. And the bureaucracy - particularly its

elite corps, the Civil Service of Pakistan (CSP) - was accused of having become the aloof, high-handed and, at times, corrupt intermediary between the political and economic systems.

4. Since the present Administration under President Yahya Khan came to power, its over-riding objective, to which all others have almost invariably been subordinated, has been to create in the country conditions conducive to the emergence of a new, viable order, compatible with preservation of the unity of the country. On the political front, President Yahya Khan declared from the outset that he saw the primary function of his Government in paving the way to the restoration of elected government. Towards this end, a number of important steps have been taken during the last fifteen months. The first major step came in November, 1969, when the Government announced that direct elections, based on full adult suffrage, would be held on October 5, 1970, for a constituent assembly which would be required to draw up a new constitution within four months./1 Should it fail in this task, it would stand automatically dissolved, and new elections would be held. Furthermore, the Government accepted East Pakistan's demand that the principle of parity of representation between East and West Pakistan, which the 1956 constitution had introduced, be abandoned in favor of representation on the basis of population which gives East Pakistan an edge of 54:46 over the West wing.

5. The second major declaration of policy was made in March this year. It comprised three major elements. First, it set down several major principles which would be required to be embodied in the new Constitution, including in particular the following provisions: the Provinces are to be united in a federation which will ensure the independence, territorial integrity and national solidarity of the country; the Provinces are to have the fullest possible degree of autonomy, provided however that the Federal Government shall have adequate powers to discharge its external and internal responsibilities and preserve the country's independence and integrity; there will be periodic free and direct elections, based on adult suffrage and population; fundamental rights of citizens are to be laid down and guaranteed; Islamic ideology must be preserved and the head of state must be a Muslim. Second, it announced that, in response to popular demands, the Province of West Pakistan would be dissolved and replaced by four provinces - Baluchistan, North-West Frontier, Punjab and Sind - effective July 1, 1970. Third, it laid down that elections for the provincial assemblies would be held shortly after the national elections for the constituent assembly, but that provincial assemblies will not start functioning until the new Constitution has come into effect.

6. Together, these various declarations amount to a carefully balanced package intended to achieve two principal objectives: first, to facilitate, to the extent possible, speedy conclusion of the deliberations of the constituent assembly - by declaring certain constitutional principles to be outside the scope of consideration by the constituent assembly; by settling beforehand a number of potentially divisive issues, such as the election system, the principle of representation, and the future organization of West Pakistan; by limiting the scope for playing off national against provincial politics and harnessing the influence of provincial assembly members for the speedy conclusion of the task

/1 To allow for preparation of the elections, the ban on political activity was lifted as of January 1, 1970.

of the constituent assembly, by scheduling provincial elections shortly after the national ones, but making the functioning of provincial assemblies contingent upon the new Constitution having come into effect. Second, to ensure continuation of effective Government, by limiting the power of the National Assembly to framing the Constitution until the Constitution Bill is passed, authenticated and in force; by vesting in the President alone the power to authenticate the Constitution Bill, to amend the Legal Framework Order and to resolve any problem of interpretation; and by giving the present Government up to 90 days after the new Constitution has come into effect to hand over to an elected government.

7. On the administrative front, 303 Class I Civil Servants were suspended in December 1969 for suspected dishonesty or misuse of powers. With few exceptions, the suspended officers have since been either dismissed or retired from the service. This action amounted to a major purge of the higher echelons of the civil service, as it affected 15 percent of all Class I officers. Its effect on the administrative capacity of the Government is likely to be considerable, particularly in East Pakistan, but it was taken in order to demonstrate that the Government did not regard the Civil Service as immune against criticism and was prepared to act if it was found valid. In addition, the Government published the Cornelius report, prepared seven years ago, which recommends abolition of the CSP and major other reforms designed to disperse power at the local level among the functional departments and to increase mobility within the civil service. No action has, however, as yet been taken.

8. On the social front, too, the Government has taken a number of measures. As these are discussed in some detail in Chapter III, suffice it here to present merely a brief summary of major actions. To calm urban unrest, the Government enacted a minimum wate law which increased by 50 percent the wages of the lowest paid industrial workers. It also permitted the resumption of trade union activity. Furthermore, it put into effect anti-monopoly legislation and launched a drive against tax evasion. Finally, in July, 1969, it put forward for public debate proposals for a new educational policy which led to the adoption by Government of the New Education Policy in March 1970.

9. Throughout this period, since March, 1969, there has been considerable - and, on certain issues, fierce - debate on economic objectives and the future shape of economic policy. However, in contrast to other areas, much of this debate has not yet led to concrete action. The exception was the decision in 1969/70 to make a major effort to enable East Pakistan to expand public development outlays and, to that end, to raise a considerable amount of additional revenue. As it turned out, this effort met with only limited success, largely because increases in government salaries and unexpectedly large demands on the Government for providing rupee financing for Tarbela pre-empted a significant part of the additional resources raised. In any event, most of the basic issues were debated less in the context of immediate action, but rather centered around the Fourth Five-Year Plan, due to take effect July 1, 1970, which had been under preparation since 1968.

10. During the past fifteen months, as the political and economic debate proceeded both within and outside the Government, the approach to the functions of this Plan and its nature changed several times. There were those who argued that the preparation of the Plan was a prerogative of the elected government to come and that therefore all preparatory work should be suspended, pending installation of the new Government, while temporizing in the meantime with annual planning. On the other hand, there were those who contended that suspension of long-term planning would very seriously jeopardize the rational approach to economic management, which the Government had spent years to develop and gain acceptance for, and might so erode the planning machinery that it would be difficult to resurrect later. Considerable debate also centered on the question whether, if a Plan was to be prepared, it should contain essentially an exploration of various alternative courses of action on major issues, or whether it should present a firm framework for action.

11. In the end, the Government decided, in the interest of continuity of the process of planning and economic decision making, that the Fourth Five-Year Plan be launched as originally scheduled on July 1, 1970, and that the Plan should provide a firm set of objectives and guidelines to Government action. In accordance with this decision, a draft Outline was prepared and submitted to the National Economic Council (NEC) in early February this year. From the NEC meeting emerged instructions to the Planning Commission to strengthen the emphasis in the Plan on measures to reduce the regional disparity in incomes, particularly between East and West Pakistan, to devise a concrete package of programs and policies to further social justice and to re-examine the possibilities of mobilizing additional resources to support a higher level of development outlays than proposed in the Outline. Furthermore, the Planning Commission was asked to set up several panels of independent experts to review the proposals incorporated in the Outline, including in particular a panel of economists drawn from East and West Pakistan to examine the macro-economic framework of the Plan.

12. Not surprisingly, perhaps, it was the deliberations of the panel of economists that revealed how difficult it was to examine issues of economic objectives and policy with professional detachment and divorced from the stresses and strains of transition in the political order, particularly when so much of the impetus for political change had come from frustration of economic aspirations. Thus, the panel's discussion centered almost exclusively around the issue of regional income disparity, its causes and feasible courses of action towards its reduction. In the end, the panel was not able to agree on a joint report and recommendations to the Government, and it was left to the Planning Commission to devise a compromise and to the NEC to adjudicate the issue. The NEC decision, in early June, went quite far towards accepting the views of the East Pakistan economists.

13. Understandably, at the time this report is being written, the Government is still considering how to give concrete shape to its economic and social objectives, by which means to achieve them and how to raise the resources required. Concurrently, work is proceeding on the Annual Plan and the Budget for 1970/71 which are to be announced at the end of June. Thus, in looking to the future, this report is essentially concerned with elucidating issues and identifying constraints standing in the way towards their resolution.

14. One further important point should be noted. Less than two years ago Pakistan experienced a popular uprising which left hardly any part of the established political, social and economic order untouched. It was no doubt a traumatic experience for Pakistan which in ten years of political and social calm and steady economic advance had come to regard itself - and to be regarded by others - as almost immune to such upsets. Yet, what happened in Pakistan was not, of course, unique; on the contrary, it has happened in so many other developing countries that it probably has to be looked upon as a reflection of the strains and stresses of development.

15. The task before Pakistan today is the construction of a new, viable order. This is essentially a political process, involving the creation of a political structure to serve as the channel for reaching, by democratic means, a new national consensus. The present Government has conceived of its primary function as providing an umbrella for this process. This will mean, as it has meant over the past fifteen months, that the Government's overriding concern will be with this political task, including especially the preservation of the unity of the country, and that all other objectives will be subordinated to it. The recent upsurge of demonstrations and strikes, especially in East Pakistan, once again underscores the difficulty of this task.

II. RECENT ECONOMIC DEVELOPMENTS AND POLICIES

Introduction

16. Pakistan's economic performance in 1969/70 - the terminal year of the country's Third Five-Year Development Plan - did not remain unaffected by the political and social disturbances that took place in early 1969 and subsequent events. Private investment and exports in particular appear to have been affected. However, the picture that emerges from an analysis of data presently available also suggests a low level of general activity. According to preliminary official estimates, economic growth dropped from 6 percent in 1968/69 to 5.1 percent in 1969/70. However, this estimate may well turn out to have been too optimistic as it is difficult to reconcile with near-stagnation in exports, a decline in imports, and a fall, in real terms, of investment.

17. It is difficult now to gauge what influence Government policies on balance have had on the level of activity in the economy. This is partly a matter of statistics which become available only with a long lag and are often of questionable reliability. However, it also reflects considerable vacillation in the direction of Government policies as the authorities were obviously uncertain whether the situation they faced was one of excess or deficient demand. There was considerable anxiety early in the fiscal year about the combined effect on demand of a 50 percent wage increase granted to unskilled urban industrial workers, higher salary payments to the lower ranks of public employees and the reversal of the earlier decision to reduce the support price for wheat in West Pakistan. In anticipation of a strong rise in private demand, the exchange budget provided for a sizeable draw-down of exchange reserves, and in the conduct of the Government's fiscal affairs the authorities adopted a cautious attitude. However, as the year wore on, it became increasingly apparent that the expected upsurge in demand was not in fact materializing. Price movements showed little evidence of excess demand, except in East Pakistan. There, foodgrain prices rose sharply towards the end of 1969 because available supplies had been over-estimated, and arrangements had to be made for large shipments to East Pakistan, from the West wing and from abroad under PL 480, to bring the price situation under control.

18. Towards the end of 1969, a number of measures were taken to bolster economic activity. In November, supplemental appropriations were made to increase public expenditures on social services and investment. In addition, some adjustments were made in the regime for imports requiring bonus vouchers which had the effect of lowering the effective cost of such imports. However, it appears that the state of the economy benefitted only marginally. This may be because of the normal lags in the effect of such measures. It may also be that the authorities continued to be of two minds about the economic situation and therefore did not act with sufficient force in giving effect to measures intended to expand demand. Present indications are, for instance, that the amount of deficit financing through the banking system will not be significantly larger than originally estimated in the budget. Moreover, the Government became

very cautious in following up on the initiative it had taken earlier in matters of social policy. Adoption of the New Education Policy was delayed by several months by protracted debate over its financial implications, particularly in respect of teacher salaries. The question of further adjustments of salaries in the public sector was referred to a Pay Commission. Moreover, as the year advanced, it became increasingly clear that the Government did not intend to broaden the scope of legislation for wages in the private sector to cover, in particular, skilled industrial workers. As a consequence, redress was being sought by other means, and towards the end of 1969/70 it appears that strike activity was once again increasing to a level where it must have an effect on industrial production.

Investment and Output Growth

19. Preliminary estimates by the Government indicate that expenditures on fixed capital formation declined somewhat in 1969/70 from the previous year. If these estimates are correct, there can be no doubt about investment having experienced a rather sharp decline in real terms in that year, particularly since the cost of imported capital equipment was substantially raised through a rise in import duties introduced in the 1969/70 Budget. Duties on industrial machinery and component parts were raised from 35 to 50 percent for West Pakistan, and from 25 to 30 percent for imports into East Pakistan. Imports of agricultural machinery and parts were made subject to duty. The impact of these cost increases fell particularly on private investment, which constitutes the bulk of industrial and agricultural investment. Thus, in real terms private investments must have fallen sharply, a conclusion that is not immediately apparent from the national accounts which show - in current prices - a slight increase in private investment for 1969/70 as compared to a decline in public investment.

20. While political uncertainties were undoubtedly the dominant cause of this rather poor performance, there were also other contributing factors. In the case of West Pakistan, for instance, problems in securing electrical power connections - occasioned by WAPDA's difficulties in expanding its transmission and distribution system, had an impact on investment in industry as well as in agriculture where critical tubewell installations had to be postponed. With respect to public investment in both East and West Pakistan, financial constraints dominated the situation, although the ability of the administration to decide upon and effectively launch new schemes was undoubtedly affected adversely by political uncertainties including, in the case of West Pakistan, the impending division into four provinces.

21. There is some evidence that in the first half of 1969/70 private industrial investment improved somewhat, in part perhaps because the announcement of elections in October 1970 for a constituent assembly somewhat clarified the political scene, in part perhaps because the Government re-assured entrepreneurs that private industry would be expected to continue to play a major role in the development of Pakistan's economy. In total, loans sanctioned by PICIC were 12% higher in 1969 than in 1968. This rise occurred entirely because of greater activity in West Pakistan, where the amount sanctioned increased from Rs. 178.6 to Rs. 266.8 million. In East Pakistan, there was a decline from Rs.171.4 to

Rs. 126.8 million. In part, this fall no doubt reflected the general state of confidence in that wing. However, some decline would probably have occurred in any case following the large amount committed to further expansion of the jute industry in the previous year.

22. Overall economic growth in 1969/70 has been estimated at 5.1 percent, down from 6 percent the year before. However, even this rate was made possible only by the recovery of agricultural production from its weather-induced slump the year before. Apart from agriculture, the only other major sector expanding faster than in 1968 was public administration and defense, with probably very limited impact on the welfare of the great majority of the population. In all the other sectors, the pace of growth slowed down, in some cases, such as manufacturing, to a considerable extent. Furthermore, it is quite possible for the reasons indicated above, that overall growth has in fact been less than the present estimate suggests.

Fiscal and Monetary Policies

23. The principal objective of the Budget for 1969/70, as presented in June 1969, was to assure the continuity of Government operations within a framework of economic stability. On the whole, the budget was conservative and the policy measures developed in response to the disturbances were in the right direction. Whether on the tax, or on the expenditure side, these measures were a reflection of the Government's desire to develop - in steps - more appropriate fiscal policies. On the revenue side, the Central Government Budget provided for additional taxation, expected to yield Rs. 405 million, or 10 percent of total tax receipts. These measures were taken partly with a view to compensating for the inelasticity of Pakistan's tax structure with respect to increases in production and incomes, but also prompted by the slack in Government revenues resulting from sluggish developments of production and incomes. In fact, the revised estimates for 1968/69 show that the proceeds of taxes on income and production fall short of the original 1968/69 Budget estimates by some Rs. 300 million; in the event the overall shortfall was smaller (Rs. 40 million) only because of unforeseen, and heavily taxed, sugar imports which yielded substantial customs revenues.

24. The largest single increase in taxation fell on imports. As noted earlier, import duties on industrial equipment were substantially raised and introduced on agricultural machinery and parts. These measures not only yielded much needed revenue. In addition and potentially even more important for the development of the economy, was their effect on the allocation of resources, because they, first, corrected in part for the previous underpricing of capital goods which are imported at the parity rate of exchange of Rs. 4.76 to the dollar, and, second, increased the differential in pricing of capital goods between East and West Pakistan. The latter move signifies the rising awareness of the difference in industrial environment between the two provinces: the need to encourage industrial investment in East Pakistan, whereas in West Pakistan relatively more emphasis needs to be placed on bringing into production existing excess capacity, in part caused by the previous underpricing of capital goods.

This awareness, and a growing realization of the revenue costs of tax holidays, is also reflected in the decision to withdraw those tax holidays from corporations in the developed areas of West Pakistan, and to reduce them in the semi-developed areas of the West, while maintaining them in East Pakistan. There were also other measures, some of them more indicative of the desire to effect structural changes in the revenue system than merely to raise additional revenue in the short-run. Such was the decision to extend the purview of the wealth tax to agricultural land owned by persons liable to income and wealth tax. The schedule of personal income taxation was also rationalized, and effective rates were raised, albeit marginally. One weakness of direct taxation was mitigated only notionally: the maximum amount eligible for tax exemptions under the investment allowance scheme was limited to Rs. 25,000 for incomes higher than Rs. 100,000.

25. The Government of West Pakistan also mounted an effort to raise more resources. Stamp and entertainment duties were raised. So were provincial excise taxes. Water rates were increased by 15 percent. Tariffs for power and rail transport were also enhanced. In East Pakistan, however, action was limited to an increase in railway rates, despite the obvious need for more revenues. Nonetheless, altogether the measures taken in connection with the Budget for 1969/70 amounted to a creditable revenue package. Present estimates suggest that total revenue receipts of the Government, Central and Provincial, in 1969/70 will be Rs. 1,000-1,100 million, or about 13 percent, higher than in 1968/69.[1/]

26. Yet such is the degree of financial stringency in the public sector that even revenue increases of this magnitude provided little room for maneuver, in particular for giving significant effect to a redirection of Government spending, in favor of social outlays and in favor of East Pakistan. Thus, it is now estimated that of the total increase in revenue of Rs. 1,000-1,100 million over the level of 1968/69, roughly two-thirds will have gone into provisions for additional non-development outlays, largely for the purpose of maintaining current services in the face of higher salaries, defense outlays (up nearly Rs. 300 million, mainly because of increased pay), and interest payments (up Rs. 120 million). As a result, the revenue surplus did not increase very much. Moreover, of this increase, part had to be made available to defray the rise in local currency outlays on Tarbela resulting from higher wages. In addition, disbursements of external assistance to the public sector declined somewhat. In sum, resources were available only for a small increase - 4-6 percent - in public Plan development outlays, barely sufficient to maintain expenditures in real terms. This made it possible to provide for some increase in spending on social development, but not, it now appears, to raise development expenditures in East Pakistan.

27. Thus, while 1969/70 saw some action being taken towards improvement of the fiscal situation and movement in new directions, it was not a year of decisive fiscal reform. Nor can it be said that the Government made full and effective use of the possibilities of fiscal policy in bolstering the level of activity in the economy. As early as August 1968, pressures for action grew, as there were no signs of a dramatic resurgence of private investment and exports as well as imports remained below last year's level. On the Govern-

---

1/ Of this increase, roughly Rs. 700 million represents receipts from new measures.

ment revenue side, some receipts failed to increase as foreseen - which was indicative of a slow-down in economic growth - and there was also a slow-down in Government expenditures. After fully assessing the situation, the Government took action in November 1969 to raise total effective demand in the economy.

28. In November 1969 additional expenditure appropriations amounting to Rs. 430 million were decided upon, equivalent to 7 percent of anticipated Central Government revenues. Those appropriations could be spent immediately as they went for projects and programs, expenditures on which had been underestimated in any case in the 1969/70 Budget. East Pakistan received Rs. 100 million for foreign aided projects plus an additional Rs. 50 million for the rural works program. West Pakistan received Rs. 280 million: Rs. 120 million for WAPDA, ADBP, and WPIDC and the remaining Rs. 160 million went to the Indus Basin Fund to finance increased salaries. Because of some savings elsewhere and the cancellation of some unappropriated funds, total deficit financing was projected to increase only from Rs. 412 to 560 million.

29. Although these anticyclical measures came too late to avoid the six-month slump that occurred between March and September 1969 - they lacked thrust anyway - they somewhat assured a sustained level of Government expenditure for the rest of 1969/70. It is, however, not sure yet that Government's recourse to the banking system will reach the Rs. 560 million then projected. Concern about fast rises in food prices in East Pakistan in late 1969 and indications of a revival of demand for bank credit in the enterprise sector, mainly to public enterprises and large-scale private firms, supported arguments against additional expansionary financing and increased the ambivalence of Government policies.

Balance of Payments Developments

30. Balance of payments developments in 1969/70 are discussed in some detail in Chapter III of this report. Essentially, the rate of growth of Pakistan's exports declined sharply in 1969/70 and at best exports will be marginally higher than last year. While exports of manufactures continued to rise substantially - particularly in the case of cotton and jute manufactures - exports of raw cotton and jute fell markedly. Although speculation probably was a contributing factor, the poor performance of primary exports essentially appears to reflect the neglect by Government from which primary products for export continued to suffer - both in terms of assuring growers of remunerative prices (the applicable effective exchange rate being Rs. 4.76 to the dollar, as against Rs. 7.71 on average for manufactures) and in respect of supporting policies and programs.

31. At the same time, imports declined too - heavily in East Pakistan -, reflecting the depressed level of economic activity. Were it not for a small decline in disbursements of external assistance, receipts would have balanced payments. As it is, it appears that Pakistan will sustain a small loss in net exchange assets. However, this is unlikely to exceed the SDR's accruing to Pakistan during the year, so that net assets will remain roughly at US$300 million, equivalent to about 2 1/2 months' exchange payments and four months' non-aid financed payments.

III. CURRENT MAJOR ISSUES

A. BACKGROUND - DEVELOPMENTS DURING THE THIRD PLAN PERIOD

Introduction

32. It is not an easy task, looking back over the past five years, to evaluate the accomplishments and weaknesses of Pakistan's Third Plan period, 1965-1970. In part, the difficulty lies in establishing, with a reasonable degree of confidence, the factual basis for a judgment of performance, which arises because much of the statistical information about Pakistan's economy must be treated with caution.[1] For example, much of the basic data underlying the national accounts are of questionable accuracy; moreover, regional and national accounts often show widely divergent movements, at times in opposite directions. Estimates of investment, so important for calculating savings in the absence of independent estimates, are notoriously weak. According to the definition of the Planning Commission, public development expenditures during the Third Plan period in East Pakistan reached 71 percent of the revised Plan target. However, these outlays include sizeable, and fast rising, payments of debt service; if these are excluded - as they should - only 62 percent of the target was achieved.

33. In essence, of course, the difficulties of judging Pakistan's performance lie in matters of substance. Clearly, if Plan targets were taken as the basis of judgment, the large short-falls would add up to the conclusion that performance was highly unsatisfactory: GNP growth 5.7 percent against 6.5 percent; a sharp decline in the investment level to about 13 percent, against the planned increase to 20 percent by 1969/70; public development outlays over the period as a whole 30 percent short of the target in current prices and considerably more in real terms; widening, instead of narrowing, of inter-regional and inter-personal income disparities, combined with stagnation, against the planned major advance, in social services; marginal savings, instead of being considerably above the average rate, significantly less; towards the end of the Plan period, even exports, that had so far done very well, got into difficulties, while the level of debt service obligations was becoming a matter of serious concern to the Government and those providing assistance.

34. Yet clearly, judgments on performance cannot be made in the abstract, without reference to the circumstances in which actual developments took place. Over the last five years, these circumstances were unquestionably very difficult for those responsible for managing Pakistan's economy. There was the war with India, with its immediate effects and the quantum jump in military outlays it entailed. There were two poor harvests in succession, with their disruptive impact on the economy. And there were the shortfalls in the amount and the worsening terms of external assistance, which directly and indirectly contributed to the stringency of resources. In these circumstances, it was

1/ In an effort to help improve the situation the IBRD, at the request of the Government, in late 1969 organized a mission to review the statistical system. The report of the mission was submitted to the Government in June 1970.

a task of formidable dimensions to try to maintain the momentum of economic and social development. Clearly, the Government did not shy away from it, but took action over a wide front in order to protect economic growth. By changes in relative prices and administrative action, the pattern of incentives and resource allocation was shifted in favor of agriculture, where the limited resources available, in local and foreign currency, promised to yield the greatest production return, and away from manufacturing, previously the main engine of growth and modernization. A large number of measures were taken to raise additional revenue. Large adjustments were made in relative prices in favor of manufacturers for export in order to protect the target for export growth.

35. In quantitative terms, accomplishments are quite impressive. Official estimates suggest that GNP at constant prices grew somewhat more rapidly during the Third Plan period than in the first half of the 1960's. The effects of the declining investment rate were very largely borne by West Pakistan, while the share of resources devoted to investment or development outlays rose in East Pakistan. New tax and revenue measures raised roughly double the amount of Rs. 3,000 million set as the goal. It is now estimated that cumulative exchange earnings during the Third Plan period will come to 90-95 percent of the target which was considered very ambitious at the time the Plan was launched.

36. Yet, it is perhaps indicative of the situation that in each of these cases a qualification is called for. In the case of economic growth, reservations do not essentially center on its pace - which, despite some doubts about the accuracy, or perhaps economic significance, of the official estimates, was probably quite respectable - but on its distribution, inter-regionally and inter-personally. In the field of public finance, the additional resources raised proved inadequate, in the face of a very inelastic basic tax structure and sharply rising claims for non-development purposes, in particular defense and debt service, to prevent a stringency of local resources that made orderly and efficient execution of programs and projects very difficult. In the case of exchange earnings, a large part of the increase was pre-empted by very much higher military imports and fast rising debt service payments.

37. In sum, one cannot but look back with ambivalence over the Third Plan period and its accomplishments, even without bringing in the obvious point that there was enough of an economic cause behind the political upheaval of 1968/69 to require qualification of whatever achievements were attained. However, the essential purpose of any review of past performance is not really to weigh the good against the bad and then come up with a total score that purportedly has some significance. It is rather to assess the size of the task lying ahead in providing the country with effective management of its economy in pursuit of its economic and social objectives. Examining performance with this purpose in mind, one cannot but be critical. In this context, perhaps the critical shortcoming in the way the Government dealt with its problems in the Third Plan period was that, altogether, the action taken - whether in devising means of achieving stated objectives, or in scaling down objectives that had proved unattainable

in the circumstances - was never quite enough to provide that additional room for maneuver critical to being able to put development on a reasonably secure basis and thereby to get away from the need for temporizing, ad hoc adjustments, with all their unsettling effects on the conduct of economic affairs in both the private and public sectors. Creation of such a basis has now become indispensable, if the Government is to be able to cope effectively with the very difficult problems of economic management to which the political events of 1968/69 have given rise. Thus, after the interlude of the Third Plan period, the accent has to be on basic reform in a number of important fields.

Economic Growth

38. Recent estimates of national income indicate that Pakistan achieved an average annual rate of economic growth of 5.7 percent in the Third Plan Period (1965-1970) which would indicate a slight acceleration over the Second Plan period (1960-1965) when GNP grew by 5.5 percent per annum. It is difficult to be sure about the correctness of those estimates - partly because of the weaknesses in Pakistan's system of national accounts, but principally because other evidence would be difficult to reconcile with an acceleration of economic growth. For one thing, statistics for both East and West Pakistan tend to indicate a deceleration of economic growth in the latter half of the sixties: data for West Pakistan reveal a decline in the growth of that wing from 6.4 percent in 1960-65 to 6.1 percent in 1965-1970. East Pakistan's growth rate dropped from 4.3 to 4.1 percent in that period. Period averages, moreover, are misleading: for the whole of Pakistan the rate of economic growth declined every year since 1967/68 and reached 5.1 percent in 1969/70. At this rate, per capita national income increases only nominally since the population has been estimated to rise at 2.8 percent per year so that, per year, not much more than US$2-3 is added to the standard of living, a very low figure for Pakistan which still remains a country of extreme poverty with a per capita income around US$100. Progress in East Pakistan is even smaller: not much more than one percent (or one dollar) per year on a per capita basis, and here is where over 70 million Pakistanis live with an annual income in the order of US$70.

39. There are other reasons for doubting the validity of present estimates of Pakistan's rate of economic growth. First, the data suggest a capital-output ratio of 2.6 for the whole of Pakistan and of 2.4 for East Pakistan. These are surprisingly low ratios, considering the large concentration of slow-maturing infrastructure projects that went into the public investment program, the imbalances in the public investment program - particularly relating to power, transport, industry and the water program - and the large amount of unutilized capacity in private industry. Second, the national income estimates indicate that over the Third Five Year Plan period the non-commodity producing sectors grew at a much faster rate (by about 50 percent) than agriculture and industry combined, and thus have been estimated to provide 50 percent of the increase in production in that period. These estimates must be regarded as questionable but, even if accepted, they would raise doubts about the economic significance of growth so obtained for the great majority of Pakistanis.

Sources of Growth
(Million rupees, constant prices)

	1964/65	1969/70	Increase	Percent Increase	Share in Increase
GDP	41,048	54,033	12,985	31.6	100.0
Agriculture	(19,761)	(24,419)	(4,658)	(23.6)	(35.9)
Industry	(4,711)	(6,541)	(1,830)	(38.8)	(14.1)
Sub-Total	24,472	30,960	6,488	26.5	50.0
Rest	16,576	23,073	6,497	39.2	50.0

40. Still, growth probably came to 5 percent a year, a respectable pace, and an important achievement of the Third Plan was the acceleration of agricultural production growth from 3.3 percent per annum in the Second Plan period to 4.2 percent in the latter half of the sixties. This reflects the agricultural breakthrough achieved in West Pakistan where significant advances in wheat and rice production were being made. As a result, West Pakistan food imports - reaching some 1.5 million tons of foodgrains in 1966/67 - were no longer necessary and West Pakistan became a net exporter of foodgrains. Unfortunately, however, in the East Wing agricultural production did not rise by more than three percent per annum, and foodgrain production rose by only 2 percent annually - substantially below the level of population increase - thus necessitating large and rising imports of foodgrains. These imports may reach 1.7 million tons in 1969/70 as compared to about 350,000 tons in 1967/68. In industry, the picture was the opposite: a halving of West Pakistan's growth rate from 11.7 percent to 6 percent, reflecting in considerable part the low priority given to that sector in the allocation of resources, while East Pakistan's rate of industrial growth accelerated to 9.5 percent per annum, up from 5.8 percent. For the whole of Pakistan, growth rates in the construction sector dropped radically, from 24 percent to 9 percent, with the most marked decline in East Pakistan. This undoubtedly reflects the decline in Pakistan's investment rate which was very pronounced in the Third Plan period. (See paragraphs 42 ff. below).

41. All available evidence suggests that Pakistan's two wings participated very unevenly in the economic growth achieved during the Third Plan period. As indicated by the official national accounts estimates, West Pakistan's growth rate (at 6 percent per annum) was some 50 percent higher than that of the East (4 percent per annum). With so much more rapid growth in the West, most of the increase in GDP was generated in West Pakistan and East Pakistan's share in the total product of Pakistan declined from 43.8 percent in 1964/65 to 40.6 percent in 1969/70, thus underscoring East Pakistan's claims that interwing disparity in incomes has tended to widen substantially during the past five years. That disparity has since become, if not the principal, then at least the most hotly debated economic and political issue confronting the authorities.

Location of Economic Growth
(Million rupees, constant prices)

	1964/65	1969/70	Increase	Percent Increase	Share in Increase
West Pakistan	21,788	29,366	7,578	34.8	58.4
East Pakistan	17,965	21,942	3,977	22.1	30.6
Unallocated	1,295	2,725	1,430	110.4	11.0
Total	41,048	54,033	12,985	31.6	100.0

Investment, Savings and Consumption

42. An important feature of developments during the Third Plan period is that Pakistan's investment rate went down steadily, and practically without interruption, from 18.3 percent of GNP in 1964/65 to 13.5 percent in 1969/70, a decline of 4.8 points. In real terms both private and public investment stagnated, and may even have declined.

Investment as a Percentage of GNP

	1964/65	1969/70	Decline
Total Investment	18.3	13.5	4.8
Private Investment	8.9	6.4	2.5
Public Investment	9.4	7.1	2.3

43. All of the decline in the investment rate occurred in West Pakistan where the investment rate dropped from 23.6 percent of regional GDP in 1964/65 to 15 percent in 1969/70. The opposite occurred in East Pakistan where the investment rate rose by nearly one point from 10.7 percent of regional GDP to 11.6 percent, thanks to a substantial increase in public investment.

Regional Investment as a Percentage of Regional GDP[1/]

	1964/65	1969/70
West Pakistan		
Private Investment	13.2	7.8
Public Investment	10.4	7.3
Total	23.6	15.1
East Pakistan		
Private Investment	4.8	3.5
Public Investment	5.9	8.1
Total	10.7	11.6

1/ Because for various reasons the sum of regional GDP's tends to differ considerably from total GDP for Pakistan as a whole, the rates shown here are not always the same as those shown in the preceding table.

44. In West Pakistan, financial constraints and administrative limitations played their part in these developments. However, they are also a reflection of Government strategy - initiated after the India/Pakistan war in 1965 - to abandon the massive investment/growth strategy and to concentrate on quick-yielding projects and programs. In terms of its objectives, this approach proved quite successful, in that despite the drop in the investment rate, the pace of economic growth was not substantially affected. The opposite occurred in East Pakistan where the investment rate rose without a concomitant improvement in the growth rate. Agriculture holds the key to this disparity. Whereas in West Pakistan agricultural growth accelerated from 3.8 percent in the first half of the 1960's to 5.5 percent in the second, in East Pakistan it remained stagnant around 3 percent per annum.

45. Questions of strategy apart, there is a good deal of evidence to suggest that in the past decade the link between public investment and economic growth has indeed been quite loose. This goes for West Pakistan, where not in all cases were projects carefully studied on their merits. At the same time, very ambitious investment targets were set which subsequently led to shortfalls in implementation and created imbalances in the public investment program. This is particularly true for power, industry, transport and water. In other words, there was considerable scope for economizing in the use of capital through improvements in public investment planning and implementation and through

improvements in sector policies, particularly in agriculture. While some of those improvements were initiated in the Third Plan, there is still considerable room for further improvements. It is encouraging to note that the authorities are now aware of the shortcomings of the past and recognize the need to achieve further improvements.

46. In East Pakistan, similar problems adversely affected the effectiveness of public investment. Analysis of the economic benefits of projects and programs was often not given the attention that would have been desirable. There was a tendency throughout this period to spread available funds, particularly in local currency, as well as technical and administrative manpower, too thinly over too many projects, causing considerable delays in execution. Moreover, the schedule of releases of funds within any given year often created further difficulties for effective execution. In a way, of course, these shortcomings were even more deplorable in East Pakistan than in the West wing. This is so partly because the bulk of the increase in investment spending in Pakistan during the Third Plan period occurred in the East wing, and much of it in the public sector. Even more importantly, however, it was in East Pakistan where, in view of the sluggishness of growth in the past, the need for achieving visible improvement in economic conditions was immeasurably greater than in the West.

47. Another striking feature of performance under the Third Plan is the poor behavior of savings. In both the public and the private sectors, savings declined substantially in relative terms, thus reflecting a marginal savings rate markedly below the average. In fact, over the Third Plan period, the marginal savings rate averaged only 6.6 percent, bringing average savings down from 11.8 percent of GNP in 1964/65 to only 9.8 percent in 1969/70.

Investment and Savings Rates
(Percentage of GNP)

	1964/65	1969/70	Change
Investment	18.3	13.5	-4.8
Financing:			
Foreign Savings (current account balance)	6.5	3.7	-2.8
National Savings	11.8	9.8	-2.0
Private Savings	(10.0)	(8.4)	(-1.6)
Public Savings 1/	(1.8)	(1.4)	(-0.4)

1/ The concept of savings in the national accounts differs from the definition of the revenue surplus used in the discussion of public finance elsewhere in this report. The figures in the respective sections are, therefore, not comparable.

48. The corollary of the relative decline in savings was an increase in the share of GDP going into consumption, from 88.2 percent of GDP in 1964/65 to 90.2 percent in 1969/70. This rise was shared by both public and private consumption:

Consumption Rates
(Percentage of GNP)

	1964/65	1969/70
Total	88.2	90.2
Public Consumption	(6.6)	(7.6)
Private Consumption	(81.6)	(82.6)

The rise in public consumption primarily reflects the marked increase in defense outlays that occurred over the past five years. Private consumption increases took place despite the relative drop in private disposable income, thus occurring at the expense of private savings. On the basis of these figures, private consumption per capita must have risen considerably, a conclusion that can only be reconciled with studies which show that per capita consumption of 16 major commodities of mass consumption declined over the past five years, if during the Third Plan period distribution of income became much more skewed.

49. These developments are in clear contrast with the objectives of Pakistan's Perspective Plan which calls for rising investment and savings rates, and -- in this context -- reduced dependence on foreign capital inflows. The degree of dependence on foreign savings did indeed decline over the Third Plan period, so that national savings financed 72 percent of investment in 1969/70 as compared to 64 percent in 1964/65. However, this was achieved in the context of falling investment and national savings rates. If national savings could have been maintained at the 1964/65 rate of 11.8 percent, dependence on foreign capital could have been substantially reduced, thus easing Pakistan's external debt position. Alternatively, Pakistan's investment rate could have been made higher -- a course of action that would clearly have been preferable because there is no question that continuing major additions to Pakistan's capital stock will be required to sustain economic growth and that, therefore, the objective of a rising investment rate in the Perspective Plan remains valid.

Fiscal and Balance of Payments Management

50. Fiscal performance since 1965 has been far from satisfactory. The ratio of tax proceeds to GNP was only 8.4 percent in 1964/65, and -- despite all the revenue action taken in the past five years -- it was estimated to have reached only 8.9 percent in 1969/70, a figure that is very low, both in terms of Pakistan's internal needs and in comparison with other countries that are at a comparable stage of development. On the basis of international comparisons, Pakistan's ratio of taxes to GDP should at least amount to 15 percent. Pakistan's structure of taxation remains inelastic with respect to growth in incomes and production and contains many elements of inequity, as witnessed by the sharp relative drop in personal income taxation and the preponderance of indirect taxes in total Government revenues. In the face of these shortcomings in revenue performance, expenditures on defense remained high through the entire Plan period and consistently accounted for some 40 percent of non-developmental expenditure. Defense expenditure now absorbs 3.4 percent GDP, up one point from where it was just before the India/Pakistan war.

51. In an effort to make up for low revenues and high defense expenditures, the rate of growth of current expenditures other than defense was consistently kept low so as to enable development expenditures to rise from some Rs. 4 billion in 1964/65 to Rs. 6 billion in 1969/70. While the rationale for this policy was, in principle, understandable, it is by no means clear that it made economic sense to pursue it as strongly as in fact it was. Above all, it led to inadequate provision for current expenditures, which against the background of rising capital expenditures necessarily meant that newly created facilities -- such as schools and other completed projects -- could either not be staffed adequately or not be maintained properly. The consequences were poor utilization of newly installed capacity as well as wastage of resources resulting from a reduction in the useful life of assets, which contributed to raising the cost of investment in Pakistan.

52. There is, undoubtedly, much scope in Pakistan for mobilizing additional resources through new revenue measures, through raising the efficiency of the public undertakings, through raising the current surplus of public utilities such as WAPDA in West and East Pakistan -- where rates of financial return are unusually low while keeping in check growth of non-essential current expenditures. There is also great need for such measures, not only to provide the public sector with resources commensurate with its role in Pakistan's economic and social development which, in the light of recent events will perforce have to expand, but also to make taxation an instrument for the gradual redistribution of income which is needed if social progress is to become a reality.

53. Developments in Pakistan's balance of payments during the Third Plan period present a very mixed picture. As regards earnings, the authorities had themselves a 9.5 percent average annual rate of growth as the target -- a goal that was widely considered to be out of reach. In effect, it now appears that Pakistan comes very close to reaching its target, as aggregate earnings over the five-year period are now estimated at 90-95 percent of the amount projected originally. This represents a considerable achievement. In respect of merchandise exports, it was made possible by rapid growth of manufactures which expanded by nearly 20 percent annually, from Rs. 775 million in 1964/65 to Rs. 1,915 million in 1969/70. In contrast, exports of primary commodities more or less stagnated at a level somewhat below that of 1964/65 for most of the period. This stagnation occurred despite the fact that prices were generally firm and although, in the case of raw jute, Pakistan continued to make the most out of the short-term market situation, disregarding the potentially damaging effects of such a policy on the market in the longer run. In other words, the cause of the poor performance of primary exports lay on the supply side where output did not grow fast enough to provide for the rapidly increasing off-take of manufacturing and expand sales abroad. This situation reflects principally the unfavorable treatment accorded export agriculture in the Government's exchange policy, that is discussed in detail in a later section of this chapter, combined with the failure so far to develop comprehensive programs for the promotion of agricultural production for export, particularly cotton and jute. The effects of past neglect began to make themselves felt strongly in 1969/70. Although speculation was probably a contributing factor to the slump of primary exports that year, the basic problem was insufficient supplies, to which attention now needs to be given as a matter of urgency.

54. However, the problems of economic management on the export side were dwarfed by those on the payments side. A rough indication of the dimensions of these problems is given by the fact that the amount of exchange actually available for financing normal imports fell short by about US $1,500 million, or 30 percent, of the projections. This shortfall arose in roughly equal proportions out of a deficiency in disbursements of external assistance and out of additional claims on exchange resources largely associated with military purchases, but also including food imports and somewhat larger debt service payments than projected. It would probably have been possible to deal with either of these shortfalls, without significantly disrupting the orderly advance of the economy, but in combination they proved a problem that could not be handled without affecting the economy severely. The difficulties involved are only partially apparent in the amount of the shortfalls involved; their full impact can only be appreciated when the actual situation is seen against expectations in the mid-1960's. At that time, it seemed quite reasonable to assume that Pakistan could look with confidence to continuing fairly rapid expansion of imports. Thus development strategy, with its emphasis on investment and manufacturing as the main sources of growth, and, consequently, the structure of the economy and the pattern of policies and investment decisions were deeply influenced by this expectation. When it turned out that it had been a false expectation, the re-adjustments called for were so drastic that the capacity of any group responsible for managing an economy anywhere in the world would have been taxed very severely.

55. So it was in Pakistan. Not surprisingly, in an effort to ease the immediate difficulties, Pakistan resorted to more borrowing abroad on hard terms than was prudent, so that debt service obligations rose sharply, causing considerable concern to the Government and those providing assistance. Not surprisingly, either, ad hoc adjustments of the import regime were used as an expedient for dealing with the immediate balance of payments situation. The problem is that, in managing the country's exchange resources, the Government never went beyond short-term expedients, and ad hoc adjustments, in **prices and though an elaborate system of quantitative restrictions, became the chief instrument for keeping payments roughly in line with receipts and for** allocating available resources among various users. Moreover, throughout this period the Government was unable to resolve the conflict between the principal objective of its development strategy -- the achievement of growth primarily through better utilization of existing capacity rather than through additions to capital stock -- and an exchange policy that, through adjustments in the effective rupee cost of imports and through quantitative restrictions, threw the major burden of adjustment to the short-fall in resources onto imports of raw materials rather than capital goods. Neither of these aspects of Government policy made it easier for the economy to adjust itself, in reasonably efficient fashion, to the sharp change in external circumstances.

Conclusions

56. In accordance with what was said at the beginning of this chapter, the essential purpose of the foregoing review of developments during the Third Plan period has not been to examine whether the Third Plan was a success or, perhaps, a failure, or to evaluate how well, by some standard, the Government has done in managing the affairs of the economy in what undoubtedly were very difficult circumstances. The intention has rather been to assess how well

prepared Pakistan is at the end of the Third Plan period for coping effectively with the problems of the future. There is no question that these problems will at least match in difficulty those encountered over the last five years because -- as will be discussed in detail in the remainder of this report -- in addition to setting conditions conducive to sustaining economic growth at a fairly rapid pace, the Government will be compelled to pay much more attention than it has in the past to the social aspects of development which specifically means, inter alia, accelerating economic growth and, through investment, laying the basis for future economic advance in the poorer regions of Pakistan, especially the East wing; and, by various means -- giving better opportunities for economic improvement to the poorer parts of the population, providing better education and health facilities, and more emphasis on direct taxation -- reduce the skewedness of income distribution and achieve visible improvement in economic conditions for the population as a whole. It is in relation to these tasks that the weaknesses in the present state of the economy -- an effective growth rate considerably below what will be required in future; a tendency for both investment and savings rates to decline; a low tax rate; difficulties in management of the balance of payments, and, partly for that reason, in the allocation of resources -- must be cause for concern. In this context, the approach to management of the economy, as practiced in the Third Plan period, must also raise questions. On the one hand, one cannot but be impressed by the tremendous effort -- political, administrative and technical -- that went into devising and administering measures designed to improve the functioning of the economy. On the other hand, however, one is also struck by the fact that much of this effort was somehow dissipated -- thus, the very sizable effort to raise revenue through new measures to a large extent simply compensated for the low elasticity of the existing tax structure; very largely, the efforts that went into adjusting the exchange regime did not result in ensuring reasonably efficient allocation of resources; and the very substantial effort devoted to screening project and program proposals, through department working parties, industrial investment schedules, etc., was largely frustrated, partly because of the inherent difficulties of the task in the face of very severe distortions, partly because the number of proposals sanctioned exceeded available resources by a very large margin and ultimately selection was based on criteria that were never quite clearly stated.

B. THE REGIONAL DISPARITY PROBLEM[1/]

57. With the prospect of national elections based on the principle of "one man, one vote" which would assure East Pakistan of a majority of votes, regional disparity came to the foreground of national concern in 1969 and now dominates the political, social and economic scene. This is not to suggest

1/ The discussion in this section focusses on regional disparity as an East-West problem. It should be noted, however, that disparity is also a problem between the provinces of West Pakistan. The recent break-up of this wing into four provinces has revealed the considerable gap in the development level of the rich Punjab and relatively poor Baluchistan and North West Frontier. These two latter provinces with an income per capita of Rs. 300 and Rs. 400, respectively, rank below East Pakistan as ... (cont'd) that the issue did not exist or was not recognized. On the contrary, it has been strongly debated over the last two decades, but detailed discussions of the economic relations between West and East Pakistan were not, until recently, brought into the open. It is striking now to note how little the argument has progressed since the mid-1950's. The issue of economic disparity between regions in Pakistan therefore needs to be looked at in a long perspective.

58. At the time of Independence, East Pakistan was less developed than West Pakistan, but appeared to offer some promising possibilities on which further development could be based. It was especially in agriculture that the East wing was better endowed. The alluvial soils of this region had high fertility; abundant rainfall assured greater water availability; Bengal enjoyed a long tradition of intensive cultivation and the area double cropped was 75 percent larger than in West Pakistan. Above all, East Pakistan was producing close to 6 million bales of raw jute, or 80 percent of the world output. These relative advantages that Bengal had developed over past centuries had resulted in a high concentration of population which was later to become one of the greater hindrances to East Pakistan's economic growth.

59. In other respects, however, West Pakistan was better endowed. It had better means of communication. Partition left an integrated railway system comparable to Bengal railways centered in Calcutta; a large port, Karachi, open to international trade; and many more roads of reasonable standards. Bigger cities provided more specialized manpower and larger markets. Industrial production in large-scale plants was well established, and available skilled manpower was reinforced by migration from India. West Pakistan had a much larger participation in, and control of, government services and defense. In addition to human resources, the West wing also had the benefit of larger financial resources. In 1949/50, its income per capita was about 25 percent higher than that in East Pakistan. There was also a greater concentration of wealth, indicating a higher saving potential.

60. Indicators of economic growth in the two regions since Independence are scarce and unreliable. It is, however, possible to measure the changes in disparity through sectoral developments in the last two decades. This shows that the relative advantages of West Pakistan in industry and transportation have been confirmed while its progress in agriculture has eliminated East Pakistan's initial superiority.

61. In manufacturing and mining, it is clear that the absolute increase in capacity and output was far greater in West Pakistan than in East Pakistan during the 50's. The 1957 Census of Manufacturing Industries shows that more than 70 percent of Pakistan's large-scale industries were then located in West Pakistan. The value added by West Pakistan's manufactures was three

... a whole, whereas Sind and Punjab enjoy per capita incomes of Rs. 900 and Rs. 600. Improvement in economic conditions in West Pakistan's provinces will no doubt require the attention of Government. However, in terms of their impact on overall Government policy, the measures required to deal with the disparity problem within West Pakistan are not comparable to those involved in East-West Pakistan relations, because of both the very much smaller population and geographical contiguity.

times higher in food processing, mainly for sugar and edible oils; in textiles, where cotton mills had expanded considerably faster than East Pakistan's jute industry; and in metal industries with the expansion of the smelting and rolling facilities. Production of basic chemicals, pharmaceuticals and cement was concentrated in West Pakistan, whereas paper and allied products were mainly produced in the East Wing. Regional income disparity increased under the Second Development Plan (1960-1965) when value added by industry grew at an annual rate of 11.6 percent in West Pakistan and 5.8 percent in East Pakistan. In 1964/65, the West Wing was semi-industrialized, with a contribution of large-scale industry to the gross regional product as high as 15.5 percent, compared with 5.5 percent in East Pakistan which probably represents an over-estimate.

62. Disparity in means of transportation and communication also increased; 5,000 miles of good roads were built in West Pakistan between 1947 and 1960, against 500 miles only in East Pakistan. 1/ Gross investment in railways has also been much larger, although route mileage increased by 93 miles (6 percent) in East compared to 17 miles (3 percent) in the West during the same period. Despite the improvement of Chittagong Port, West Pakistan's port handling capacity was still 50 percent higher in 1960. Development of inland water transport, so vital for East Pakistan, was comparatively neglected. In view of this considerable difference between the two regions in terms of transport facilities, it is startling to note that value added by transport and communication is estimated to have contributed practically the same amount to regional incomes in both wings in 1960. The same accounts show that during the Third Plan period (1965-1970), annual value added by the transportation sector rose at a rate of 11.2 percent in the West and 3.7 percent in East Pakistan, which seems more reasonable than the earlier estimates.

63. In view of its importance for the regional and national economies, the progress in West Pakistan's agriculture has marked a critical point in the economic history of regional disparity. Agricultural developments in the 1950's are difficult to assess, and in fact estimates of the relative increases in output in the two regions differ with the choice of the base period. East Pakistan's output may have grown by 30 percent while West Pakistan's rose by 54 percent, but other estimates show increases of 40 percent and 30 percent for East and West respectively. What is less controversial is the sizeable difference in agriculture inputs: an acreage four times higher (4 million acres) was brought under cultivation in West Pakistan through irrigation, drainage and embankment, twice the volume of fertilizers was put at the disposal of West Pakistan farmers, together with a better supply of credit and improved seed varieties. These efforts brought results in the latter half of the sixties when growth in West Pakistan's agriculture reached an annual rate of 5.5 percent, compared to 3.0 percent in East Pakistan. More than anything, however, one should underline the ability of West Pakistan to seize the opportunity given by the improved cultivation of wheat and rice. The increased availability of agricultural inputs in the mid-sixties was justified by technical progress in West Pakistan's main crops. In the 1960's, cotton in West Pakistan, and rice

---

1/ In judging the significance of these figures, account must, of course, be taken of the fact that in area West Pakistan is six times larger than the East.

and jute in the East, did not present comparable opportunities. The initial advantage of East Pakistan in agriculture has thus disappeared, but its potential still remains, and there are now indications that, with new high-yielding varieties of rice as the vehicle, it may lead to a breakthrough in the not too distant future.

64. Whereas total regional income of West Pakistan was slightly lower than that of the East at the time of Independence, it is now at least 25 percent higher. However, it is impossible to assess the difference with any degree of accuracy because present estimates of regional products are not reliable. There are grounds for believing that West Pakistan's production is underestimated, while value added in East Pakistan is probably overstated. In terms of per capita income, present disparity would appear to be somewhere between the official estimate of 38 percent and private calculations of over 100 percent.

65. However, once it has been established that at present disparity in per-capita incomes between East and West Pakistan is substantial, it is not altogether clear that disparity as such can serve as a very useful analytical tool in efforts to develop a constructive approach to the problems of East Pakistan. In essence, these problems lie in the fact that economic growth in East Pakistan has so far barely exceeded, if it has not remained below, the increase in population so that living standards there have certainly not improved significantly and may well have deteriorated. This fact indicates that as yet it has not been possible to develop a strategy that has proved effective in the circumstances of East Pakistan in generating adequate economic growth. In part, this reflects the concentration in the past on nation-wide policies, and there is a need now, therefore, to integrate regional aspects into development strategy, which means that the potential and the requirements of the regional economies will have to be examined explicitly, and that Government policies will have to be adapted to specific regional needs within the context of a coordinated approach to the development of the economy as a whole. There was no regional approach in the First and Second Five-Year Plans of Pakistan. The country was considered as an integrated entity, implying that the same treatment be given to all its parts. A few steps towards differentiation were taken in the sixties but in a piecemeal fashion; a consistent approach was not developed. There were no regional studies and few regional data were prepared. A Finance Commission was appointed in 1960 to study economic relations between West and East Pakistan but its report remained secret. It was a Government rule during the sixties to refrain from preparing regional data or breaking down national statistics. It was only in 1970 that some attempts were made to make public limited information on regional developments in income, capital and credit flows.

66. At the same time, however, it needs to be recognized that in recent years attempts were made on several fronts to stimulate economic growth in the East wing. They have generally been directed towards the level of investment and thus to produce growth through the creation of physical assets. Towards this end, the Third Plan allocated to East Pakistan 52 percent of total projected Plan outlays of Rs. 52,000 million. In the private sector, half of total investment, or Rs. 11,000 million, was to go to East Pakistan. In the public sector,

the East was to receive 53 percent, or Rs. 16,000 million out of a total of Rs. 30,000 million. Taking into account expenditures of roughly Rs. 3,500 million on Indus/Tarbela (entirely in West Pakistan) which was treated as being outside the Plan, it was intended that 48 percent of public development outlays would be spent in East Pakistan.

67. Actual outlays fell short of these projections by a very considerable margin. They probably came to about Rs. 16,000 million, as against the planned amount of Rs. 27,000 million. Roughly half of this shortfall occurred in the private sector. Here, one might, of course, question whether the large shift in the regional composition of private investment, that was implied in the original projections, represented a realistic appraisal of what could possibly be achieved within a five year period. It amounted in effect to suggesting that the private sector could be transformed from a relatively minor contributor to regional product (outside of agriculture) into the main engine of growth that it was in West Pakistan. Clearly, this would have been difficult to achieve without strong support from Government policies. As it was, however, such Government support was not forthcoming. The differential fiscal incentives that were introduced to direct private investment into the backward areas of Pakistan were quite limited in scope and proved insufficient to attract private capital into the really poor regions, their main result being some decentralization around the major cities of West Pakistan. Moreover, the authorities in East Pakistan did not adopt the unequivocably favorable attitude towards private investment, particularly where it involved entrepreneurs from West Pakistan, that would have been consistent with the approach implied in Plan allocations.

68. There were also substantial shortfalls in public development outlays, with actual spending coming to about Rs. 10,400 million as against the planned amount of Rs. 16,000 million. These reflected very largely the stringent resource shortage that developed during the Third Plan period and that Government revenue action was never quite enough to overcome decisively. With this constraint, the possibilities of giving East Pakistan's development a major push through a very large increase in public development outlays were circumscribed severely. Nonetheless, considerable progress was made during this period in shifting the pattern of resource allocation in favor of East Pakistan: it received 50 percent of all public Plan outlays, as compared with 38 percent in the preceding five years; even with the inclusion of outlays on Indus/Tarbela in West Pakistan, its share came to 43 percent of the total. Moreover, while in absolute terms total development outlays very nearly stagnated in West Pakistan, they almost doubled in the East wing, indicating that a very large part of the additional resources becoming available for development was channelled in the East.

69. Two further comments seem worth making in this context. First, it is doubtful that there is a causal relationship between the shortfall in East Pakistan's share in development outlays and the failure of economic growth to accelerate as projected. The latter is almost entirely associated with the continuing slow growth in agriculture. This in turn reflects very largely the fact that it was not possible in the Third Plan period to develop for East Pakistan high-yielding varieties to serve as a vehicle for improving productivity - to which West Pakistan owes so much of growth in this period -

rather than shortfalls in investment in improving the environment for agricultural production which would in any case have materialized only much later. This argument has an important corollary. Much of the debate about regional disparity and means of narrowing it, has on the part of East Pakistan, centered around the East's share in the allocation of resources for development, and that very largely meant investment. No doubt, there is a great deal in this argument. Any economy with as little capital stock in directly productive assets and in infrastructure as East Pakistan presently has, would face great difficulties in sustaining over time economic growth at a reasonably rapid pace. This is all the more true for East Pakistan with its very difficult physical environment. Yet the conclusion is also inescapable that, particularly in the difficult circumstances of East Pakistan, no amount of additional investment will be capable of producing the acceleration in economic growth over the next few years that has become an economic and, above all, a political necessity. As will be discussed in Chapter IV, there now appears to be the potential for a significant acceleration in agriculture, but its exploitation will require carefully devised and effectively executed programs and policies. There also seem to be promising opportunities in industry, including in particular in petrochemicals based on natural gas. In view of the constraints in managerial, administrative and technical capacity that now exist in East Pakistan, a choice will have to be made between exploiting the potential for growth in the medium term, based on more productive use of existing resources combined with judicious investments, and going all out to build up the Province's capital stock as a pre-condition for much faster growth in output later. It would seem unfortunate if - whether out of frustration over East Pakistan's treatment in the past in matters of investment, or out of pre-occupation with investment-output models - the balance was struck in favor of the latter approach at a point where East Pakistan's prospects for accelerating growth in the medium term would be hurt.

70. The second comment that seems worth making is that, whatever role deliberate policies of discrimination may have played, the principal cause of East Pakistan's slow development appears to lie, in the context of national economic policy pre-occupied with maximizing growth, in lack of knowledge about potential opportunities in the East and inability effectively to link national policies, project appraisal and investment decisions. As it will be seen below, these nationwide policies have often led to an increase in disparity. It should, however, be pointed out that a total reversal of the national approach can also be harmful. Ample evidence exists elsewhere that regional considerations may degenerate into duplication of efforts and, consequently, waste of resources. The possible multiplication of competing investments, especially in manufacturing, can weigh heavily on the whole economy which can only offer a limited market at its present state of development. These dangers, no doubt, also exist in Pakistan.

71. On the whole, the argument in favor of an optimization of overall growth of Pakistan still appears valid. In the past, this argument was often put forward as a justification for granting preferential treatment to West Pakistan's agriculture and industry. It should now be understood as part of a national policy aiming at reducing disparity between the various regions. Transfers of existing income or wealth would imply very drastic measures, which may well not be politically feasible. It is likely to be much more palatable, and therefore in practical terms more effective, to aim at redistribution out of additional income generated by current economic growth. On these grounds, maximization of economic growth may well prove to be the most appropriate strategy for Pakistan to pursue in support of redistribution of income and reduction in disparity at the fastest possible pace as national objectives. The implications of this income-transfer-cum-growth model will be studied later in this report.

72. At the present juncture, further growth of Pakistan's income requires thorough appreciation of regional complementarities. Over the next few years, these complementarities should be looked at less in terms of investment, either quantum or location, than in terms of production policies. Past investments in West Pakistan have laid the bases for rapid future growth, whereas in East Pakistan large outlays are needed to expand the capital stock, particularly in infrastructure. Investments in water and flood control, transport facilities or education in East Pakistan are not likely, however, to bring quick results. At the same time, there is a substantial amount of unutilized capacity in West Pakistan's industry. In other words, as already noted above for East Pakistan, there does not appear to be a very close link in the medium run between capital formation and output growth in either West or East Pakistan. The compulsion for looking at the economies of the two wings in terms of complementarities will come from the needs of East Pakistan to supplement its real resources and West Pakistan to find an outlet for potential surpluses in manufacturing and agriculture. As will be seen later, interwing trade will need to be developed into a demand for effecting a transfer of income between the two regions.

73. Probably the strongest obstacle to the economic complementarity argument gaining acceptance is the likelihood of comparative advantages operating to widen, rather than to narrow, regional disparity. The relatively more advanced state of development of West Pakistan at the time of Independence has had a cumulative effect on investment and production. External economies obtainable in West Pakistan could not be transmitted to the other Wing because of the geographical separation of the two regions. Under liberal policies, private capital would be expected to be more attracted by a country providing better infrastructural facilities, larger urban markets and more skilled manpower. The initial advantages of West Pakistan in these areas were compounded by Government policies that went along with the natural tendencies of the private sector. Financial institutions were located in West Pakistan, credit policies

favored well-established large enterprises, protection from competing imports was mainly assured to West Pakistan industries. This resulted in the rapid expansion of the private sector in this region whereas more backward areas remained undeveloped. Strong reliance on private initiative as the engine for growth in Pakistan was sound and should be maintained. However, it certainly does not follow that government policies, expenditures and investments need to be so conceived as to amplify the disparate effect of private economic activity.

74. In this connection it also needs to be said that the limited contribution which the private sector has so far made to developing East Pakistan's economy - in contrast to its leading role in the West wing - cannot be taken as a fair test of its potential, precisely because Government policies tended to re-inforce, rather than act as a countervailing influence on, the natural tendencies of private capital and entrepreneurship. Little was in effect done to attract mobile capital and managerial capacity to the East. And although some effort was made - largely through the East Pakistan Industrial Development Corporation acting as a catalyst - to tap local entrepreneurship with limited amounts of capital at its disposal, much more could undoubtedly be done. Moreover, strong measures supporting greater private participation in the development of East Pakistan's economy will be indispensable if economic growth in East Pakistan is to receive the thrust necessary for marked acceleration. In this effort, the public sector will in any case have to carry a very large burden which will strain its capacity to the utmost, particularly in fields such as agriculture and infrastructure. Overstraining this capacity would bring little benefit to East Pakistan's population and would result in inefficiencies in the use of scarce resources which neither East Pakistan nor Pakistan as a whole can afford. Thus, to the fullest extent possible, in the design of programs and policies as well as in the delineation of spheres of activity, considerable care will have to be taken that the fullest possible use is made of the private sector, particularly in manufacturing.

C. THE SOCIAL PROBLEM

75. Over the past ten years or so, Pakistan's development policies have put primary emphasis on programs designed to achieve a high rate of economic growth through large investments in infrastructure and in the directly productive sectors of the economy. In view of Pakistan's poverty at the beginning of this decade - which still persists - emphasis on rapid expansion of investment and growth of production was appropriate because, above all, Pakistan needed to generate additional resources in support of broadly-based economic and social development at a later stage. As a result of these policies, a reasonably rapid growth of the economy was indeed obtained - probably around 5 percent per annum in the sixties - and per capita income rose by some 2 - 2.5 percent per annum. The sharp fall in mortality rates and the rise in life expectancy would indicate that the fruits of economic growth have not altogether by-passed the rural and urban masses. Yet, there

was undoubtedly a very wide discrepancy between observable improvement in their standard of living, which remains one of the lowest in the world, and the widely acclaimed achievements of Pakistan in general economic growth.

76. Most of the benefits of economic progress went to a small minority of larger farmers and industrialists, while the emerging small middle class - the Civil Service, the Army and white-collar workers - received most of the benefits from the modest social programs that were initiated in the past decade. This was so because of the large incentives and generous subsidies that were made available to larger farmers and industrialists as an inducement to save and invest. As a result, the tax structure was eroded and the Government deprived of resources that might otherwise have been available to carry out social programs. In fact, the regressiveness of Pakistan's taxation structure - personal income taxation is hardly significant in Pakistan and collections compare unfavorably with many countries of Latin America - made the after-tax income distribution even more skewed. Finally, the stress in expenditure programs on relatively high-cost public housing, medium - and higher-level education and on urban health facilities meant that most of the poorer sections of Pakistan's population benefitted only marginally from the meagre social development programs.

77. Clearly, achievement of a more equal distribution of income was not, until recently, an important objective of the Pakistan Government. During the Second Plan the view was held that "it will be necessary to tolerate some initial growth in income inequalities to reach high levels of savings and investment. What is undesirable is a wide disparity in consumption levels." And the Third Plan stated: "what is basic to Islamic Socialism is the creation of equal opportunities for all rather than equal distribution of wealth". Statistics on the distribution of income and wealth are scarce and unreliable. It has been suggested that in the mid-1960's close to one-half of Pakistan's national income accrued to 20 percent of the population. Official estimates tend to dispute this. What is undisputed, however, is that "income distribution has become fairly skewed in the process of economic development". This is the conclusion derived from studies that indicate that real wages of industrial workers declined by about one-third in the past decade, that landless laborers and urban unemployment increased - the latter being estimated at some 20 - 25 percent of the labor force - and that there was little, if any, gain in the real income of the smaller farmers which constitute the bulk of Pakistan's population.

78. Admittedly, in the case of Pakistan there has not been much scope for income redistribution in view of the large number of poor people involved. Yet, much more could have been achieved if the tax system had been used to effect some income transfers, and if development programs, particularly in the latter 1960's, had been so framed as to give effect to the need to economize in the use of capital, particularly because of the existence of pressing social needs which could not be satisfied. That these needs are very pressing indeed

is exemplified by the poor state of housing, health and sanitation facilities and the small size of the programs mounted to meet that need. Also, more could have been done if taxation had not been so regressive which must have had an impact on consumption levels of the poorer strata of society: there have been studies that show a decline in per capita consumption of 16 basic commodities during the 1960's, these commodities absorbing some 80 percent of consumer expenditures. In clear contrast to those developments, luxury consumption of the higher-income groups rose markedly in that period, as evident in statistics on luxury housing construction, automobile sales, air travel and production of other durable consumer goods.

79. In 1969, popular dissatisfaction with the Government's neglect of the social aspects of development was violently expressed, and it became clear that the policies of the past decade could not be continued. A number of measures were taken, including a sizeable wage increase for unskilled industrial workers under legislation introducing a system of minimum wages, and a new labor policy was announced that recognized the workers' right to organize and bargain effectively. At the same time, proposals were made for a new educational policy, the 1969/70 Budget introduced some tightening of the generous system of income tax concessions, and there was recognition of the need to devote more resources to social development in the Fourth Plan that was being prepared. Proposals now being discussed center around four possible lines of attack on the problems of social justice: first, measures designed to curtail private control over property, including nationalization of industry and banking institutions; second, a major push towards greater direct taxation; third, the establishment of specific targets for the supply of key commodities of mass consumption and for employment; fourth, substantial increases in outlays on social programs. However, no firm comprehensive program has yet emerged which is hardly surprising, considering how profound a shift in emphasis in Government policy is involved. An added element of difficulty has apparently been concern that too much of a shift towards social objectives might take place, to the detriment of economic growth, which would explain why there has been such a marked absence of Government action since its first, bold initiatives around the middle of last year.

80. There is no question that for a country at Pakistan's level of poverty pursuit of economic growth must remain the principal objective of Government policy. However, the assumption of an inherent sharp conflict between economic growth and social justice, that has been implicit in past policies and plays a role in the current discussions in Pakistan, is clearly debatable. In fact, there is scope for a wide range of measures in favor of greater social justice that would not detract from the objective of maximizing economic growth. In fact, there are substantial areas where the dictates of social justice coincide with those of growth. A prime example are production-oriented policies. As regards the banking system, for instance, thorough examination may well reveal that the present system of interlocking control over credit and manufacturing and trading enterprises is not compatible with maximum efficiency in the use of the country's resources. In manufacturing, there is considerable evidence to indicate that the present framework of policies permits high profits to go

hand in hand with often deplorably low efficiency; clearly, considerable economic and social benefits could be obtained by tightening Government policies, short of nationalization with all its attendant difficulties. Moreover, measures designed to facilitate the entry of new entrepreneurs into manufacturing clearly would not only meet social needs, but would also be highly desirable from the economic point of view as they would broaden Pakistan's entrepreneurial base. Clearly, too, there is not only scope, but also a pressing economic need, for raising the productivity of smaller farmers who are the mainstay of agriculture in East Pakistan and in West Pakistan must be brought into the orbit of the 'green revolution' if rapid growth of output is to be sustained.

81. Similarly, as regards taxation there does not seem to be any conflict between the requirements of social justice and those of economic growth. Both point to the urgent need for making direct taxation a major integral part of the Government's revenue system, for the present low rates of effective taxation of the higher income groups not only breed social discontent with the uneven sharing of the sacrifices required of Pakistan's population as a whole, but have also been a cause of the low elasticity of the revenue system. Progress in this direction could be accomplished by reducing the incidence of industrial protection and by a change in agricultural pricing policies. At the same time, the large tax concessions still being granted to industrialists could be reduced and phased out over time. In addition, income taxes should be levied vigorously on the farming community and there can be no further postponement of improving income tax collections from the urban well-to-do and of the introduction of a realistic property tax. There would also be a case for extending the range of taxable income downwards in the schedule of personal income taxation. These measures could go far in raising resources for development, while also introducing more equity into the social framework of Pakistan. When taken, those measures would add substance to the general proposition of the Plan that "fiscal policy must be used to tax the rich and provide relief to the poor".

82. Finally, as regards social programs as such, here again there are large areas where the requirements of social and economic objectives coincide. This is certainly so in the field of education where the present system provides - both in scope and orientation - a very weak basis for achieving sustained improvements in productivity which, in view of Pakistan's limited endowment with natural resources, will become increasingly contingent upon the abilities and skills of its population. To a considerable extent, it also applies to health programs, particularly in the rural areas where health standards are low and access to medical services often forbiddingly difficult. Other parts of the program - such as housing and urban services - however, would be determined predominantly by social considerations.

83. Two further comments on social programs as a means to achieving greater social justice seem worth making. First, no amount of increase in public outlays on social programs will be effective in achieving the social ends desired, unless it is accompanied by conscious re-orientation of emphasis, because in the past it has been the middle and upper income groups, rather than the country's poor, who received most of the benefits of the Government's social programs. This is a striking characteristic of practically all past programs. In education, more than half of expenditure goes to secondary and higher education whose beneficiaries are very largely drawn from the higher income groups. Most health expenditures are for urban areas. And nearly all public funds for housing are for middle and upper income groups. In short, if greater emphasis on social programs is to serve the purpose of increasing social justice, the programs will have to be designed carefully to ensure that they in effect benefit the low income groups. Second, effective implementation will require administrative reform. In part, this is a matter of raising the administrative and executive capability of the departments and agencies concerned. In addition, however, it will also be necessary to integrate Central and Provincial programs with those operated by local government bodies, and in that context it may be desirable to re-order the relationship between agencies at various levels of Government.

D. THE INTERNAL RESOURCE PROBLEM

1. Public Finance

The Background

84. In the Third Five-Year Plan period, Pakistan has not done well in the mobilization of domestic resources. At the end of the Second Plan, in 1964/65, domestic savings stood at 11.8 percent of GNP which, with a sizeable inflow of external assistance, permitted an investment rate of 18.3 percent of GNP. Although in 1964/65 taxes accounted for only 8.4 percent of GNP, public savings reached 1.8 percent of GNP in that year which together with a high level of private savings and external resource inflows ensured a high rate of investment, both public and private. The picture has changed radically in the Third Plan. Although in terms of the absolute amounts involved substantial additional revenue was raised, the tax ratio remained low - about 8.9 percent for 1969/70 - and public savings declined to 1.4 percent of GNP 1/ largely because the tax system has been strikingly unresponsive to production and income increases, so that additional revenue measures were needed mainly to compensate for the tendency of revenue from existing taxes to grow much more slowly than GNP. In contrast to the resource picture of the Second Plan, foreign savings no longer compensated for low domestic, and particularly public savings, as foreign savings as a percentage of GNP fell from 6.6 percent in 1964/65 to an estimated 3.7 percent in 1969/70, and the public sector resource picture became critical. Inadequate revenue, shortfalls in external assistance including PL 480, in combination with high defense spending and increasing allocations to the Indus Basin works, could not but lead to shortfalls in operating expenditure, particularly in the social sectors, in public savings and therefore also in Plan expenditure.

1/ Revised estimate for 1969/70.

85. In 1969/70 the ratio of taxes to GNP was only marginally higher than at the end of the Second Plan. International comparisons based on per capita income and degree of openness of the economy, indicate that Pakistan's trend line value or norm for 1968/69 would be a tax ratio no less than 15 percent. Actually, tax revenue that year amounted to 8.5 percent of GNP. This suggests that, whereas Pakistan originally planned to raise Rs. 3,000 million in additional tax revenue over the Third Plan and in effect raised some Rs. 6,500 million, it should have raised a total of some Rs. 11,000 million to arrive at its norm by 1969/70. It is true that norms of tax effort cannot and should not be judged merely by per capita income and openness of the economy. However, in Pakistan, neither non-tax revenues, nor profits of public enterprises, nor mobilization of private savings compensate for the deficient tax effort. By international standards, therefore, Pakistan's tax effort is far from satisfactory.

Total Government Revenue and Expenditure as Percent of GNP

	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70
Tax Revenue	8.4	8.4	8.6	8.0	8.5	8.9
Total Revenue	11.6	11.2	11.1	10.7	11.5	12.0
Non-Development Expenditure	8.3	11.2	8.4	8.1	8.2	8.5
Of which, Defense	2.4	5.4	3.7	3.3	3.3	3.4

86. Government non-tax revenue increased by slightly less than tax revenue. Its share in GNP declined from 3.2 percent in 1964/65 to 3.1 percent in 1969/70. By far the most important item has been rising interest receipts from the Government's own lending operations and its relending of foreign loans. Interest receipts from Government loans to local funds are a particularly important item in the Provincial budgets. In comparison, the return on investment in Government corporations, if measured by the interest earnings accruing to the Central Government, is low. In 1969/70, merely Rs. 45 million were to be recovered under this head, of which half would come from Pakistan International Airlines. Sales of goods from Ordinance Factories and other surplus defense material contributed some Rs. 600 million over the Third Plan period. Receipts from telegraph and telephone services are estimated at Rs. 520 million over the five-year period.

87. In principle, a policy to contain growth of non-development expenditure 1/, such as the Government pursued throughout the Plan period, to achieve a maximum surplus to finance development outlays is commendable. Total non-developmental expenditure as a proportion of GNP was 8.3 percent for 1964/65;

1/ Throughout, non-development expenditure is defined to exclude grants and loans to Provinces and interest as well as debt repayment from Provinces to the Centre.

for 1969/70 it is estimated at 8.5 percent. Thus, the growth of current expenditure has roughly been kept in line with the growth in GNP. But it should be realized that this restraint has been carried too far and has been detrimental to the maintenance of standards of public services. In Pakistan, particularly the social sector has been suffering. In contrast, defense expenditure has been high and consistently accounted for no less than 40 percent of total non-development expenditure. In fact in 1965/66, defense expenditure amounted to 48 percent of total non-development expenditure or 5.4 percent of GNP. After this peak due to the war with India and the subsequent absolute declines in 1966/67 and 1967/68, expenditures again started to rise. The defense expenditure - GNP ratio is estimated at 3.4 percent for 1969/70; this is one percentage point higher than for 1964/65. In view of the scarcity of resources the continuing high allocation to defense has been an important factor explaining the relative neglect of social program expenditures.

88. Total Government current expenditure upon civil administration increased only moderately at an annual compound rate of growth of 5 percent. In fact, in East Pakistan between 1964/65 and 1968/69 spending on this head declined consistently in absolute terms. Total Government spending on developmental departments rose at a rate of 8.5 percent per year in the same period. Despite the relatively high growth of development expenditure, maintenance of completed projects lagged behind, and there was in particular a serious deterioration in the provision of social services. Central Government "interest payments" classified as non-development revenue expenditure are also worth special attention. 1/ These payments rose at an annual compound rate of growth of 13 percent over the Third Plan. Most of the increase occurred towards the end of the period. Between 1967/68 and 1969/70, interest payment rose from Rs. 513 million to Rs. 711 million, mainly on account of the domestic debt.

89. The slight improvement in the tax ratio which has taken place has been directed to maintain government savings, not to improve administrative standards. Provisional actuals for 1968/69 and revised estimates for 1969/70

1/ The appropriation for avoidance and reduction of debt has been up to now included in non-development revenue expenditure. This item logically is a capital account item, and in the Report tables, it has been reclassified as such. The reduction in non-development revenue expenditure becomes considerable; for 1967/68 through 1969/70, the amounts transferred to the capital account are Rs. 100 million, Rs. 187 million and Rs. 246 million, respectively. In 1964/65 this debt repayment item was Rs. 50 million. With this correction the increase in interest payments over the last three years becomes less stark.

show some improvement in savings after the very low level in the first three years of the Plan. In 1969/70, this surplus financed 38 percent of total capital expenditures, as compared to an average of 32 percent over the Third Plan period. Although this surplus is not strictly Government savings, it can be considered as a meaningful approximation. On this basis the Government contribution to national savings amounted to about 25 percent between 1965 and 1970.

90. Government Plan expenditure during the 1965-1970 period is estimated at Rs. 20,600 million after corrections for internal debt service payments of Planning Commission's data. 1/ This compares with a Plan target of Rs. 30,000 million and implies an implementation rate of no more than 65 percent in current prices, considerably less in real terms. Plan expenditures roughly increased on average by Rs. 500 million a year. In 1969/70 they were budgeted at Rs. 5,200 million. To reach the objective of achieving a distribution ratio of Plan expenditure between East and West of 53:47, the acceleration of Plan expenditure had to be more marked in East than in West Pakistan. In East Pakistan, Plan expenditure according to budgets rose by Rs. 1,300 million between 1965/66 and 1969/70, whereas in West Pakistan the increase was Rs. 750 million. Throughout the Plan period, Provincial Government savings for Plan purposes as a percentage of each Province's development program averaged 35 percent for the East and 40 percent for the West. In fact, in East Pakistan over the Plan period, the percentage of "self financing" fell from 44 to 26 percent, whereas in West Pakistan this ratio remained almost unchanged between the first and the terminal year of the Plan. The deterioration for East Pakistan reflects higher Plan allocations as well as the lower resources of this Province.

91. Part of total Plan expenditure consists of the Central Government's own development outlay. Over the Plan period, the Center's own development expenditure increased at roughly the same rate as total Plan expenditure; in total it averaged 20 percent of total Plan expenditure over the period. Planning Commission estimates show that these expenditures have been shared between East and West Pakistan in the ratio of 41:59. To arrive at a full comparison of the

---

1/ The Planning Commission estimates for Plan expenditure are higher than those derived from the budget consolidation. Planning Commission estimates are based on expenditure reports from departments and agencies and since there are delays of several years in final classification of expenditure in the budgets, it is not surprising that the two sets differ. In addition, unauthorized spending by autonomous bodies has frequently taken place, financed through borrowing from commercial banks. In the past this practice is reported to have been common both in East and West Pakistan in particular for the Railways, WAPDAs and the PIDCs. As regards the Plan expenditures themselves, a correction had to be made to eliminate the debt service paid by East Pakistan public agencies to the Government, a payment which should not be included under developmental outlays.

Provincial shares of public investment, the Indus Basin Works, which have remained outside the Plan, also must be included. Indus Basin outlays have reduced domestic resources available for Plan purposes. They rose from Rs. 237 million in 1965/66 to an estimated Rs. 955 million in 1969/70. If these expenditures are added to Plan expenditure in West Pakistan, the distribution ratio for total Central and Provincial development expenditure, between East and West Pakistan becomes 43:57.

92. Other capital outlays rose from Rs. 630 million to more than Rs. 1,100 million between 1964/65 and 1969/70, mainly on account of repayment of domestic and foreign debt and transfers to the private sector through Government-supported financial institutions. Non-bank borrowing and other capital receipts only kept pace with this increase, so that no additional amount of savings was mobilized for the public sector over the Plan period, except through taxation.

93. Domestic resources financed about 53 percent of Government development expenditure over the Third Plan period as a whole. The share of external assistance declined from 45 percent in 1964/65 to less than 40 percent in 1969/70, after having reached a peak of 50 percent in 1966/67. The impact of the India-Pakistan conflict was felt mainly in 1965/66, when the revenue surplus disappeared and half the development expenditure was financed through recourse to the banking system.

Financing of Development and Indus Basin Expenditure
(in billions of rupees)

	1964/65	1965/66	1966/67	1967/68	1968/69	1969/70
Revenue Surplus	1.6	-	1.6	1.6	2.4	2.8
Net Capital Receipts	0.3	0.1	0.8	0.2	0.1	0.2
Expansionary Financing	0.3	1.5	- 0.2	0.6	0.6	0.6
Sub-total	2.2	1.6	2.2	2.4	2.9	3.6
Foreign Aid	1.8	1.4	2.0	2.4	2.6	2.4
Total Development Expenditure	4.0	3.0	4.2	4.8	5.5	6.0

94. Half of the deficit financing occurred in 1965/66; in later years the amounts have been small and decreasing. Over the five-year period, total deficit financing is estimated at some Rs. 3,000 million, as compared to the original Plan projection of Rs. 2,500 million. 1/ In view of the relative price stability - except for food prices - and the fact that a sizeable foreign exchange reserve has been built up in 1968/69, additional deficit financing could probably have taken place in 1969/70.

1/ Deficit financing indicated in the Plan was Rs. 1,500 million; but an unbridged gap of Rs. 1,000 was left, which makes a total of Rs. 2,500 million.

The Expenditure Issue

95. Over the Third Plan, there has been evidence of a growing imbalance in public sector resource allocation between investment and recurrent expenditure and between productive and social sectors. In fact both resource constraints, the domestic as well as the external, have operated to curtail recurrent expenditure which led to a poor utilization of invested capital. Fixed investment, that is additions to capacity, has been given priority over the operation and maintenance of completed projects in both the economic and social sectors.

96. The maintenance of infrastructure and the operation of completed projects have been given lower priority. Examples of this imbalance can be found in the irrigation and forestry sectors, where there has been a lack of funds for the maintenance of completed projects. But in the social sector, too, particularly in education, it has been easier to get funding for physical construction than to provide for the necessary quantity and quality of teachers. Over the Third Plan, this led to a deterioration in student-teacher ratios, declining real wages of teachers and a general dissatisfaction with working conditions which expressed itself in repeated teacher strikes.

97. Thus, over the next several years considerably more money will have to be allocated for administration, operation and maintenance of completed projects and on-going programs if existing facilities are to be used effectively. Moreover, the cost of providing these services must be expected to go up, possibly substantially as a result of pay increases for public employees. Low ranking employees were already granted higher pay in 1969, and a substantial raise was announced for teachers in March this year. A Pay Commission has been set up to study the question of further adjustments in public scales.

98. In addition, Government services will have to be expanded in several areas as part of a general effort to improve the standard of public services and in furthering the general strategy of relying heavily on better utilization of existing capital stock as a source of economic growth. A prime example are agricultural services. Whereas the increased availability of current inputs, seeds, fertilizers, pesticides have been major factors in the growth of food-grain output in West Pakistan, the role of the extension services in the West and even more so in East Pakistan will have to be considerably expanded in order to spread the benefits of improved productivity to small farmers.

99. To ensure growth over the long run, it is readily apparent that not merely current expenditure but also investment must increase. The growing realization of the importance of semi-fixed investment, particularly in achieving growth in agriculture, has somewhat reduced the significance of fixed capital investment as the source of growth in Pakistan. But even with this reservation, the decline in fixed capital relative to GNP, from 18.3 percent to 13.1 percent, during the second part of the 1960's, cannot be viewed with equanimity, and growth is bound to suffer unless the investment rate is raised again.

100. Proposals for the Fourth Plan period envisage a very substantial increase in public sector outlays. The draft Outline of the Fourth Plan suggested an allocation of Rs. 45,000 million. This was raised to Rs. 49,000 million by the National Economic Council at its meeting in early June. These figures compare with actual expenditure of about Rs. 20,600 million during the Third Plan period. The Annual Development Program for the coming fiscal year 1970/71, the first year of the proposed Fourth Plan, is likely to be around Rs. 7,500 million, over 20 percent above estimated expenditures in 1969/70. In the consideration of a public investment program, however, correct setting of priorities is at least as important as the overall magnitude. In this area, there have been considerable weaknesses in recent years. In the face of a generally tight resource position, there has been a tendency both to over-estimate available resources and to under-estimate the financing in local currency required for on-going projects and programs. As a result, new schemes were taken up, while on-going ones had to be slowed down for lack of adequate rupee funds, so that orderly and speedy execution became increasingly difficult.

Public Sector Resource Mobilization

101. Considering these various pressures on the public sector, there is no doubt that Government claims on national resources will have to increase very substantially. It is equally clear that decisions must be taken to mobilize additional resources in very large amounts for the public sector as a pre-condition for moving the public development program out of its near-stagnation in real terms since 1967/68. Determined action on this front is central to the Government's ability to carry out any kind of meaningful development program, and a clear strategy to this end needs to be laid down.

102. Government revenues amounted to 12.0 percent of GNP in 1969/70; the tax ratio stood at 8.9 percent. Experience over the last few years has clearly demonstrated that these shares are too low to enable the Government effectively to meet its obligations in Pakistan's development. Growth of tax revenue has been mainly obtained through additional taxation, mostly increases in rates. Were additional revenue not to have been raised, the 1969/70 tax ratio would have been as low as 6.7 percent, compared to 8.7 percent in 1964/65. This points to the inelasticity of tax proceeds to rising income and, therefore, to the need for fundamental reform of the fiscal system.

103. To begin with, the strategy to increase public resources must focus on improving tax administration. Without improvements in this field there is not much sense in introducing new tax measures. Heavy tax arrears have accumulated over the years. Action under the Martial Law regulations of 1969 has apparently been quite successful in capturing revenue previously evaded. However, this was essentially a one-shot effort which now must be institutionalized. To improve performance in tax collections, and to reduce widespread corruption and tax evasion, it is essential that the calibre of the staff and the statistical reporting system be improved. On the one hand, standards of assessment leave much to be desired, while on the other hand appeals have been frequent, not with any expectations of success, but with the sole intention of delaying matters because of bottlenecks in the appeal procedure. Training of tax officers should be speeded up and simultaneously the enforcement of the tax laws must be greatly improved and made credible.

104. In fact, regardless of the degree of efficiency in tax administration, low and inelastic tax revenue cannot but be expected from a tax structure which virtually exempts the fast growing agricultural sector from income taxation. Revenue generation is almost entirely a function of non-agricultural income and foreign trade. The situation has been aggravated because taxable non-agricultural income has been eroded through generous exemptions and rebates. Moreover, in the foreign trade sector, although customs duties provide one fourth of tax revenue, revenue generation has been lower than expected, since the difficult balance of payments situation required dutiable imports to be kept considerably below earlier expectations.

105. Direct taxation on agriculture is almost negligible. Merely on this account, it is not astonishing that the rate of growth of direct taxes has been sluggish. Between 1965/66 and 1969/70, the ratio of direct to total taxes decreased from 18.8 to 16.9 percent. Direct taxes related to agriculture, land revenue and the nearly negligible agricultural income taxes, all of which are collected by the Provinces, formed 2.6 percent of total direct taxes in 1965/66; in 1969/70, this proportion had decreased to 2.0 percent, which attests to the inelasticity of Provincial taxes. In short, the combination of very low and inelastic taxes on agriculture at the Provincial level and the exemption of agricultural income from the Central income tax has meant that the high incremental incomes in agriculture over the Third Plan period in West Pakistan have been virtually untaxed.

106. Over the past decade, agricultural value added in current prices grew by Rs. 7,900 million in West Pakistan. Meanwhile taxes on agriculture, including water rates, rose by Rs. 105 million. These taxes now only amount to 2.2 percent of agricultural income. It is obvious that taxation policy for the next five years would face an impossible task, unless a constructive approach is taken to mobilizing at least part of the agricultural income for the public sector that has so far remained practically untapped. The base of the Central Government wealth tax has been broadened to encompass also agricultural land, but only for persons already liable to pay Central income or wealth taxes. To make this reform meaningful in terms of revenue, the valuation of agricultural land must finally be made realistic and Provincial laws be changed, where necessary, to achieve this end. A reassessment of land values would also lead to larger Provincial revenues. Moreover, all agricultural land must be brought under the purview of the wealth tax, if the agricultural sector as a whole is to be taxed.

107. Reassessment of agricultural land and a determination of landholdings on a family basis should take place. Compared with productivity in modern agriculture and present prices of agricultural produce, the land tax is negligible and even a tenant should have no difficulty in paying. It is true

that province-wide assessment and land surveying is expensive, but the cost should be compared with future benefits in the form of additional revenue. In fact, a revaluation of land should start with the wealthy. There is already a very strong case for increasing taxation of the wealthiest farmers and rent receivers.

108. Simultaneously, it is quite clear that work must proceed to reform the system of agricultural taxation. A system merging the land tax and agricultural income tax with the income tax proper for levying income tax on total income, agricultural and non-agricultural, in combination with a graduated system of land revenue for small holdings would seem appropriate. For smaller to medium holdings, there could be a graduated system of flat rates. For larger holdings, instead of a flat rate, a presumptive system of income tax can be levied with the option of being taxed on actual income if the assessee so desires.

109. Apart from the general exemption of agricultural income from the Central income tax, many exemptions have been granted within the present system and the loss of proceeds is substantial. The personal income tax should be reviewed; the number of income tax-payers is small, slightly above 300,000 in 1967. The taxable base has been eroded through exemptions which by their nature only benefit the higher income groups and are of little social value. There is scope for substantial reduction if not complete elimination of some of these exemptions. The situation of a household with at least three children, deriving an annual income from salaries of Rs. 20,000, in Pakistan a very high income, may serve as an illustration. When all exemptions are deducted, including the investment allowance which is 40 percent of total income with a maximum of Rs. 25,000, taxable income is merely Rs. 2,900, on which Rs. 165 is paid in tax. Thus, the effective rate of taxation is a mere 0.8 percent, which clearly points to the need to tighten exemptions presently granted. This includes the investment allowance which is reportedly subject to abuse on a considerable scale and even to the extent it encourages genuine savings - which might be very marginal at higher income levels - its cost in terms of revenue loss is formidable.

110. A "poll" tax on professions may well be a way of bringing self-employed professionals to pay income taxes. The elasticity coefficient of the personal income tax was 0.8 during the Third Plan period. That of the income and super-tax on corporations was even lower. With a flat rate of 60 percent on corporate profits, the coefficient relating proceeds to value added in larger scale manufacturing, was 0.5. No estimates are available of the loss of revenue from tax holidays and rebates, but it must be quite substantial, and with doubtful benefits to the economy. The effect of tax holidays and rebates, reinforced by the import regime, has been to encourage additions to fixed capacity which, particularly in West Pakistan, have often proved of limited usefulness at a time when existing capacity had to be operated substantially below capacity because of shortages in imported inputs.

111. The effect on revenue of the excise tax on industrial production capacity has been disappointing. On one hand the taxation of capacity, in lieu of excise duty, should provide an incentive to increase production and to improve labor utilization. Moreover, it was believed that its introduction would reduce the possibilities of tax evasion. On the other hand, the system requires a constant assessment of capacity in order to prevent a stagnation of government revenue. The performance of revenue from capacity taxation has so far been disappointing. Although production difficulties in the industries concerned probably were partially responsible as was the loss of revenue resulting from refunds on exports, 1/ the fact remains that under the present system tax liability of a concern does not increase either as a result of increased production or higher prices; the analogy with agricultural taxation is apparent. A reexamination of the assessment system seems called for, which would evaluate whether the income and employment effects of this type of taxation outweigh stagnation in revenue over time.

112. Much could be said about customs duties in Pakistan and the need for simple and more uniform taxation of imports. However the revenue earning aspect is so entangled with the domestic output protection-incentive features that it is difficult to mention any specific measure other than the need of a general overhaul of the system. One can only point out that if the Government decides to raise the effective cost of imports, it usually has the option of putting an imported commodity under the bonus or the cash-cum-bonus scheme or increasing customs duties. The government therefore has the choice between collecting more duties or leaving the benefit of a higher bonus value to the exporter-seller of bonus vouchers.

113. To raise additional tax revenue the catalogue of possible measures is not exhausted. In both Provinces, revenue from urban property is low. In East Pakistan, it is estimated that three times as much revenue could be realized, without raising rates, were the present tax more vigorously enforced. The acquisition of urban property and luxury housing is a traditional form of investment by upper income groups, in urban as well as rural areas. Taxation of fixed and visible assets is relatively easy to administer and the possibilities of introducing a self-assessment system for urban property, combined with an option by Government under certain conditions to purchase property believed to be under-valued, appear worth exploring. Moreover, the urban property tax would lend itself to conversion into a betterment levy to finance urbanization, particularly in cities like Karachi and Lahore. Provincial resources could also be improved by raising the license fee on private automobiles.

114. In East Pakistan, there are reports that the tax effort at the local level has deteriorated in recent years. A major weakness apparently is that relatively wealthy farmers - not the poorer ones - often are permitted to

---

1/ It is also questionable whether the system of export rebates of this tax does not lead to excessive profits for the exporter.

accumulate large arrears in taxes which remain uncollected. To counteract this practice, the Government of East Pakistan has in a number of cases required a higher local tax effort before Rural Works Program grants were released to Union Councils. Perhaps this approach can be generalized by instituting a system of matching grants to stimulate the local tax effort.

Government Pricing Policy

115. The pricing policy for government services also requires review. There is a need to examine both the pricing policy and administrative practices of Government corporations. Proposals for the Fourth Plan call for an additional Rs. 1,500 million from this source over the next five years. There is no doubt scope for additional action in this direction on a considerable scale. For instance, Government expenditure on education could be defrayed in part through the selective imposition of student fees, particularly as much of public expenditure for secondary and higher education is at present in effect a subsidy to the higher income groups rather than the poor. Entry to publicly subsidized higher education is not based strictly on merit. Both in colleges and secondary schools, fees, presently only a fraction of recurrent costs, could be raised, combined with liberal grants and loans for students from low income groups to encourage them to pursue higher and technical education and vocational training.

116. Before taxation of agricultural income becomes effective, Government pricing and subsidy policy, as it affects agricultural production, should be modified. In contrast to the adverse terms of trade for agriculture during the Second Plan, the maintenance of high and rising prices on agricultural produce during the Third Plan has raised agricultural income, thereby reducing Government revenues both because of the direct cost of maintaining a release price which is lower than the support price, and indirectly because of the absence of effective taxation of agricultural income. In West Pakistan, steps could immediately be taken to raise the price at which the Government releases its reserve stocks of wheat. 1/ For 1970/71, the cost to the Government of West Pakistan of handling storage and disposition of wheat is estimated at no less than Rs. 130 million.

117. On the input side, there are subsidies on pesticides, fertilizers and irrigation. It seems particularly important to accelerate the reduction in fertilizer subsidy in view of the substantial increase in the distribution of fertilizer expected in both West and East Pakistan. It is true that there will be an automatic reduction in subsidy because of lower production costs ensuing from larger production capacity. In addition, present proposals call for a further reduction of the subsidy towards the end of the Plan period. But certainly in West Pakistan, where the use of fertilizer is an accepted practice and where the mobilization of agricultural incomes is more urgent than in East Pakistan, faster reduction in fertilizer subsidy is warranted. Possibly smaller

---

1/ The prices at which flour mills sell wheat flour and other wheat products should be permitted to increase correspondingly.

farmers should be exempted from a complete reduction in subsidy and this might, in fact, be administratively feasible through the cooperative system.

118. Increases in irrigation water rates should be considered in West Pakistan. It has been estimated that current rates only cover about one fifth of the marginal cost of irrigation water provided and that benefits greatly exceed this cost. An effort to double the yield of water rates over the next five years would seem a reasonable objective. In East Pakistan the collection of water rates must be enforced. Evidence from East Pakistan attests to the capacity to pay taxes or charges, provided projects are effectively carried out and agricultural inputs and extension services are provided adequately. EPWAPDA has received practically all its resources for investment in the water sector from the Center in the form of loans. Since no water rates have been collected, accumulating debt service charges have led to a reduction in actual development outlays. Recently, maintenance and operation of completed projects has been transferred from EPWAPDA to the Works, Power and Irrigation Department and therefore debt service should no longer be charged to EPWAPDA. However, for the Province as a whole, with the existing system, the problem of debt service will remain.

The Provincial Issue

119. Future patterns of Government expenditure and revenue will have to take account of the relationship between the Central Government and the Provincial Governments, and of the relative position of the Provincial Governments in East and West Pakistan. These are areas in which the new Constitution will probably bring extensive changes about which nothing can be said now. However, it is possible to put into perspective four relevant issues: provincial debt service to the Center; the relative decline in provincial shares of centrally collected revenue; the lower government revenue receipts of East Pakistan; and regional distribution of government expenditures.

120. The constraint upon the growth of non-development expenditure, referred to above, is inherent in the mechanism of fiscal transfers between the Center and the Provinces. The Provinces have to repay loans received from the Center with interest, at present 6 1/4 percent. Debt service is usually charged to the Revenue Account as part of non-developmental revenue expenditure. Over the Third Plan period, debt service to the Center from Provinces has risen rapidly, from Rs. 600 million in 1965/66 to Rs. 1,178 million in 1969/70. Debt service payments by East Pakistan were Rs. 272 million in 1965/66 and rose to Rs. 618 million in 1969/70; in West Pakistan they increased from Rs. 328 million to Rs. 560 million.

121. One reason for the sharply increasing debt service is the rising cost of debt to the Central Government, which required raising interest charges in 1968/69 from 6 to 6 1/4 percent. But the more important reason, particularly for East Pakistan, lies in the increasing financial assistance in the form of loans both in absolute terms and as a proportion of total financial assistance. Between 1964/65 and 1969/70, loans both to East and West Pakistan have trebled; from Rs. 662 to Rs. 2,004 million in the East,

from Rs. 459 to Rs. 1,415 million in the West. In the same period, the proportion of grants to total financial assistance declined from 23 to 8 percent for East Pakistan, and from 29 to 11 percent for West Pakistan.

122. The provincial share of total centrally collected revenue declined from 26 percent in 1964/65 to 20 percent in 1969/70. The sharing arrangements exclude customs duties and the major part of the large excise tax collections. The provincial share is therefore dependent upon the growth of direct taxes which has been sluggish. Consequently, the contributions of the Center to provincial tax revenue diminished from 60 percent to 57 percent in West Pakistan and from 64 percent to 61 percent in East Pakistan between 1964/65 and 1969/70.

123. In recent years West and East Pakistan have equally shared the Central contribution, but total revenue available to the West exceeds that of the East by more than 40 percent, mainly on account of non-tax receipts. The local tax effort of West Pakistan has been deteriorating; revenues locally raised dropped from 4.7 percent of regional GDP in 1964/65 to 4.0 percent in 1969/70, while in East Pakistan this ratio remained constant around 2.8 percent. Over the Third Plan, lower revenues and higher debt service payments to the Center, have caused non-development expenditure, net of transfers, to be on the average almost Rs. 600 million lower per year in East than in West Pakistan. This is despite the fact that the East, starting from a smaller base, has had a higher growth rate, 12 percent compared with 6-7 percent in West Pakistan. In other words, the East Pakistan Government is severely handicapped, compared to West Pakistan, in supplying services in education and health, as well as in other fields. On a per capita basis, this comparison, of course, becomes even more disadvantageous to East Pakistan. Moreover, this disadvantage is reinforced by the fact that the Center spends most of its non-development expenditure in the West, where most of its institutions are located. The extent of regional disparity in this respect is also evident in the national accounts which show that value added (in constant prices) by civil administration increased by almost 15 percent annually in the West, but by only 4 percent in the East, during the Third Plan period.

Conclusions

124. Major issues are facing Pakistan with respect to public finance. There is the need to increase Government expenditures, both current and capital. Past distortions in the expenditure pattern have to be corrected. The present low fiscal effort provides ample scope for mobilizing additional resources and improving the distribution of the tax burden. Correction for present disparities between West and East Pakistan will require a relatively faster increase in expenditures in the East, and a substantial rise in the revenue contribution of the West.

2. Mobilization of Private Savings

125. All available evidence suggests that resource stringency in the public sector was accompanied by a decline in the savings rate of the private sector. While there were fluctuations from year to year, it appears that on average the share of private savings in GNP remained 1-2 percentage points below the level attained in the first half of the 1960's and hovered around 7 percent. Moreover, there were no signs of private savings recovering towards the end of the Plan period. These developments are difficult to explain, considering that economic growth maintained a fairly rapid pace and that the marginal rise in the share of total resources going into the public sector in the form of taxes and other revenues did not materially affect private disposable income.

126. These conclusions are derived from the national accounts and, in the absence of independent estimates of private savings, they must be treated with caution. All the more so, as statistical problems abound. On the most general plane, there is the problem that, private savings being derived as a residual, they are affected by all the estimating errors from which the other, much larger items in the national accounts suffer. More specifically, with all the price distortions in Pakistan's price structure, there is a serious question how meaningful exact figures of investment and savings rates are. Furthermore, the decline in private savings rates occurred during a period when economic growth, and even more so growth of incomes, shifted towards agriculture in West Pakistan where much of the larger part of private savings originates; the difficulties of estimating investment are very much greater in agriculture and in the rural areas generally than in manufacturing, so that it is possible that in recent years private investment and, consequently, private savings have been underestimated.

127. Still, while allowance for these factors might modify the figures somewhat, it is unlikely to reverse the trend from a decline to a rise, and thus remove the behavior of private savings as a cause for concern. This means that, just as in the field of public finance, strenuous efforts will be required in raising the level of savings in the private sector. The difficulty is that, being unable to explain satisfactorily why the private savings rate declined in the first place, one cannot really be very specific about the forms such an effort should take. Nonetheless, a few general observations may be worth making.

128. To a considerable extent, private savings in Pakistan are probably determined by the existence of attractive opportunities for investment. Very largely, this is likely to mean investment in physical assets. There is no question that, because of Pakistan's difficult exchange position, such opportunities were quite limited during the Third Plan period, particularly in manufacturing. Present proposals for the Fourth Plan period call for

continuation of these restrictions, particularly in respect of private investment in West Pakistan. While, for the reasons discussed above, there is strong justification for expanding the role of the public sector in Pakistan's economy, it is questionable whether present proposals - which would in effect keep total private investment in real terms roughly to the absolute amount actually spent over the last five years - do not go too far in that direction. In this context, an important consideration is whether, within the limited investment opportunities envisaged, there would in fact be sufficient incentive for private savings to recover. It may well be that, with such stringent limitations, potential savings in the private sector will be frustrated. If this happens and the Government at the same time is unable - as it may well be - to capture these potential savings through its revenue system - the pace of development would suffer.

129. In addition to the size of investment opportunities, the amount of resources required to be raised within the private sector for financing a given level of investment in real assets is probably a factor influencing private savings. In the past, the Government has been very generous in supporting private investment - directly through the transfer of public funds to financial institutions engaged in lending to the private sector, generally at very favorable rates of interest; indirectly through giving private investors access to imported equipment at comparatively low effective cost of exchange. Considering how tight Pakistan's overall resource position and the financial situation of the public sector in particular are likely to be over the next several years, it appears questionable whether continuation of Government support on the present scale is warranted. In view of the high rates of profit obtainable from most investments, whether in agriculture or manufacturing, any such reduction is not very likely to entail a decline in private investment but would probably be compensated by increased efforts to mobilize private savings. Moreover, such an approach would have the additional advantage of enabling the Government to direct what limited resources it has available in support of private economic activity towards specific areas where assistance from the public sector is necessary as a catalyst and where stimulation of activity serves the public interest, e.g. in East Pakistan, in the promotion of new entrants into industry.

130. Private savings are also generally believed to be a function of the ready availability of financial instruments and the return earned on them. In this general area, the Third Plan period saw a number of welcome initiatives being taken. Mutual funds were successfully introduced. The commercial banks, seeking deposits and limited by the State Bank in establishing additional branch offices in major cities, expanded rapidly in the rural areas. Clearly, there is scope for considerable further efforts in these directions. Moreover, they could be made more effective if combined with more active use of interest policy as an instrument of stimulating savings and, in the rural areas, with improvements in the organization and operation of the co-operative banking system and the postal savings schemes both of which have on the whole continued to languish.

E. THE EXTERNAL RESOURCE PROBLEM

1. Introduction

131. The main objective of balance of payments strategy in the Third Plan was "to move towards greater economic viability and finance an increasing proportion of development imports from the country's own resources". An export growth rate of 9.5 percent per annum, considerably greater than that of GNP (6.5 percent) was to be achieved by appropriate setting of bonus (exchange rate) and fiscal policies supplemented by allocations of development expenditures to export oriented industries. On the import side it was expected that exchange, tariff and fiscal policies would be formulated with a view to continuing a program of import liberalization intended to shift control over the level and composition of imports from detailed, quantitive allocations to more indirect controls exercised through the market pricing mechanism. Expanding export earnings, supplemented by foreign assistance and coupled with reform of import controls, were expected to improve the availability of imported raw materials and spares to required levels and thus allow for fuller utilization of installed capacity, increased output, and efficiency. Further development of the capital goods industries was to be supported by appropriate changes in the tariff structure which had in the past been shaped to stimulate investment in, and rapid development of, consumer goods industries.

132. The war with India and consequent higher defense expenditure, two successive poor crops leading to unexpectedly large food imports, coupled with the pause in and reduced level of foreign assistance were significant causes for very substantial deviations from the original Plan targets for external resource mobilization and expenditure. The basic direction for balance of payments strategy sketched above, however, remained essentially valid, although its implementation became far more painful to achieve, and in the event, as will be seen below, policy adjustments did not, on the whole, amount to the consistent pattern that had been envisaged.

2. Balance of Payments Management In the Third Plan Period

Exports

133. The Third Plan target for total foreign exchange earnings was set at an annual rate of growth of 9.5 percent, to yield Rs. 20,000 million from the original base. It is clear from the partial data available for 1969/70 that the Plan period will end with unusually poor exports. However, for the five years as a whole export performance, in contrast to many other aspects of the Plan, has come remarkably close to the target, although it was the export target which, more than many other Plan projections, was widely criticized as being far too ambitious. Defining the precise score is troubled by technical problems of measurement beside estimating earnings in 1969/70. However, it seems fair to say that cumulative exchange earnings will be from 90 to 95 percent of the target. The lower figure will apply if the revised (higher)

base for 1964/65 is used, invisibles are treated on a gross basis, and the mission's lower forecast for this year's earnings is used. Since there is no question that over the next five years Pakistan will have to increase exchange earnings at a rate well in excess of GNP growth - the Fourth Plan Outline proposes an annual rate of 8.5 percent - Pakistan's experience in the latter half of the 1960's warrants thorough examination, for both its strengths and weaknesses.

134. Merchandise exports as recorded by the Central Statistical Office show that the value of shipments in the current fiscal year, from July 1969 through April 1970, was Rs. 2,692 million, a 2.1 percent decline from the comparable period in 1968/69. For the year as a whole merchandise shipments are likely to become roughly equivalent to last year's exports of Rs. 3,240 million. Export receipts, however, which tend to lag, are likely to be up slightly, perhaps by 2.5 percent. Commodity details are not yet fully available but it is clear that the poor showing is the result of a sharp drop in primary exports. July through February figures show exports of major primary commodities down about 25 percent from comparable 1968/69 levels (raw jute down 11 percent, raw cotton 54 percent and rice 52 percent), whereas major manufactures were up 16 percent. Changes in unit prices roughly offset each other so that it is a decline in the volume of exports, not in international prices, which explains the fall in export value. No doubt, a number of special - and temporary - factors provide part of the explanation for this fall. However, it also appears that developments this year have brought into the open some basic problems.

135. Incentives for export in Pakistan are given through a number of schemes and programs, the total impact of which on effective exchange rates (total rupee earning per dollar value of export) for different commodities is probably impossible to quantify precisely. However, the dominant influence on effective exchange rates for different exports has been the export bonus scheme and it is in good part the working of this scheme which has determined the rate and pattern of export growth for different commodities. An appreciation of developments with respect to exports can be gained from a simple examination of data on bonus and total exports in conjunction with their approximate effective exchange rates for the years 1964/65 - 1968/69.

Total Exports

Export Type	1964/65 Value (Rs. mil.)	1964/65 Bonus Cov. %	1968/69 Value (Rs. mil.)	1968/69 Bonus Cov. %	Percentage Change in Value
Primary	1,696	(12)	1,548	(9)	- 8.7
Manufactures	775	(100)	1,678	(100)	116.5
Invisible	622	(7)	574	(14)	- 7.3
Home Remittance	182	(100)	453	(100)	148.9
Total Export Receipts 1/	3,208	(37)	4,151	(56)	29.4
Average Effective Rate	5.35		6.43		20.2

- Continued -

Exports Under Bonus

	1964/65		1968/69		Percentage
	Value (Rs. mil.)	Aver. Effec. Exch. Rate 2/	Value (Rs. mil.)	Aver. Effec. Exch. Rate 2/	Change in Value
Export Type					
Primary 3/	203	(6.22)	145	(7.10)	- 28.6
Manufactures	771	(6.19)	1,658	(7.66)	115.0
Invisible 3/	42	(6.72)	79	(7.33)	88.1
Home Remittance	182	(6.94)	453	(8.23)	148.9
Total Bonus Exports	1,198	(6.33)	2,336	(7.72)	95.0

1/ Totals for export receipts for 1964/65 and 1968/69 adjusted to exclude respectively Rs. 67 and 102 million of freight included in primary and manufactured merchandise exports. See Table 3.4 in Volume II for details.

2/ Rs. per U.S. dollar.

3/ Items covered by bonus have varied. The exclusion of rice from bonus in 1968/69 explains the drop in primary exports.

136. In 1964/65 bonus exports were Rs. 1,198 million, equivalent to 37 percent of total foreign exchange receipts of Rs. 3,208 million; in 1968/69 bonus exports had risen to Rs. 2,336 million or 56 percent of total receipts. During the past four years bonus exports increased by 95 percent while non-bonus exports declined absolutely from Rs. 2,010 million to Rs. 1,815 million. The overall growth in exchange earnings between 1964/65 - 1968/69 was about 29 percent or 6.6 percent per annum. Exports under bonus grew by 18.2 percent per annum, while those not subject to bonus declined by 2.5 percent per annum. The average effective exchange rate for bonus exports rose from 6.33 in 1964/65 to 7.72 in 1968/69 while the average effective exchange rate for total export receipts increased from 5.35 to 6.43.

137. It is clear from the above table that manufactured exports all receive bonus and that their growth has indeed been impressive. The average effective exchange rate for the group rose from 6.19 to 7.66. The issue that arises with respect to manufactures results from the structure of the effective exchange rate system. It has been shown that for some cases (cotton yarn and jute sacking) foreign exchange earnings from the manufactured item are no greater than the amount that could have been earned by exporting the raw material that went into the manufactured item. In other words, value added in manufacture of exports has in some cases earned no additional foreign exchange.

138. Invisible earnings under bonus have shown a sharp increase over the past four years. However, it is significant to note that they comprise less than 15 percent of total invisibles and that invisible earnings as a whole have declined. 1/ It appears from casual observation that lack of growth in this item is due to the fact that, given the inherent problem of policing this type of transaction, more transactions are taking place outside the exchange control system as effective rates move away from official parity. This seems especially true of earnings from tourists. The growth of home remittances, which has consistently received the highest bonus rate, testifies to the efficacy of offering a rate near the market rate.

139. It is clearly apparent in the table above that, in contrast to other sources of exchange earnings, primary exports - which account for about 50 percent of merchandise exports and about 35 percent of total foreign exchange earnings - have not done well at all. In fact, they declined somewhat between 1964/65 and 1968/69 and fell considerably in 1969/70 as the exportable surplus decreased because increases in output fell short by a considerable margin, particularly in the case of jute, of the expansion in demand by the manufacturing sector. No doubt, part of the explanation for this situation lies in the fact that export agriculture on the whole did not receive much support from the Government's agricultural programs. Again, this is particularly true of jute. At the same time, however, it is also obvious that the Government did not act, as it did for all other major exports, to provide incentives for increased production through the bonus system. In fact, over 90 percent of primary exports have remained outside that system, at a time, when returns obtainable from competing crops went up considerably as a result of increasing prices and, in the case of wheat in West Pakistan, in yields.

140. It is difficult to justify this approach to primary exports on economic grounds with respect to either domestic supply elasticities or international conditions. Estimates of supply elasticities have generally shown that farmers respond favorably to price incentives. The argument, especially made with respect to jute, that the benefits of other Government programs designed to increase productivity have acted to offset an increasingly adverse price situation, is invalid because these programs for jute especially, have on the whole not been very effective.

141. Except for jute, Pakistan's primary exports are relatively small in international markets so that international prices for exports are given within a very wide range of export volumes. In jute, of which Pakistan is a major supplier, the situation is different. Here, export volume and unit prices are inversely related, and Pakistan's choice of export strategy is determined by judgements about the elasticity of demand with respect to price. So far, export policy has been governed almost exclusively by short-term considerations, that is, it has been designed to obtain the highest possible price consistent with current market conditions. With such a policy, Pakistan has been quite successful

---

1/ The figure for 1964/65 invisible receipts may be in error for it appears inconsistent with some other data but it seems that at best earnings remained constant.

in maintaining jute prices at a high level. At the same time, however, it has with such a policy given encouragement to competing producers, notably Thailand, and to the synthetic fiber industry to expand their production. Implicit in the export policy that Pakistan has so far followed is, therefore, the judgement that there is no difference between the short- and the long-term price elasticity of demand for Pakistan's jute and that, therefore, its earnings are maximized by exploiting to the full the advantages of relatively low elasticity in the short run. There is considerable evidence to suggest that a thorough re-examination of the validity of the assumptions under this judgement is urgently needed.

Bilateral Trade

142. In 1968/69 bilateral exports, mostly to Socialist Bloc countries, were Rs. 396 million or about 12 percent of merchandise export receipts. Bilateral exports have grown rapidly since 1964/65 when these arrangements were first introduced. However, in relation to the value of the trade involved, Pakistan seems generally to have run a large credit balance with Bloc countries which suggests that Pakistan has found it difficult to import goods from these countries. In view of these apparent difficulties, it is encouraging to note that the Government is presently undertaking a study to evaluate the benefits Pakistan has derived from these arrangements and to determine future policy.

Imports

143. A major policy goal enunciated in the Third Plan was that of import liberalization - the replacement of direct, quantitative controls over imports by indirect financial controls. Implicit in this goal was the recognition that, within a setting of equitable access to foreign exchange, more effective use of limited foreign exchange resources will be achieved through the market than through administrative controls. On balance little, if any, progress has been made over the last five years towards achieving this goal. Obviously, as will be seen below, factors beyond the full control of Government were in good part responsible for creating conditions that made achievement of a restructured import control system difficult and painful. However, it is also clear that the system as it actually evolved over the years of the Third Plan period was not the only one possible in the circumstances.

144. Movement towards a more rational and liberal import regime as envisaged in the Third Plan was upset by two significant deviations from Plan projections of expenditures and resources: first, higher defense expenditure and, second, short-falls in external assistance. The following table summarizes the situation:

Sources and Uses of Foreign Exchange, 1964/65 - 1969/70[1]
(Rs. million)

	Plan Projection	Estimated Actuals	Difference	Achievement (in percent)
Total Payments	35,500	30,860	- 4,640	87
Goods and Services	32,690	27,691	- 4,999	85
Debt Service	2,810	3,169	+ 359	113
Total Sources	35,500	30,860	- 4,640	87
Own Earnings	20,000	19,145	- 855	96
Foreign Resources	15,500	11,579	- 3,921	75
Project Aid and Technical Assistance	(9,300)	(7,069)	(- 2,231)	(76)
Commodity Aid	(5,500)	(3,981)	(- 1,519)	(72)
Foreign Investment	(700)	(529)	(- 171)	(76)
Reserve Use	-	136	+ 136	-

1/ Because of subsequent revisions of Third Plan benchmarks, comparisons between Plan projections and the actual outcome do not precisely indicate the discrepancy between expectations and actual events.

145. Included in the estimated actual imports of goods and services for the Third Plan period is Rs. 3,500 - 4,000 million of expenditure for military and some food imports. If this amount is subtracted from Rs. 27,691 million of actual imports, the shortfall from projected Third Plan requirements is in the order of Rs. 8.5 - 9.0 billion and import availability for productive use is reduced from 85 percent to 72 - 74 percent of the original target. It is this latter figure which indicates how severe the pressure on import availability was to the economy during the last five years. The table also shows that external assistance fell short of projections by Rs. 3,921 million, roughly equivalent to defense-food expenditure of Rs. 3,500 - 4,000 million. It is the combination of these two factors - excess outlays on military and food imports and the shortfall in aid - that dominates the external resource picture. By comparison, the shortfall in export earnings and the excess in debt service payments are almost insignificant.

146. Alternatively, the situation that developed may be described as follows. From the 1964/65 base year level the cumulative increase in exports during the Third Plan amounted to about Rs. 3,500 million. This increase was pre-empted in its entirety by imports of military goods and food. Coupled with a reduced aid inflow of a like amount, the level of other imports that could be financed was drastically reduced below projected requirements. How the adjustments made necessary by these events affected the composition of imports and how they were brought about, is discussed below in some detail, not only for the

explanation such an analysis provides of significant aspects of Pakistan's economic situation during the past five years, but also - and more importantly - for the insights it might give into Pakistan's external resource position as the country enters the next Plan period.

147. Changes in the composition of imports between the Second and Third Plan periods are shown in the table below:

Composition of Merchandise Imports 1/
(Percent)

	Second Plan	Third Plan
(1) Consumer goods	24.6	22.1
(1a) Consumer goods net of food grains	(12.0)	(10.9)
(2) Raw materials	43.2	41.0
(2a) Raw materials net of fertilizer imports	(42.3)	(37.7)
(3) Capital goods	32.1	36.9
	100.0	100.0
Total Merchandise Imports	Rs. 19,917 million	Rs. 23,900 (est.) million

1/ For details and source see Table 3.3 in Volume II. Military imports are excluded. Third Plan proportions are based on actuals for four years, 1965/66 - 1968/69.

The first striking feature of this table is that merchandise imports, as recorded by the Central Statistical Office, were only about 20 percent larger during the Third Plan period than during the first half of the 1960's. This is confirmed by data on private imports licensed by the Chief Controller of Imports and Exports. Such licenses cover almost all private imports, except imports of capital goods financed externally through the development banks, and comprise therefore essentially consumer goods and raw materials including fuels. Imports so licensed (including bonus imports) are estimated at Rs. 10,250 million in 1965-1970, as against about Rs. 9,000 million during the Second Plan, an increase of only 14 percent. The second striking feature of the table is the extent to which the burden of adjustment fell on raw material imports. More specifically, it fell on intermediate imports to the industrial sector, while fertilizer imports grew very rapidly in support of the food grain self-sufficiency program. Indeed, if fuel is also excluded, the decline is from 36.4 to 30.7 percent, which probably measures as accurately as possible the tremendous burden of adjustment faced by the manufacturing sector of the economy. It indicates that imports of industrial materials did not increase at all, while even without further investments in 1965-1970, capacity in operation would have been substantially larger as a result of the boom in manufacturing investment in the latter years of the Second Plan period.

148. The rise in the proportion of investment goods in total imports and the decline in proportion of raw materials imports for industry in an economy troubled by under-utilized capacity and sputtering growth in the manufacturing sector throughout this period, indicates that adjustment to the foreign exchange resource constraint lacked balance. However, this does not mean necessarily that it would have been within the power of Pakistani authorities to bring about a radically different composition of imports. The observation above assumes that foreign exchange resources were in fact fully fungible as between different uses. This was not so. As noted above, a good part of Pakistan's own earnings was pre-empted, while external assistance was much more readily available for projects than for financing commodity imports. In these circumstances, raw material imports became the residual claimant on foreign exchange resources, but the cost to the economy of this situation must have been very high indeed.

149. To effect the necessary adjustments in imports, Pakistani authorities used both quantitative restrictions and changes in the effective cost of exchange. Changes in the latter are depicted below:

Average Effective Exchange Rates 1/ 2/
(Rs. per US $)

% Share in 1968/69 Imports	Item	1964/65	1968/69	% Increase Between 1964/65 and 1968/69
19.1	(1) Consumer goods	6.55	9.62	46.9
(6.4)	(1a) Consumer goods net of food grains	8.75	12.52	43.1
(6.4)	(1b) Consumer goods net of food grains and sugar duties	8.26	10.74	30.0
43.4	(2) Raw materials	6.18	8.11	31.2
(39.9)	(2a) Raw materials net of fertilizer	6.19	8.41	35.9
37.5	(3) Capital goods	5.83	6.55	12.3
100.0	Average effective rate for merchandise imports 3/	6.17	7.82	26.7

1/ Average rupee cost, including duties and, where applicable, bonus, per US dollar.

2/ The classification of imports corresponds to the preceding table, except that imports of consumer goods were further subdivided, in order to eliminate the disturbing effect on the effective exchange rate of consumer goods in 1968/69 of abnormally large imports of sugar which carries a very heavy duty.

(Continued on next page)

150. Taken with the table on the composition of imports, several conclusions may be drawn about the adjustment process to the exchange constraint. It is obvious that the heaviest burden in price adjustment has been carried by the raw material group which, as noted above, has also carried the bulk of the quantitative adjustment in foreign exchange allocations. As a result, the price differential between capital goods and raw materials, insignificant in 1964/65, widened to as much as 30 percent by 1968/69. The emergence of such a differential has obviously circumscribed severely the effectiveness of the Government's development strategy which sought to stress better utilization of existing capacity, as against additions to capital stock. It also limited the extent to which plans for developing the domestic manufacture of capital goods could be translated into reality. These are problems to which solutions must be found if Pakistan is to be able to use its exchange resources efficiently, all the more so as the present outlook suggests that exchange resources will remain very scarce indeed.

3. Dimensions of the Task Ahead

151. In the course of the Third Plan period, the foreign exchange gap emerged as a severe constraint on Pakistan's development. As shown above, extensive action was taken during these years to adapt the exchange regime to the change in circumstances, with respect to both exports and imports. It took the form of substantial increases in effective exchange rates, but also involved extensive use of quantitative controls as a means of both keeping total imports within available resources and of allocating exchange between various categories of imports. Altogether, however, it appears doubtful that the exchange regime, as it has evolved, can be relied upon to perform effectively in dealing with the problems that lie ahead.

152. A very important element in the outlook for the next several years is external assistance. Here, disbursements out of the Indus and Tarbela funds will decline from past levels as these projects near completion, and Pakistan's program in the production of foodgrain is reducing the scope for assistance under PL 480. For these reasons, and because of the rising debt service obligations built into external debt now outstanding, the net amount of resource transferred from abroad will decline substantially, if the remainder of assistance continues at present levels and on current terms, as shown in the following table.

3/ A study done by the Planning Commission estimates that the aggregate average exchange rate for merchandise imports was 6.02 in 1964/65 and 7.87 in 1968/69, thus the estimates made by the Mission are in accord with them. It might be noted that in making the estimates care was taken to resolve allocations in favor of showing increased prices for capital goods over the period; thus the estimates, on which the conclusions in the text are based, are conservative.

Net Transfers of Resources
(US $ million; annual averages)

	1965/66-1969/70	1969/70	1970/71-1974/75	1974/75
Gross Disbursements				
Indus/Tarbela	98	120	58	24
PL 480	92	85	47	40
Other Assistance	454	461	500	500
Total	644	666	605	564
Debt Service	138	185	264	321
Net Transfers	506	481	341	243

The possibilities of adjusting external assistance policy with a view to preventing the sharp decline in net transfers depicted above, are currently under consideration by the Pakistan Consortium. In particular, the feasibility of keeping net transfers over the next five years at the level of the second half of the 1960's, i.e., at roughly US $500 million a year, is being examined. However, even if measures to this end are in fact taken, Pakistan's ability to increase imports above present levels would still be dependent entirely on its success in expanding exchange earnings. Thus, fast growth in exports must remain a very important objective of Government policy. Conversely, even expansion of exchange earnings by as much as 8.5 percent annually would only prove sufficient to support increases in imports at an annual rate of about 6 percent i.e., roughly in pace with GNP. Thus, a tight external resource situation will remain with Pakistan, as will the task of ensuring the most efficient possible use of available exchange.

IV. SECTORAL STRATEGIES

A. INTRODUCTION

153. From the discussion in the preceding chapter of major current issues, emerges a number of important compulsions and constraints that will dominate the setting for Pakistan's economic and social development over the next several years. As regards the management of the economy in this setting, probably the foremost problem, on whose effective resolution practically every other aspect of development will depend, is that of mobilizing additional resources, domestic as well as foreign, to support the substantial expansion of public sector activities that is called for and to meet the requirements of the economy in general for strengthening, after a period of declining investment rates, the base for sustained economic advance in future. One obvious conclusion to draw is that measures directed towards mobilizing resources -- domestically, in the form of public revenues as well as total savings, externally in the form of exchange earnings -- must loom large in any program of action designed to break through the constricting shortages that have thwarted so many of the aspirations enunciated for the Third Plan period.

154. The other, perhaps less obvious conclusion, relates to economic growth as an objective of policy. An acceleration of growth is, in any event, imperative in East Pakistan if frustrations of long standing are to be alleviated -- and it is doubtful that any amount of success in stepping up investment spending in that Province will compensate for failure in achieving such an acceleration. Furthermore, there is a strong general case for seeking rapid economic growth in conjunction with the compulsion for a massive effort to mobilize additional resources, because it is obviously much more difficult to obtain more resources out of a given income than out of increments to income. It is this consideration that argues strongly for strong efforts to keep regional income in West Pakistan growing rapidly -- quite apart from the fact that, comparisons with East Pakistan aside, West Pakistan is still far too poor to be able to afford relaxation of efforts to maintain growth at a fast pace. The essential argument for fast growth in West Pakistan is that it is there that most of the resources will have to be generated -- in the form of public revenues, savings and exchange earnings -- which will be needed, in the context of net transfers from abroad at best remaining constant, for effecting the shift in emphasis in investment towards East Pakistan.

155. Concern over Pakistan's social problems will have to be translated into ameliorative action. As argued in the preceding chapter, this need not mean massive diversion of resources to non-economic ends. Indeed, the social problem reached its intensity in no small measure because past policies have not paid enough attention to ensuring that there was reasonably equitable access for all to opportunities for economic improvement. To provide such opportunities in future is not only a social but also an economic need in important areas of economic activity, particularly in agriculture, and must constitute an important objective of economic policy. At the same time, however, social services particularly in education, health and housing, will need to be expanded greatly, and claims on resources for these purposes will be very substantially larger than they have been in the past, circumscribing the scope for increasing investment in more directly productive activities.

156. Compulsions for increasing the investment rate in East Pakistan raise a whole host of difficult problems for the management of the economy of Pakistan as a whole. Some of them are obvious -- East Pakistan's present capital stock in infrastructure is very small -- in absolute terms and even more so in relation to the region's difficult physical environment; much of the investment will, therefore, have to go into improving the infrastructure: that is, it will create conditions conducive to future growth, but it will not produce growth by itself. It is, therefore, quite likely that, with a rising share of total investment going to East Pakistan, investment as a whole will take longer in contributing to economic growth. Several implications follow. As far as East Pakistan is concerned, great care will have to be taken in composing the investment program to balance short- and long-term considerations. As for Pakistan as a whole, the aim should be to raise investment in East Pakistan within the context of a rising over-all investment rate, that is to try to avoid a further decline in the investment rate in West Pakistan which has already fallen from above 20 percent to around 15 percent over the past 5 years. In essence, this is, of course, a further argument for a large-scale effort to mobilize additional resources. Nonetheless, resources for investment will remain very tight and investment planning and management will have to be improved considerably to use these scarce resources with the greatest possible efficiency.

157. Among the problems that are perhaps less obvious, the most important are those that derive from the fact that the regional economies of East and West Pakistan are not contiguous and -- because of the difficulties and cost of transport and communications -- do not form part of a genuinely integrated economy. Moreover, Pakistan has never really faced the issue whether its ultimate aim is the creation of an integrated or two largely separate economies. Whatever the ultimate decision on this issue, the process of transition that is ahead, towards greater economic balance between the two wings, involving, inter alia, a shift in investment towards East Pakistan, would undoubtedly be facilitated greatly by promoting regional specialization, particularly in manufacturing. Regional specialization, and the expansion of inter-wing trade to which it could give rise, would make it possible to supplement net transfers through external trade -- where by all indications the resource position will remain very tight -- by net transfers through inter-wing trade. Such objectives would obviously have to be reflected in the regional pattern of investment.

158. In this context, one further point about the pattern of investment may be worth making. It relates particularly to West Pakistan. If the process of transition referred to above is to proceed with a minimum of economic disruption and dislocation, West Pakistan's economy will have to generate over the next several years very substantial surpluses of commodities for shipment abroad as well as to East Pakistan. It is doubtful whether this could be achieved within the proposed division between private and public investment, according to which private investment over the next five years would be kept at the same absolute level (in nominal terms, considerably less in real terms) as during the Third Plan period.

159. There is one final point that has been implicit in much that has been said above but which needs to be made quite explicit. Even more so than usual within a five-year time horizon, the desired rate of economic growth and desired rate of investment are essentially two separate objectives. In terms of economic management, they have to be tackled as such. This means that economic growth has to be obtained very largely by means of making more productive use of existing assets, and economic policies and programs intended to promote growth will have to be focussed accordingly.

B. AGRICULTURE

Introduction

160. By far the most important achievements of the Third Five-Year Plan were the breakthrough in agricultural production which occurred in West Pakistan and, perhaps, the establishment of pre-conditions in the East wing for a similar success during the coming quinquennium. This is so important because the large majority of Pakistan's population lives in rural areas and earns a living from agriculture. At the same time, this creditable achievement should be viewed against the background of near-stagnation in agricultural production over the 1950-1965 period, threatening in that period the ability of Pakistan to guarantee its rapidly-rising population a life free from hunger in the face of not-so-exceptional droughts and other natural calamities. In addition, reliance on foodgrain imports could be reduced. In West Pakistan, agricultural production rose by 5.5 percent annually in the Third Plan period -- by about double the level of population increase -- which made it possible to raise per capita food consumption, to eliminate PL 480 imports of foodgrains and to achieve better than self-sufficiency in wheat and rice, so that the West wing could supply East Pakistan with considerable quantities of foodgrains, particularly with wheat and rice. In contrast, in East Pakistan where the majority of the population lives at an extremely low level of poverty and where agriculture accounts for 58 percent of GDP, aggregate agricultural growth failed to accelerate from the 3 percent rate achieved in the Second Plan period and barely kept pace with the population growth rate. More serious, however, was that foodgrain production rose by only 2 percent per annum, thus necessitating large and rising foodgrain imports from abroad. The latter would have been higher but for foodgrain shipments from West Pakistan. However, programs and policies were mounted which could lead to a sizable increase in food production over the next five years, particularly in the critical field of rice, and therefore to a reduction in what already is a very heavy reliance on food imports from abroad.

1. West Pakistan

161. The very high level of wheat imports into West Pakistan, reaching close to 1.5 million tons in 1966/67, did much to impress upon the authorities the need for forceful action with respect to the development of foodgrain production, and programs and policies were formulated to reach food self-sufficiency at an early stage. These programs and policies were, on the whole, remarkably successful: at the present time, West Pakistan is a net exporter of wheat, even after a 30 percent increase in domestic wheat consumption. Rice production nearly doubled in the last four years. There were also important, though less spectacular, improvements in the productive performance of cotton, sugar and oilseeds.

162. The advance in foodgrain production was made possible by the availability of new wheat and rice varieties (Mexipak for wheat and IR-8 for rice) and by Government policies under the "food self-sufficiency program": subsidies for nearly all farm inputs, combined with high support prices for wheat and rice, provided the incentives and inputs for complete self-sufficiency. But the key development in having adequate water availability -- both from surface and from groundwater sources -- relieved the most important constraint to agricultural development in West Pakistan where water is the most critical factor of production. The success achieved so far is an indication of the structural strength of the West Pakistan agricultural sector and the recognition by farmers of the opportunity to earn additional income by raising productivity. It is also an indication of the potential of West Pakistan's agriculture which can be realized with an appropriate set of Government policies and programs.

163. The success of West Pakistan's food self-sufficiency program, however, was confined to the irrigated areas -- and particularly to wheat and rice producers -- and to the larger farmers, thus increasing regional income disparities and those within the farming community. At the same time, the high support prices for wheat -- which are very considerably above world market prices when the latter are converted at the parity rate of exchange -- and those for rice, were passed on to the consumer, thus adding pressures on the domestic price level and contributing to the decline in urban real wages. Thus the need is there, and the authorities realize this, for the development of a new agricultural strategy that would consolidate the advances made in wheat and rice and concentrate on policies and programs aimed at stimulating the production of other crops -- such as cotton and oilseeds -- and at raising the productivity and income level of the smaller farmer. This is not going to be an easy task, but an essential one if all-around, steady economic and social progress is to become a reality.

Analysis of the "Green Revolution"

164. When the IBRD-sponsored Indus Special Study[1/] was completed in 1966, there were clear indications that the Third Plan period was likely to see considerable advances in agricultural production if the Action Program, then formulated, was vigorously carried out. The cardinal points of the Action Program were investments in public sector tubewells, the encouragement of private sector tubewells, the provision of power supplies adequate to sustaining and accelerating tubewell pumping, and in addition, the provision of investment and current resources both to satisfy the then evident increasing demand for fertilizers and to make new high-yielding varieties available on a large scale. On the whole, the Action Program was carried out as foreseen and the agricultural take-off effectively took place in the 1967/68 season when the production of grains started to rise impressively.

1/ Pieter Lieftinck, et.al., "Water and Power Resources of West Pakistan", the John Hopkins Press, Baltimore, 1968.

West Pakistan: Production of Foodgrains

(Thousand tons)

	1964/65	1965/66	1966/67	1967/68	1968/69	Estimated 1969/70
Wheat	4,518	3,854	4,266	6,317	6,513	7,000
Rice	1,329	1,296	1,343	1,475	2,000	2,300
Other	1,366	1,250	1,306	1,581	1,297	2,300
Total	7,213	6,400	6,914	9,373	9,810	10,600

165. There are three main factors that have paved the way for West Pakistan's particular type of Green Revolution: increase of water availability, from both wells and surface sources; rapid adoption of new dwarf wheat and rice varieties; and the greater use of fertilizers. It was fortuitous that the introduction of new wheat varieties on a significant scale in 1967/68 coincided with a season of exceptionally favorable rainfall. The combination of these events led to a sharp increase in production which appears to have had the effect of inspiring farmers to adopt a new attitude towards agriculture.

166. The following table sets out the water supply situation as it developed between 1965 and 1970:

Irrigation Water Availability at the Field

(MAF)

	1965/66	1968/69	1969/70
Surface Supplies	57.3	63.8	60.8
Private Tubewells & Persian Wheels	8.7	12.5	14.0
Public Tubewells	2.6	4.6	5.3
Total	68.6	80.9	80.1

167. The principal factors that have influenced the availability of irrigation water during the past five years are:

i. The dramatic increase in the number of private tubewells from 32,000 in mid-1965 to 81,000 in mid-1970.1/ The latter figure would have been higher if rural electrification had been more rapid.

ii. The continuation of appreciable flows from the Eastern rivers (Ravi and Sutlej) over and above the Indus Basin Treaty requirements, following the commissioning of Mangla.

1/ There have been other tubewell counts showing slightly different numbers.

iii. The operation of canals by more than 10 percent above their designated full supply discharge, so bringing on the land a considerably larger quantity of surface irrigation supplies -- particularly during the kharif period.

iv. The valuable regulation effects of Mangla reservoir, particularly during the early rabi planting period -- quite apart from its basic storage/replacement function.

168. In contrast to the rapid expansion of private tubewells, the public tubewell programs have fallen substantially short of achieving their objectives, largely because of major difficulties with electric power supply, but also due to financial and administrative constraints:

Growth in Numbers of Public Tubewells (Electrified)

	mid-1965	mid-1970	Awaiting Electrification mid-1970
WAPDA	2,206	4,926	2,485
Irrigation Department	85	542	691
Total	2,291	5,468	3,176
ISS Action Program	2,206	9,051	

169. The table above clearly indicates that if electrification could have kept pace with the drilling and installation program, the shortfall against the original Indus Special Study target would not have been seriously large, perhaps only about 1,500 wells. Apart from the problem of insufficient electrical connections, there have been serious shortcomings and failures in electricity supply to both public and private tubewell operators. Failure to maintain the right supply conditions has resulted in failures of transformers and motors, which have been all the more serious in the case of public tubewells, owing to the chronic shortage of spare parts and poor associated maintenance and repair capability.

170. The introduction of improved high-yielding crop varieties was mainly limited to wheat and rice. New cotton and corn varieties were used only on a relatively small scale, most probably due to problems with pest control. Within the space of three seasons, a total of 6 million acres were brought under Mexipak wheat varieties which amounts to more than one-half of the irrigated wheat area. Within the same period, 1.5 million acres were brought under Irripak rice, thus covering some 35 percent of the total rice area. Fertilizer use trebled from around 80,000 nutrient tons of nitrogen in 1965/66 to more than 200,000 tons in 1968/69 and phosphate off-take has now reached nearly 40,000 nutrient tons, up from a negligible level at the beginning of the Plan period. In contrast, plant protection has not become effective and Government

is now considering transferring plant protection services to the private sector. The number of farm tractors doubled to 17,600 in the space of four years, and while it is difficult to assess the effect of mechanization on agricultural production, particularly its effects on yields, there is no doubt that tractor mechanization has permitted an expansion of the cropped area through double cropping.

171. During the Third Five-Year Plan period, there was an expansion of irrigated cropped areas by about 3 million acres, brought about by additional surface and groundwater supplies. The composition of the expansion was:

Crops	Million Acres
Wheat	2.0
Rice	0.2
Cotton	0.5
Other Crops	0.3
Total	3.0

In addition, there was extension of irrigated cropped areas outside the canal commands, notably wheat at 0.4 million acres and rice at 0.2 million acres.

172. The general composition of the cropping pattern changed little over the five years; the proportions of the major crops average:

Crop	Percent of Cropped Area
Wheat	35
Rice	12
Cotton	13
Fodder	15
Other Crops	24

The average cropping intensity increased over the last four years from 86 to 99 percent. Increases have occurred throughout the country but are more marked in public tubewell project areas such as Khairpur and SCARP II.

173. Yield increases have been spectacular for both wheat and rice. The average wheat yield rose from 11.5 maunds in 1964/65 to 14 maunds in 1968/69, mainly in the last two years. The new high-yielding dwarf varieties have given much higher average yields than the traditional varieties. Last year, Mexipak wheat averaged 17.5 maunds per acre and Irripak rice 30 maunds (paddy) per acre. Cotton has also shown a steady average yield increase of about 4 percent per year to reach 10 maunds of seed cotton per acre by 1968/69.

174. While there is no doubt that West Pakistan has made impressive progress with foodgrain production, there are questions about the absolute level of wheat production. These questions originate with the problems of quality control of both the collection and processing of production statistics. A matter of major significance is the possible undercounting of production --

particularly in respect of crop yields -- which, if true, could mean that West Pakistan is well on the way to serious overproduction of foodgrains. Making projections for the original Indus Special Study, official production estimates were increased by 15 percent for wheat and 10 percent for all other crops to allow for a measure of undercounting. More recent evidence, and analysis of it by a number of Government agencies, indicates that actual wheat production may be at least 25 percent higher than the official estimates. Objective yield estimates, however, appear to be generally some 25 percent above official figures, and dietary surveys (particularly the Nutrition Survey of 1964) indicate foodgrain consumption then was about 16 oz/capita/day. This latter measure compares with the figure of about 12 oz/capita/day according to the official production estimates. Further indication of undercounting is provided by a comparison of the calories obtained from foodgrains with the Ministry of Health's standard diet for West Pakistan, having allowed for calories provided by other foods. With per capita foodgrain consumption of 12 oz/cap/day, the population would be 30 percent underfed, whereas with foodgrain consumption at 16 oz/cap/day, underfeeding would be considerably reduced.

Prospects for Wheat and Rice

175. Although the recent sectoral performance in wheat and rice production has been heartening, there is no reason to feel there can be relaxation of effort to maintain and expand water resource development in the future. The larger than anticipated contribution from private tubewell development to some extent made up for the shortfall in planned public tubewell development; the continued availability of some supplies from the eastern rivers was also an unanticipated benefit during the recent past. However, rational further development of groundwater areas will require something more consciously directed to provide assured and qualitatively reliable water supplies than these two instances. Specifically, certain of the areas in the original Action Program of the Indus Special Study will become increasingly vulnerable to the waterlogging and salinity effects of rising water tables, and combating these will require further public tubewell project development. At least one area not included in the original Action Program, e.g., the Ghotki canal command, is also facing severe waterlogging conditions. A recent review of the agricultural and water development prospects concluded that an investment program of 3,000 public wells fully installed within the Fourth Plan period, in addition to the bringing to full operation of those installed but not electrified during the Third Plan period, was a minimum requirement. Additional development beyond this would be desirable, and could take place in the form of partial completion of project areas already identified in the Indus Special Study. Such partial development would be concentrated in areas with dangerously high water tables. A certain amount of canal remodelling and strengthening of canal banks would also be necessary to maintain the important contribution from surface water supplies, as well as in expectation of increased surface water availability after 1975 when Tarbela becomes operable.

176. With present technology, continuing input availability and current strong incentives, it is within the possibility for West Pakistan to reach the present target of an additional 3 million tons of wheat production by 1974/75. This would assure West Pakistan of wheat self-sufficiency, increased per capita consumption for which there might still be some scope and exports to East Pakistan on the order of a million tons a year. Beyond that, West

Pakistan should not increase its production of wheat as exports to the world market would be difficult given present domestic prices and wheat quality. As said earlier, there are uncertainties about West Pakistan's wheat production and consumption level which could mean production is already substantially higher than the official estimates. If this can be more firmly determined, caution should be exercised with expanding wheat production along the target lines. From this point of view, it can well be argued that present wheat production incentives should be reduced somewhat -- either in absolute terms or relative to other crops -- so as to induce some wheat acreage contraction in the next five years while still maintaining adequate production levels through higher yields.

177. In the case of rice, further increases in production are in store for the next five years and there has been some question about the possibilities for Pakistan to market somewhere near 500,000 tons of non-Basmati rice by 1974/75. There have also been questions about the prospects for exporting Basmati rice, against the background of current marketing problems. The Mission considers that most of the prospective increase in rice production could be exported to East Pakistan, with some possibilities for developing markets abroad.

178. The near-term outlook for sales of West Pakistani rice in world markets is quite uncertain. Most of Pakistan's large stocks of Basmati, from the crop harvested during 1969/70 cannot be sold this year, even at prices considerably below last year's quotations. Pakistan will also accumulate inventories of other kinds of good quality long/medium grain rice for sale abroad until various minimum improvements in both the quality of paddy and the efficiency of milling are carried out. Furthermore, large stocks of rice in both the U.S. and Japan and bigger supplies in Far Eastern and Mediterranean countries practically ensure that more rice will be available for sale on world markets this year, and probably next year too, than will be purchased at current prices. In other words, two factors will limit Pakistan rice exports during the next few years, on the average, to less than 200,000 tons a year: (a) Pakistan does not have available for export any supplies of high quality non-scented varieties for which market opportunities may exist; and (b) the excessive inventories of rice currently held by traditional exporters and Japan, much of which could be sold on concessional terms.

179. One can assume conservatively that if Pakistan makes major investments in rice processing and marketing facilities and carries out extensive market development and promotion work, it could acquire and keep foreign markets for 300-500 thousand tons a year of high and medium quality milled rice by the middle of the 1970's. These estimates include exports of 125-150 thousand tons of Basmati, which should sell abroad at a price of US $180/ton. The balance of the rice, if it is of a quality comparable with the best Thai and U.S. long/medium grain rice, should sell for $150-160/metric ton, f.o.b. Karachi, during 1974-76. Prices by 1979-81 are expected to be $5-10/metric ton lower. These estimates assume that changes in current rice production, milling, and marketing practices in West Pakistan will enable exporters to offer good quality rices other than Basmati on world markets. All the reports by consultants and advisors agree on three points: (a) without major investments encouraged by suitable government policies, Pakistan will not be

able to expand her exports significantly; (b) potential markets may be lost by default during the next five years if Pakistan's rice industry does not make these adjustments in the meantime; (c) paddy drying and storage and probably rice milling facilities existing in most of West Pakistan today are inadequate, even when judged by current rather than prospective needs.

180. Until these developments have occurred, and unless the world rice market becomes a seller's market again, the strategy recommended for West Pakistan (and the Central Government) is to continue to export Basmati, and to ship coarse rice to East Pakistan. In fact, East Pakistan may also prove to be the best market for significant quantities of the newer high-yielding varieties of satisfactory milling and cooking qualities which West Pakistani producers will probably grow during the mid-1970's. Finally, the effective demand for Basmati among traditional cash markets in the Near East and East Africa during the last few years amounted to something less than 90,000 tons a year, and development of other markets deserves high priority if Basmati is to retain its high (30-50 percent) premium over the better grades of milled rices of Thai and U.S. origins. The promotion and servicing of these new markets probably should be done by competent, interested international firms, or private Pakistani organizations which demonstrate solid business connections in prospective foreign markets and possess grain procurement, storage, and merchandising capabilities.

Other Crucial Issues

181. Now that West Pakistan has made encouraging progress in its efforts to boost production of foodgrains which, it should be remembered, aimed at substituting for the previously high level of food imports, new policies and programs are needed that would put continuing rapid agricultural development on a sound financial basis, and with suitable diversification in terms both of products and regions. Critical elements in such a new development strategy include: the degree of Government institutional and financial support to be given to agriculture, the development of cotton as the next major agricultural crop, the nature of regional agricultural development (particularly with respect to the non-irrigated areas), and the kinds of programs which are made available to involve the smaller farm in the agricultural breakthrough.

182. There is no doubt that continuing increases in agricultural production require major organizational and other inputs that the Government would find hard to supply, given the already strong demand for Government services that exists in the fields of extension, education and general administration of West Pakistan. The strain would substantially increase with the break-up of One Unit and the establishment of four new Provinces in West Pakistan. At the same time, the experience of the past five years clearly indicates that the private sector has served West Pakistan's agriculture well, as exemplified by the progress in the private tubewell installation, production-response in the fields of wheat and rice and the establishment of agricultural processing industries. The question is now, whether the Government should not be thinking in terms of stimulating the private sector further at the next stage of agricultural production, i.e., the stage of greater commercialization of agriculture.

183. The Government has already, and rightly, decided to transfer the important task of plant protection to the private sector, and the Mission considers that further progress can indeed be made toward involving the private sector in such areas as foodgrain storage, rice-milling, marketing and grading of rice, and in agricultural credit. Advantages would be from the twin standpoints of the greater ease with which the private sector might move into them (particularly in foodgrain storage and rice-milling), and the Governmental financial and human resources which this would free for other development objectives.

184. As said earlier, the progress in agriculture that was achieved in the past five years took place in an environment accustomed to near-stagnation in agricultural production and rapidly rising food import requirements. From this point of view, it was understandable that the agricultural strategy was based on a set of incentive policies designed to assure maximum financial gains to those farmers who undertook investments which led to output growth. These policies consisted of high support prices for agricultural output, sizable cost-reducing subsidies for inputs and near-complete exemption from taxation of the additional incomes so earned. These policies benefited wheat and rice producers mostly and were remarkably successful. Now that the import gap in these products is filled, however, major policy changes are necessary. This is not only to shift the balance of financial inducements to other crops, but also to translate future agricultural production and income growth into public savings that can be used, and are needed, for the development of other sectors of the economy. This is not going to be easy, particularly since the farming community is now well accustomed to the benefits of earlier Government policies.

185. In the short-term, as West Pakistan is committed to wheat as the major winter crop, planning will have to be on the basis of levels of production exceeding West Pakistan's immediate requirements. There are dangers that in the near future serious over-production could develop if the higher production estimates, previously referred to, are confirmed. This would argue in favor of reducing the current high support price for wheat, either in absolute terms, or relative to other crops. The latter appears a more preferable course of action, particularly since the events of last year clearly illustrate the kinds of difficulties that an absolute reduction in the wheat support price would entail. Nonetheless, in the short-term there are other measures that could be taken which would go far in securing part of the profits earned in wheat production. These measures would be in the areas of subsidy reductions and taxation measures, referred to in the preceding chapter.

186. With regard to subsidies there is, first, electricity to agricultural users, mainly for tubewells, which is supplied at a preferential rate. As private tubewells show a very high financial return to the farmer, there is no reason why tubewell owners should not pay the full economic cost of supplying power. Rate increases are, therefore, clearly called for, and a general case for such measures is presented in Section D of this Chapter. Irrigation water from public tubewells also appears to be provided at less than the economic cost. Again, the benefits from this flexible source of supply are so great that the economic costs should be borne by the users of tubewell water. At the same time, there is substantial room for increasing charges for surface water. Finally, subsidies on fertilizers should also be eliminated, perhaps in stages, but they should not be allowed to continue beyond the next 2-3 years.

187. At the same time, however, the development of non-foodgrain crops should be pursued actively and as a matter of urgency. Oilseeds, alfalfa and pulses could become attractive alternatives to wheat. However, foremost attention needs to be given to cotton. Raw cotton does not earn an export bonus so that the price to the grower is determined by the parity rate of exchange, whereas the manufacturer receives a bonus and thereby enjoys a very substantial advantage from Pakistan's multiple exchange system. At the current price level, the growing of cotton compares unfavorably with wheat growing and it has been for this reason that since 1967/68 -- when wheat growing was made very profitable through the high support price and the sharp jump in obtainable yields -- cotton acreage and production has stagnated. There is an urgent need to provide adequate incentives for cotton so as to regenerate farmers' interest in that crop, which is essential if raw cotton exports are to be stepped up -- which is needed if Pakistan's export earnings are to grow at a reasonably rapid rate -- in the light of currently declining exportable volumes of cotton. However, it would be an oversimplification to attribute the current stagnation in raw cotton production solely to low producer prices. Another cause is surely the current pre-occupation with manufacturing to the relative neglect of field production and ginning. There is, therefore, a need to study the whole range of problems of the integrated development of cotton from field production through to manufacturing and marketing.

Regional Agricultural Development

188. There is a great need for undertaking programs for the development of agriculture in the non-irrigated areas. There are several possibilities and the Mission considers that the development of the livestock industry in Baluchistan and the North West Frontier would be feasible, provided it is integrated with the agricultural system of the Indus Basin. The Government is rightly considering to undertake a comprehensive review of the livestock sector throughout West Pakistan which could lay the basis for subsequent project identification, preparation and execution. Development of livestock production is also important from the protein-intake point of view. There will be other opportunities for developing agriculture in the non-irrigated areas, but careful study will be required. In this connection, research activities could well be directed more towards the problems of these areas.

The Smaller Farmer

189. Programs will also have to be devised for bringing the "Green Revolution" to the smaller farmer who constitutes the great majority in West Pakistan, where 50 percent of the farmers cultivate less than 5 acres. Major problems to be solved relate to tenancy conditions which do not favor tenant investments and to design a system that is efficient in terms of reaching the smaller farms with extension service and other agricultural inputs such as water, fertilizer and new plant varieties. In this connection, there appears to be a need for expanding the Government's agricultural extension service, and while this may be difficult and costly, it is an essential step if the present formidable obstacles to entry into the "Green Revolution" by smaller farmers are to be overcome. This is particularly necessary for social reasons, but from the economic point of view as well, since the new technologies are capable of yielding substantial economic and financial returns to small farm investments, so that farms of, say, 10 acres that were previously hardly economical can be made viable economic units.

2. East Pakistan

Introduction

190. Heavy and rapidly increasing population pressure, reflected in high man/natural resources and high man/land ratios, continues to dominate East Pakistan's economy. The population growth rate is high and may have exceeded 3 percent per annum during the Third Plan period. There is no significant scope for extending the area under cultivation beyond the 22.4 million acres now being cultivated. In 1969/70 the population was estimated at about 71 million, i.e., at about 2,100-2,140 per square mile of cultivated land (some 1,300-1,360 per square mile of the total area of the Province). Population density will be about 2,300 per square mile of cultivated land by 1985 (about 2,000 per square mile of the total area of the Province); the cultivable land per capita will decline from about 0.3 acres to about 0.2 acres, unless the rate of growth of population is reduced.

191. The pressure on cultivable land could be even higher than these figures indicate. This is strongly suggested by the fact that inhabited areas, including village grounds and village ponds, now occupy some 40 percent of the total land area in non-flooded, good farming areas. Similar population densities can be expected in areas provided with flood protection in the future. Thus, with improvements in the quality of land, the quantity of cultivated area will further decline, and the already acute scarcity of land will be accentuated even more. Intensification of land use grows more and more vital with such developments.

192. East Pakistan is heavily dependent upon agriculture. About 90 percent of her population is rural and over 80 percent works in agriculture. Agriculture generates about 60 percent of the gross provincial product, over 90 percent of the exports of the Province, and nearly one-half of all of Pakistan's exports.

193. The gross regional product of East Pakistan increased by some 4 percent per annum during the Third Plan period as against a possible population growth rate of over 3 percent per annum. Thus, there was only a notional improvement in East Pakistan's per capita inoome. But the standard of living probably declined for large segments of the rural and agricultural population in that period. Unemployment and underemployment increased in the rural sector over the Plan period. The population on farms of 1 acre or less -- estimated at about 13 million -- is underemployed and not self-sufficient in food production. Towards the end of the Third Plan, rice prices increased sharply, and since the bulk of the population lives outside the area of influence of ration stores operated by the Food Department, the bulk of the population was undoubtedly hard hit by these increases in rice prices. In fact, many Government authorities consider that actual hunger prevails in the countryside. The development objective of the bulk of the rural as well as urban population is expressed in popular terms as a wish "to have one square meal a day".

194. Yet, a small minority of farmers who were able to benefit from irrigation and other agricultural intensification measures probably improved

their incomes substantially as rice prices rose. These apparently intractable problems are attributable to lagging developments in many of the principal activities of agriculture. The gross regional product of agriculture grew only about 2.3 percent a year over the Third Plan period. Production of rice, which is by far the most important food crop, grew perhaps slightly more rapidly but was clearly lagging behind the population growth rate. Minor crops grew faster but due to their small importance, their impact on overall food supply fell far short of making good the gap in food requirements.

195. Thus, East Pakistan has become increasingly dependent upon food imports. During the last five years total foodgrain imports averaged about 1 million tons a year as against less than half a million tons a year at the beginning of the 1960's. Imports were 1.1 million tons in 1968/69 and are expected to increase to 1.7 million tons in 1969/70. Such a development is likely to place an ever-increasing burden on the exchange earnings of Pakistan, since the trend appears to be towards declining food imports on concessional terms.

196. Malnutrition prevailed and apparently grew worse over the Plan period. Serious malnutrition existed already earlier in East Pakistan according to the 1962-64 nutritional survey: the diet was short of proteins and vitamins. Government authorities apparently underestimated the population growth rate. Consequently, they overestimated per capita foodgrain availability and underestimated import requirements during the Third Plan period.

Agricultural Exports

197. Regarding exports, the production of jute, which is the most important cash earner for farmers and the largest foreign exchange earner for the country, has only grown at a very modest rate of about 2 percent a year during the last decade. In the absence of adequate price incentives to farmers, and in the absence of appropriate policies and measures to encourage jute cultivation, export markets for raw jute were being lost rapidly while the expanding domestic jute manufacturing industry absorbed increasing quantities of the total raw jute output. Exchange rate policies, according to which raw jute was exported at the parity exchange rate, while manufactured jute goods were exported at a bonus rate, assured relatively cheap raw material for the domestic industry while they did not provide an adequate incentive to farmers to expand jute production.

198. The development of substitutes for jute -- the expansion of kenaf production in Thailand and the expansion in the output of synthetic substitutes (such as polypropylene) by various industrialized countries -- highlights the fact that Pakistan would have to substantially expand her export market to maintain her raw jute exports. Because the Government failed to initiate adequate jute industry policies, most of the raw jute market lost to date may have been lost for good.

Policies and Programs

199. The slow growth of agricultural production reflects lagging yield improvements and prevalence of traditional farming practices. However, a good start has been made with the introduction of improved practices. It should be noted also that their impact has been partly obscured by temporary fluctuations

in farming conditions caused by variations in rainfall, drainage and flood patterns. In 1969/70, total fertilizer use was estimated at about 365,000 tons, the number of low-lift pumps in use at about 18,000, the number of tubewells in operation at around 1,200, and the total acreage sprayed with pesticides at roughly 20 percent of the crop area. IRRI rice varieties (IR-8 and IR-5) have been in use, although not with spectacular results and the cultivation of improved local rice varieties has expanded.

200. With the launching of the Ganges-Kobadak irrigation project in the mid-1950's and with the subsequent establishment of WAPDA in 1959, a serious effort was initiated to introduce better water control, such as flood protection and irrigation. In spite of the substantial capital expenditures, the production impact of these efforts has been modest to date. Reflecting this disappointment, the Government increased its expenditures on inputs -- which produce results in the short and medium term -- much more rapidly during the Third Five-Year Plan than on major water control works such as those being built by WAPDA. In fact, the growth of WAPDA expenditures leveled off. Thus, in 1969/70, the yearly expenditure on short and medium term inputs exceeded substantially those on major water control works. This shift in emphasis was initiated with the "Grow More Food" campaign, which resulted from a critical review of the production potentials in the early part of the Third Plan period. The shift in emphasis was consistent with the conclusions of the IBRD review of IECO's master plan for water and power resources development in East Pakistan. In view of an urgent need to expand food production, this change in emphasis was sound.

Constraints

201. The principal constraints to agricultural development are the complexity of East Pakistan's natural resources demanding, in principle, a relatively sophisticated input package and correspondingly sophisticated management; a lack of trained manpower; weak institutions; a low overall level of education affecting the farmers as well as all levels of administration and management, both in agriculture and in the non-agricultural sectors of the economy; an inadequate physical infrastructure, such as transportation, to support an agricultural modernization drive; lack of focus on the most promising development areas and regions as well as a lack of focus on key Province-wide programs; and inadequate growth rates in the non-agricultural sectors of the economy which could absorb the growth in the rural population.

202. A dominant characteristic of East Pakistan's agriculture is that its productive and economic potentials are mainly determined by hydrologic conditions, i.e., by drainage and flood conditions during the rainy season, and by the supply of irrigation water (but also by natural soil moisture) during the dry season. This hydrologic pattern is extremely complex; and with up to 70 percent of the Province seasonally flooded to some extent, the flood protection question has tended to become an obsession in formulating sound agricultural development programs.

203. Although flooding is a serious constraint to agricultural as well as non-agricultural development on a substantial portion of the land, there are large areas suited for intensified use without the need for construction

of drainage and flood protection works. These areas comprise about 6 million acres of land which are not flooded in excess of 1 foot after the end of July, and are thus suited for cultivation of new transplanted IRRI rice varieties (an additional 3 million acres are flooded approximately up to 1-2 feet and are thus suited for the cultivation of local transplanted rice varieties); and 14 million acres of land where IRRI boro/aus rice varieties can be grown; and about 4 million acres of land that is suited for double cropping of IRRI rice varieties. This breakthrough in knowledge was attained only during the last 18 months or so with the evaluation of the findings of the UNDP Soils and Land Capability Survey at its termination stage.

204. Another breakthrough with major consequences for rice production prospects has been in the development of IRRI rice varieties for the aman season resulting in a new variety (IR-20), which is clearly superior to its predecessors. The identification of suitable land for the cultivation of IR-20 has provided a basis for a major change in rice production programs from their previous exclusive dependence on the capacity to expand irrigation. With this new opening, much of the emphasis in the future will be placed on increasing the production of aman season rice crops -- which constitutes about 60 percent of the total annual rice production -- and an accelerated rice production program has been introduced recently. As its initial phase, about 200,000 acres will be planted with the IR-20 variety during the summer of 1970. This area should be adequate to produce seed for about 24 million acres. This means that there is an ample margin for failure, i.e., about 50,000 acres should be able to produce enough seed for the total area of 6 million acres on which IR-20 can be grown during the aman season. Thus, the seed could become the vehicle for achieving major improvements in rice production.

205. Nevertheless, the expansion of low-lift pump irrigation and tubewell irrigation as well as other aspects of boro/aus rice cultivation programs should be pursued energetically since there is no assurance as yet that IR-20 will be a success. In addition, it should be noted that new improved IRRI rice varieties are in sight also for these seasons. Irrigation is also needed for rabi crops -- such as pulses, oilseeds, sugarcane and tobacco -- which can take the place of boro rice in cropping patterns assuming that self-sufficiency in rice cultivation would be attained.

206. An increased reliance on the production contribution of major water control works will be necessary in the future because of the above-highlighted scarcity of land. Thus, the preparation and subsequent execution of polder projects for flood protection, drainage and irrigation appears necessary and foundations of these developments must be laid early enough to allow for their long gestation periods. However, in formulating such programs a clear distinction needs to be drawn between production and expenditure programs: there is a strong tendency in the thinking of many Pakistan authorities to consider that the development contribution of a program can be measured in terms of the volume of expenditures. In view of this, it needs to be noted that even the ambitious water control program will most likely have only a substantial impact on food and other agricultural production after 1980. This time lag was strikingly highlighted by the production projections made by WAPDA's general consultant for the tentatively considered so-called "hardcore program" which was an interim phase in formulating the water control program of WAPDA for the next few years.

207. East Pakistan's critical food supply situation, her pressing need to improve nutrition, her urgent need to improve farm incomes and increase foreign exchange earnings, seem to dictate that the overall agriculture sector program of the next five years must be so balanced as to assure an adequate effort and investment on inputs yielding production increases in the short and medium terms. It seems hardly justified to exempt WAPDA from this requirement since WAPDA is one of the three biggest spending agencies in the agricultural sector.

Development Strategy

208. The Government of East Pakistan has prepared proposals for an overall strategy for the development of agriculture over the next several years. They are essentially a continuation of the course of action that evolved during the last five years. Thus, agriculture and food programs would continue to receive high priority, while the importance of the water control program of WAPDA would decline. This reflects reservations about expansion of expenditures on water control programs, held since the "Grow More Food" campaign was launched during the early part of the Third Plan period.

209. The strategy proposed is sound in its main aspects. However, it overlooks certain development opportunities; more attention needs to be given to several major components implicitly included in the strategy and a further examination of the water control strategy is warranted. In short, certain modifications are called for. In particular, a need emerges for assessing the production potential for crops other than rice in the identified non-flooded areas; for accelerating ground and surface water investigations in these areas; for identifying the potential for increasing production in the short run in major existing WAPDA projects -- such as the Coastal Embankment and Brahmaputra Right Bank Embankment projects -- and in various areas considered for new WAPDA projects -- such as Barisal -- and for drawing up programs for them to develop their agricultural potential and to improve the supply and management of water; for re-examining the WAPDA program with a view to introducing better phasing of the entire program. The main change called for would be to divide major water control projects into several phases, each of which would bring tangible benefits to agriculture, i.e., the introduction of low-lift pumps in prospective polder project areas would form the first phase; pumping stations (stationary or possibly floating) with bigger pumps to lift more water into natural water channels previously supplied by low-lift pumps would form an interim phase of such development; and the construction of polders and provision of drainage and flood protection would form the final phase of project development.

210. There is no question that development of East Pakistan's agricultural potential is a task of formidable dimensions. It will require very large efforts to build up the capacity of the institutions involved in agriculture. The supply of inputs on a much larger scale than in the past must be organized. Moreover, stepped-up efforts to develop agriculture will have to be supported by programs elsewhere, particularly for the improvement and expansion of facilities for training and education and for the more adequate provision of physical infrastructure, especially in transport. In view of the dimensions of this task, concentration of effort on certain regions and crops will be necessary to ensure effective use of scarce resources. As for crops, rice obviously requires concentrated attention. In addition, however, jute -- long neglected

in a manner inexplicable in a country so dependent on it as a cash crop and an earner of foreign exchange -- urgently needs to be given attention and as a first step a comprehensive study of the industry, covering all its aspects -- from cultivation through marketing and processing to export -- and related policies should be undertaken.

211. The IBRD is assisting Pakistan in formulating a program for the development of the Province's agriculture and water resources. Its report -- expected to be available shortly -- deals in detail with specific programs and policies for the agricultural sector in East Pakistan.

C. INDUSTRY

212. Accelerated industrialization has been a major objective of economic policy of successive administrations during the last twenty years. The need for rapid sustained industrial growth results from three basic factors: First, Pakistan has large masses of unemployed and under-employed labor. With a population exceeding 130 million, it is the third largest developing country in the membership of the Bank, with a correspondingly large labor force. At the present per capita income and population growth rate close to 3 percent, agriculture must obtain first priority, but only a fraction of the labor force can be employed in agriculture productively and at rising real wages. No sustained advance in per capita income is possible without a massive shift in the occupational distribution in the direction of industry and associated service activities. Second, expansion of primary production for exports can provide only limited possibilities for growth in output and employment. Exports of primary products now account for less than 5 percent of GNP, and they consist predominantly of commodities - cotton and jute - for which world demand increases slowly, partly because of severe competition from synthetics. Third, a viable long-run balance of payments position cannot be envisaged without a large-scale expansion of industrial exports. Sustained growth in real income will require substantial growth in imports. A large proportion of capital goods will have to be imported for a considerable period; and Pakistan's natural resource base, as presently known, does not encompass petroleum and non-ferrous metals and therefore they must also be bought abroad in growing quantities to enable real income to increase. For reasons stated above, Pakistan cannot rely on primary export goods to assure the required long-run growth in the supply of foreign exchange.

213. Obstacles to industrialization were, and continue to be, formidable. They can best be visualized if it is recalled that at the time of Independence, Pakistan had almost no industry and that in some of the recently established plants, particularly in East Pakistan, the labor force has come straight from the rural areas, without any tradition in industrial skills.

214. The chief element of past growth strategy has been the development of industries based on processing domestic raw materials. This has meant, in the first place, the establishment of jute mills and cotton textile mills, catering to the needs of both the domestic and the world markets. These two industries now account for 45 percent of aggregate employment in large-scale manufacturing. Other agro-based industries -- sugar, leather, tobacco, paper, wool textiles -- account for an additional 20 percent of total industrial employment; of these, leather and wool processing are export-market oriented.

215. The rest of the industrial structure is essentially of import-substituting nature. This is the case with the metal-working industry, consisting mostly of light engineering goods, which employs 15 percent of the industrial labor force; and also with most of the chemicals, non-metallic minerals, rubber and miscellaneous industries which employ the remaining one-fifth. Among the latter, there has been notable development of large-scale production of construction materials (cement and glass, employing 2 percent of

the labor force) and of the fertilizer industry where some major new facilities are presently under construction. Both these industries are essentially based on the exploitation of domestic primary inputs.

216. The key criterion in project selection imposed by the Government, particularly in recent years, has been the minimization of use of imported inputs. Since it is agro-based industries that normally show small import dependence -- about 5 percent of gross sales value -- and since they are normally labor intensive, particularly in low-skill labor, the industrial structure which has emerged is characterized by heavy reliance on the two plentiful domestic inputs. The major exception occurred in the early 1960's, when many plants were licensed in import-dependent industries, induced by the low cost of exchange for imported capital equipment and for imported inputs.

217. The key mechanism of policy has been the manipulation by Government of prices of inputs and outputs and the associated shifts in profit rates, both between industry and other sectors of the economy and within industry, in order to pull private capital into the desired directions. Government ownership of industry is limited: in recent years, public investment has accounted for about one-fifth of the total, and in the earlier period it was even less. However, it is likely to increase in the future.

218. Economic growth in the different regions of Pakistan has been traditionally uneven and the resulting differences in income levels have presented the Government with very difficult problems in resource allocation. In particular, the issue of acceleration of growth in East Pakistan has proven most intractable. This region, where more than one-half of Pakistan's population is concentrated, has a narrow resource base; it suffers from a transport cost disadvantage in relation to other suppliers of the major markets in North America, Western Europe and Japan; and together with West Bengal, South and Central India, it contains the largest concentration of poverty in the world economy. The Government has attempted to stimulate industrial growth in East Pakistan through public investment, particularly in recent years, and special fiscal incentives have been applied to promote investment in private industry. These efforts have been only partly successful: private investors have preferred to undertake industrial projects in the more developed West. In the mid-1960's, only one-fourth of production and less than one-third of employment in large-scale private industry were located in East Pakistan. Despite large public investment, total annual industrial investment, public and private, in this region has remained below 40 percent of aggregate yearly investment in all Pakistan; and the proportion is lower both in aggregate accumulated capital stock and in aggregate industrial production and employment. Acceleration of industrial growth, and of overall growth, in East Pakistan has remained a major unresolved development problem for Pakistan and for the world community.

219. Despite the disappointment in East Pakistan, the results that have been achieved in the country as a whole have been impressive. Starting from scratch two decades ago, industrial production now accounts for 12 percent of aggregate output of goods and services and industrial investment represents one-fourth of total fixed capital formation. Since 1959/60, after the initial wave of industrialization, output has risen at almost 12 percent per annum. This is faster than the average in either developing or developed countries.

Substantial capital stock has been accumulated and rapid industrial growth is no longer a matter of large percentage increases on small base numbers. Gross sales of industry are now probably approaching the equivalent of US $2 billion.

220. The distinctive feature of much of Pakistan's industrial growth has been its export orientation. While the initial phase of industrialization was of import substituting nature, this has given way, since the late 1950's, to a continuing rapid expansion of production for exports. Cotton textiles and jute goods have been in the forefront of this expansion, but many other manufactures, ranging from leather to machinery, have also penetrated the export markets. Expansion of sales of manufactures has been the source of almost all growth of exports in the late 1960's; and today the former, at the level of about US $400 million, account for 60 percent of aggregate merchandise exports. Pakistan is one of the few developing countries in which industrialization has been accompanied by such rapid transformation of the export structure.

221. Following a period in which rapid industrial growth was accompanied by stagnation in agriculture, Pakistan has succeeded in achieving a large measure of inter-sectoral balance in recent years. The combination of new technology, a large increase in fertilizer use, and water availability due to irrigation investment, has brought about a substantial improvement in the agricultural situation. This has alleviated fears that further industrial expansion would be threatened by lack of effective domestic demand in the rural areas and shortage of agricultural raw materials for the processing industries. It can now be assumed that with appropriate programs and policies the agricultural constraint to rapid industrial growth will be less serious in the 1970's than was thought likely only a few years ago.

222. A substantial diversification of the production structure occurred during the last 10 years, with industries other than jute goods and cotton textiles increasing at a very fast rate. This was the case with chemicals, paper and paper products, and above all, engineering goods. Between 1959/60 and 1967/68, output of the engineering industries rose at almost 19 percent per year compared to the over-all growth rate in industry of 12 percent. The fastest increase was recorded in the output of machinery, both non-electrical and electrical, followed by processing of basic metals. The rapid growth of the engineering industry is explained, first, by a large and growing domestic market for capital goods, and second, by the availability of low-priced and mechanically-inclined labor with a long tradition in metal work and machine repair in certain regions in West Pakistan.

223. It would be surprising if past developments had not generated problems which now call for solutions. The most serious ones concern under-utilization of a part of industrial capacity, uneven distribution of benefits from industrial growth, and rising cost and price levels in industry.

224. Despite the high rate of export expansion, part of the sector suffers from a severe foreign exchange constraint 1/ which is reflected in insufficient supply of imported industrial raw materials,

---

1/ For an analysis see para. 144 ff. above.

components and spare parts. Together with a marked slow-down in the expansion of industrial investment, this has caused a sharp fall in the rate of growth of output by large-scale manufacturing from 15 percent a year in the first half of the 1960's to 8-9 percent in the second half. The foreign exchange constraint has resulted partly from the shortage of savings in the economy in relation to investment targets, accentuated by growing foreign debt service and possibly non-economic uses of exchange; partly, it has reflected the existence of surplus capacity -- surplus from the viewpoint of domestic demand and not sufficiently efficient to produce for exports -- induced by proliferation of new plants in an uncoordinated manner, particularly in the early 1960's; but mostly, it has been the result of practices which have stimulated the imports of finished products, particularly capital goods, and the associated establishment of new capacity while existing capacity, which could have been used to meet a part of the demand for finished goods, has remained under-utilized due to insufficient supply of imported inputs. The problem of capacity utilization has affected in particular the engineering industry in recent years: in mid-1969, it operated at probably one-half of capacity. Additional imports of inputs needed for this industry are of the order of $125-140 million per annum. Shortages of imported raw materials and spare parts are also encountered in the chemical industries; their magnitude varies greatly from industry to industry and would have to be separately investigated. In agro-based industries, shortages are mainly in spare parts.

225. The benefits from industrialization have been unevenly distributed. There has been growing concentration of industrial and financial power. Employment in industry and aggregate wages have been increasing _pari passu_ with the accumulation of industrial capital, but it is more doubtful whether there has been any significant increase in real wages. It is claimed that they fell between the mid-1950's and the early 1960's;1/ since then, there have been sharp increases in consumer prices which have probably offset nominal wage increases. Stagnating real wages and unsatisfactory working conditions in many plants, in the face of sustained high industrial profits, were a major cause of the social and political unrest in early 1969. Since then, minimum wages have been increased. There is a great deal for the Government to do to bring about improvement in working conditions.

226. Pakistan's industrialization has taken place at a price level different from that corresponding to the parity rate of exchange (Rs. 4.76 per US $1). On the average, industries based on processing domestic materials, mostly agriculture, export their products with a subsidy, in relation to the parity exchange rate, of about 70 percent; engineering industries sell their products on the home market at prices slightly less than double the C&F prices of competing imports; and chemical industries charge prices between 2.0 and 2.7 times C&F imports.

227. The widespread and large difference, at the parity exchange rate, between the domestic and foreign prices of industrial goods is a function of three factors: First, the parity rate reflects the relative efficiency and the wage levels in primary export agriculture, not in industry. The cost levels in the latter, relative to those abroad, are higher than cost levels in primary export agriculture, again relative to those abroad. Consequently,

---

1/ A.R. Khan, _What Has Been Happening to Real Wages in Pakistan_, Pakistan Development Review, Autumn, 1967. The period covered is 1954 to 1963/64.

while raw jute, raw cotton, rice and a few other primary goods could be produced and exported at the parity rate, neither industrial growth nor, indeed, virtually any activity outside traditional export agriculture is possible at that rate.[1/] Since the employment potential of the traditional primary export activities is severely limited, the policy of expanding employment, and specifically the policy of industrialization, has called, at the margin, for a cost-price relationship with foreign goods substantially different from that in the traditional and only slowly growing export agriculture. Second, profit rates in industry are higher than the international standard and this has tended to raise industrial prices. The reported average profit margin on sales is now 11 percent and was 14 percent in the early 1960's; the reported average profit rate on net worth is 19 percent; and informed observers argue that the true profits may be double the reported values. High profit rates have partly resulted from decisions on the rates of protection and of export subsidy; but they have also reflected the inducements needed to transfer capital from land and commerce into modern industry. Third, industrial goods, as well as imported inputs for their production, are subject to high fiscal charges in the form of sales taxes (20-26 percent) and import duties (frequently in excess of 50 percent), and these are transferred to final product prices. Taxation of industrial goods is a substitute for other sources of finance for the large Government expenditures and it has been increased frequently to meet urgent fiscal requirements.

228. The strength of each of the above three factors varies widely from product to product, and this leads to a divergence of the domestic price pattern from that in the outside world. Pakistan has succeeded in avoiding major direct adverse effects of this situation on the balance of payments, by operating a scheme incorporating both protection and export subsidies in different degrees for different products. However, the indirect adverse effects on resource allocation have remained, and they have increased as the industrial structure has become more complex. The engineering industry in particular has been exposed recently to drastic changes in cost-price relations which adverse affect its profitability and prospects for future growth. Cutting across individual product divergencies is the generally high price level of industrial goods in relation to prices of the traditional primary products; and as industrial production and other new activities gained in weight in relation to the traditional ones, the over-all price level has tended to rise.

229. Overshadowing these problems is the enormity of the task ahead. At the time of the last census of manufacturing in 1966/67, employment in [illegible] scale private industry was estimated at close to 600,000. Allowing for employment in small-scale industry and in Government-owned plants, total industrial employment is of the order of 900,000. This compares with the labor force which cannot be much less than 50 million. It is in this perspective that solutions to individual problems have to be found.

229. In the light of this analysis and the compulsions and constraints set out at the beginning of this chapter, several major considerations emerge that should act as guidelines for policies and programs for the development of manufacturing over the next several years. First, very substantial increases in industrial output could be obtained by fuller utilization of

1/ There is strong evidence that exports of both raw jute and raw cotton now suffer from inadequate production incentives as provided to producers by the Government's exchange policy.

existing capacity, particularly in the engineering goods industry. Measures designed to exploit this potential need to be given first priority, even if in view of the over-all constraint on exchange it is necessary, temporarily, to reduce investment in new facilities. To be fully effective, however, such measures need to be combined with modifications in the present policy framework surrounding industry with a view to ensuring greater efficiency in the use of resources.

230. Second, as regards investment in new facilities, questions arise with respect to both the pattern of future development and the instruments used for channelling resources in the directions desired. Industries producing light consumer goods based on processing domestic agricultural raw materials have in principle comparative advantage in Pakistan. Value added and the employment potential are high because major inputs are of domestic origin and the labor component in processing costs is substantial. Costs are comparatively low because wages are low in the production both of inputs and outputs, while the differential in the cost of transport of raw materials and finished goods favors location at the source of materials.

231. This comparative advantage in principle, however, holds only up to a certain point. If the absorptive capacity of the world market for specific products of agro-based industries is severely constrained, the operative significance of comparative advantage is severely curtailed once the supplying country's sales become a large proportion of the aggregate market. Volume increases then become offset by price reductions so that expansion in the value of sales fails to materialize, at least until competitors are driven out; and if they refuse to be driven out because they do not have easily exploitable alternative employment opportunities, cut-throat competition may ensue in which all competitors lose for a considerable period. Also, if there are quantitative restrictions on the volume of sales in the world market, expansion of sales becomes either impossible or possible only within clearly defined limits. Comparative advantage then almost ceases to be of any advantage.

232. The problem is compounded further if the country's primary export products also face severe market limitations and if the country suffers from large levels of unemployment and under-employment. In that case the expansion of primary exports can provide only limited relief to unemployment; and since under conditions set forth in para. 231. the employment potential of the agro-based industries is similarly constrained, the investible resources have to be channelled to the third best alternative. In short, the country then has to operate on the principle of least comparative disadvantage.

233. The effect is that the rate of growth in real income is lower than potentially possible. This works through prices and exchange rates. Domestic costs in the third best alternative (non-resource based industries), in relation to costs abroad, are higher than in the first (primary products) or the second (resource-based industries); this is reflected in an increase in domestic prices; these price increases spread over the economy as the weight of the new projects gains in relation to the total; ultimately, the exchange rate has to adjust to the new price level. Price increases of domestically produced goods and depreciation-induced price increases of imported goods depress real wages; and it is only at the relatively low level of real wages that production in the third best alternative is possible. Low real wages, of

course, mean low real income for the country as a whole. The country is still better off than it would have been without the new industries: real income is generated for as long as the costs are covered, and, also, unemployment is reduced. But the country would have been even better off if, instead of industries in the third best alternative, it could have expanded production in the second or in the first.

234. The adverse effect on resource deployment of external market limitations will be compounded if the country, restricted from undertaking the best projects, starts undertaking all projects that are offered. This will happen if protection and export subsidy for new projects are granted at rates in excess of those needed to undertake the projects in the third best alternative; or if the official exchange rate has ceased to be operative for a large segment of the economy and thus there is no general yardstick for measuring the efficiency of projects to be undertaken; or if there is no minimum standard rate of return which the new projects have to yield, at a given rate of protection and export subsidy and at a given exchange rate. (This latter point applies in particular to Government-owned projects.) In this case, the mechanism of domestic policy, designed to break the external constraint, becomes open-ended and generates projects indiscriminately, in anything-goes fashion. The result is a further shortfall from the potentially possible rate of growth in real income; and if protection is not accompanied by export subsidies, pressure on the balance of payments will increase.

235. This is obviously a simplified exposition of the problem. In practice, external market limitations are not water-tight and there is some scope for projects both in primary production for exports and in export-oriented agro-based industries. In addition, there is a domestic market for the output of these two project categories. On the other hand, in countries with large populations such as Pakistan, projects in other industries would have to be undertaken even if there were no restrictions on the exports of products of agro-based industries: this is because the latter cannot otherwise absorb all unemployed and under-employed labor. Also, the domestic market in these countries is of a size to permit a range of complex industries to operate at reasonably low real cost.

236. Pakistan faces external market constraints on its two key primary products -- cotton and jute. Such constraints also apply to finished goods based on these primary products -- jute manufactures and cotton textiles. In jute goods, the constraint arises from limited absorptive capacity of the world market and from severe competition by the Indian and the European jute industry. In cotton textiles, the main constraints are quantitative restrictions on Pakistan's exports to the developed countries and the growth of competing textile industries in other developing countries.

237. Despite these constraints, the possibilities of further production and market expansion are not exhausted. This applies not only to sales on the domestic market but also to exports. The domestic market for cotton textiles is large and growing, while Pakistan's sales to the world market, except in the case of yarn, are a small fraction of the total. World consumption of jute goods has been expanding at 4 percent per annum in the last decade; and while present projections indicate a lower rate of growth, earlier fears of total market stagnation have proved unjustified.

238. However, future expansion in these two product groups will have to be more carefully planned than in the past. Until the mid-1960's, Pakistan's share of the world market for jute manufactures was small and the expansion of Pakistan's sales had only a marginal influence on the world level of jute goods prices. By the mid-1960's, serious problems appeared: there was excessive expansion in one key product line, sacking; its price fell to the level of raw jute (indicating zero value added in manufacturing) and excess capacity had to be shut down. Pakistan's jute goods exports now account for a considerable proportion of world market in jute goods, and further expansion has to proceed according to a selective program prepared in advance if drastic falls in prices and corresponding losses in sales value are to be avoided.

239. Until now, Pakistan's cotton textile industry did not experience the restrictive effects of the International Cotton Textile Agreement: Pakistan's sales were below the quotas and the only constraint was the volume and quality of domestic production. In 1968/69, however, projected exports to the quota markets (U.S., U.K., the European Economic Community and Austria) amounted to 90 percent of the quotas. The major unfilled quota is that in the European Economic Community; expansion of Pakistan's sales to this area will require up-grading of quality and change in the product mix away from grey cloth to finished cloth. The nature of the Community's restrictions on yarn imports from Pakistan is not clear. Once the quotas are filled and unless there is a major liberalization in cotton textile imports of the developed countries, Pakistan's future export expansion has to be directed almost exclusively to other less developed countries and to centrally planned economies. Pakistan has achieved major successes in its export trade to these areas: they now account for four-fifths of its aggregate cotton textile exports. Export gains in cotton yarn to the markets in Japan and Hong Kong have been particularly impressive, although in some cases at excessive economic cost. Further export expansion is possible and some projections recently made indicate a rate of export growth similar to that of the last five years. The fulfillment of this target will depend on the speed with which competing textile industries are established abroad and on improvements in efficiency of the Pakistani textile industry. Pakistan's exports of cotton textiles -- cloth and yarn -- have increased at 17 percent p.a. in the last five years; but the world trade has been rising at only 2-3 percent. World market prospects are much better for ready-made clothing: international trade in this item has been increasing rapidly in recent years and Pakistan has considerable opportunities to participate in this expansion -- opportunities which so far it has not exploited.

240. Pakistan's achievements in the leather industry have been modest thus far. In the export markets in the developed countries, Pakistan faces tariff barriers which increase as the degree of processing increases. However, this has not been the only constraint: quality of leather goods has been low and this may have been a more important constraint to export growth than the tariff barriers. Further considerable expansion of leather goods exports is possible. In processed foodstuffs, Pakistan suffers from a disadvantage of geographical location, in comparison with other producers exporting to high income markets. However, it could develop significant exports to the U.S.S.R., especially in citrus fruits; and in frozen foods, its geographical disadvantage with respect to high income markets may not be significant and may be offset by high quality and low costs.

241. Two conclusions follow: over the medium term the existing agro-based industries can expand their exports, provided the quality of products progressively improves, price competitiveness is maintained and a careful program is prepared for future penetration of markets. In view of obstacles to trade, severe competition in the export markets for the type of agro-based goods which Pakistan produces and the likely growth of import substitution in some of its present market outlets, Pakistan cannot rely on these goods to assure over the long run that its import capacity will grow sufficiently to sustain rapid industrial advance and ultimately that its labor force will be fully employed.

242. It follows that parallel with continuing efforts to expand the exports of agro-based industries over the medium-term to the maximum extent feasible, and parallel with their expansion in line with growth of domestic demand, Pakistan must also turn to other sectors of industry which have good demand prospects and where Pakistan has, or may reasonably be expected to develop, comparative advantage and to keep to a minimum its comparative disadvantage. Such other product lines can be found in all sectors, but they are mostly concentrated in the engineering goods industry.

243. Over the last several years, a widening gap has developed between the pattern of resource allocation towards which considerations of private profitability pulled and that which was desirable from the economic point of view -- with respect to both the division of resources as between the creation of new facilities and better use of existing ones, and the pattern of new investment. In an effort to bridge this gap and make economic considerations prevail, an elaborate machinery was built up for sanctioning new investments. In the event, these efforts have proved far less successful in ensuring reasonably efficient use of resources than Pakistan's tight overall resource position would have warranted. There is, therefore, an urgent need now to bring about, through appropriate policy changes, a much greater degree of compatibility between private and economic considerations and thereby make it possible to reduce considerably the scope of direct controls over investment decisions.

244. Third, the general objective of accelerating economic growth in East Pakistan will require that strong efforts be made to raise East Pakistan's share in total investment in industry. This means that stronger incentives than have so far been employed need to be given to attract private capital to East Pakistan's industry. Part of such a package could be the restriction to East Pakistan -- with the exception of new and small entrepreneurs and, perhaps, selected priority industries -- of general tax holiday privileges. In addition, a scheme -- similar to one that has been operated successfully for the development of the depressed regions of Brazil -- might be introduced whereby companies would be allowed to invest part of their income tax liability in approved projects in East Pakistan. Even with such measures, however, a larger part of the burden for accelerating industrial growth in East Pakistan will probably fall on the public sector, principally the East Pakistan Industrial Development Corporation (EPIDC). In view of the size of the task awaiting this organization in future, its present state must be a matter of very serious concern. This is shared by the Government of East Pakistan which has begun to explore the possibilities of obtaining external assistance for improving the

management of EPIDC's affairs. In the meantime, however, the weaknesses of EPIDC will place severe limitations on the amount of additional resources that can be used effectively for the further development of public sector industry in East Pakistan.

D. POWER AND ENERGY

1. Introduction

245. Two government agencies and a private corporation dominate the power sector in Pakistan. In the East wing, the East Pakistan Water and Power Development Authority (EPWAPDA) generates and distributes all public power. In the West wing, the West Pakistan Water and Power Development Authority (WPWAPDA) - with headquarters in Lahore - serves the same function, except that the Karachi area is served by the Karachi Electric Supply Corporation Ltd. (KESC), a private stock corporation with substantial government participation. There are also some small private distributors. Captive plants in industry and elsewhere generated about 15 percent of the electric energy consumed in Pakistan in 1969, but this substantial amount is expected to decline as the quality and availability of public power supplies increase. In terms of annual generation and capacity, the power sector is only of moderate size, but in terms of area and population served, and number of employees, EPWAPDA and WPWAPDA rank among the largest utilities in the world. Total assets of all public electrical utilities are about Rs. 6.3 billion, or US $1.3 billion. Although this is a substantial amount, it falls short of the investment level needed to assure adequate and reliable power systems in Pakistan.

246. KESC has about 220,000 customers and sales were about 1,000 GWh in 1969. Its sales have been growing by about 17 percent in recent years, although the growth rate slowed down to 11 percent last year due to the generally unsettled political and economic conditions in the country. KESC has been able to keep up with fast-growing requirements for power for three main reasons: it has dynamic management, it operates on a sound financial basis and its commercial flexibility has ensured adequate operational success. Heavy investments were carried out in the past decade, in support of which KESC has received four IBRD loans since 1955, and the most recent one, made available in 1967, financed a 125 MW unit so that KESC's capacity is now 390 MW compared with a demand of 215 MW.

247. A total of Rs. 5.5 billion rupees has provisionally been allocated to the power sector in the Fourth Plan. The program is one of consolidation and reinforcement and rightly so. Less than 10 percent of the allocation is for new generation and the bulk goes for expansion and reconstruction of transmission and distribution facilities. Nonetheless, the proposed investment program should prove adequate to meet the needs of the sector through the Plan period (more than adequately in the East), provided that investments are channelled into system improvements as planned. Any deviation from this policy (e.g., extensive rural electrification) can only result in prolonging and worsening the unsatisfactory system conditions that presently exist in many areas.

248. The small generation component in terms of cost is the result of two factors: First, the low incremental costs of extending generating capacity at Mangla and Tarbela in the West, and, second, catching up in

transmission and distribution with the large over-investment in generating capacity made during the Third Plan in the East. The situation in the Fifth Plan will not be nearly so favorable.

249. There is a notable lack of new large identifiable projects in the Fourth Plan period, partly as a consequence of the generating situation. This may pose serious problems in obtaining external financing for the foreign exchange cost of the program. Increasing amounts of commodity assistance (particularly metals) will be required, and financing for unglamorous transmission and distribution equipment has always been difficult to obtain. In this respect, Pakistan would be well advised to define its requests for transmission and distribution projects in terms of hardware content or objectives (e.g. KVA of substation capacity, miles of line) rather than as specifically identified physical facilities, and external financing agencies should be encouraged to accept these definitions. The particular benefit to be gained from this approach is increased flexibility (and, therefore, more efficiency) in the use of aid-financed materials.

250. Demand for electric power in Pakistan is expected to grow 2½ to 3 times within the next decade. Since, as pointed out above, the Fourth Plan investment program is essentially one of consolidation and reinforcement, if these demands are to be met, the Fifth Plan investment program will probably be at least double the one proposed for the Fourth Plan. It is not too early to start planning for the financing that will be needed to support such a program. In this respect the need for a greater return from the public corporations has been recognized in the Fourth Plan Outline. The Government's power agencies are notably deficient in this respect; WPWAPDA's return on net assets in 1968/69 was only 5.2 percent, while EPWAPDA showed hardly any return at all. In contrast, KESC's record of a 10-14 percent rate of return and the financing of over 50 percent of its capital requirements in the 1966/1970 period has been good. Authorities in both East and West Pakistan are aware of the problem and are taking steps to increase the amount of capital to be contributed to the investment program by the beneficiaries, but aggressive financial management and the wholehearted support of the Government will be needed if these efforts are to be successful. A notable difficulty is that of tariffs; particularly agricultural tariffs. In spite of the failure of WPWAPDA's efforts to introduce a revised tariff form for tubewells last year (which would have resulted in lower costs to farmers with efficiently-utilized wells, and incidentally, was less subject to subversion than the old rate form), this subject remains one of critical importance in the context of resource mobilization and channelling of investments into economic activities. A second need is some form of debt rationalization and revaluation of assets to remove the inequities that have arisen in the valuations of utilities as a result of the multiple exchange system, especially the valuation of bilateral commodity aid and imports under barter agreements.

2. West Pakistan

251. WPWAPDA operates over 1200 MW of capacity in three independent systems, but by 1975 two of these systems will have been interconnected with that of KESC to form a 3,000-MW grid covering the Indus Basin from

Karachi in the South to Tarbela in the North, a distance of over 1,000 miles. WAPDA's main generating sources are the hydro plants in the North at Warsak (160 MW) and Mangla (400 MW), and thermal plants at Lyallpur (132 MW), Multan (265 MW) and near the gas fields in the South at Sukkur (50 MW), and Gudu (220 MW, under construction). In addition, there are gas turbines at Lahore and Hyderabad, and several small hydro stations on irrigation canals. The small system at Quetta is based on a coal-fired plant.

252. Power consumption has been growing at 17-20 percent per year, and WPWAPDA has been hard-pressed to meet the demand. Unsatisfactory planning - in part attributable to the complexity of bilateral aid - inadequacies in system operations and in WPWAPDA's organization, and a serious shortage of local financial resources have resulted in the current shortage of transmission, distribution and substation capacity. The investment objectives of the Fourth Plan power program are designed to correct some of these deficiencies.

253. As of June 1969, WPWAPDA had over a million customers, mostly in urban areas, and in the preceding year had sold about 30000 GWh, in the following categories:

Industrial	1360 GWh	(47%)
Agricultural (Tubewells)	750 "	(26%)
General and Commercial	410 "	(14%)
Bulk Supply	400 "	(13%)

The importance of industrial and agricultural sales is evident. Bulk sales are primarily to private distributors operating in Rawalpindi and Multan; WPWAPDA sells at retail throughout the rest of the service area. Substantial growth rates in power sales have been maintained over the past 10 years despite load shedding due to equipment shortages and breakdowns, the Indo-Pakistan War, and periodic refusals to connect new loads (there has been a moratorium on connection of agricultural and industrial loads since September 1968). Simultaneously, there has been a steady increase in losses and energy unaccounted for, from 24 percent of net generation in 1966 (already quite high) to 32 percent in 1968/69. Increases in distribution system losses due to the need for system rehabilitation in urban areas account for a large part of these losses, but unrecorded consumption also is significant and distorts the consumption figures given above.

254. WPWAPDA's future generating program includes the 2100-MW Tarbela project (the first stage, 700 MW, is under construction), additional units at Mangla (200 MW) and a 200 MW addition at Gudu, in addition to the one presently under construction there. No new generating sites are proposed through 1980, with the possible exception of a 200 MW development at the Lakhra coal field near Hyderabad. The 132 kV transmission system will be extended south from Sukkur to Hyderabad and on to Karachi by 1972, replacing the temporary Hyderabad-Karachi connection and completing the interconnection along the full length of the Indus Basin. To make full use of Tarbela, however, a stronger tie is needed and will be provided by

a 500-kV transmission link. The first section of this line, from Lyallpur to Gudu, is to be built under a proposed Russian credit, and the Tarbela-Lyallpur link is now being designed. The section from Gudu to Karachi is being re-examined because of potential problems with saline corrosion and contamination.

255. This generation and transmission program, together with on-going projects, accounts for 52 percent of WPWAPDA's proposed investment during the Fourth Plan period. The remaining 48 percent of the investment is for secondary transmission (15 percent) and distribution (33 percent). This program would increase WPWAPDA's total fixed assets by 66 percent in the next five years. Though not an excessively high rate of expansion for an efficient utility of WPWAPDA's size, it may be expected to put a severe strain on WPWAPDA's resources until such time as organizational reforms can be introduced. It will also put a severe strain on the financial resources of the Central and Provincial Government unless WPWAPDA's internal financing capabilities are raised.

256. WPWAPDA's power investment requirements for 1970/71 through 1973/74 amount to Rs. 2,300 million (US $482 million), and an IDA credit - currently being negotiated - would cover 5 percent of these requirements, other foreign loans approximately 35 percent and loans from Government 37 percent. Miscellaneous income would provide about 2 percent and it is expected that WPWAPDA would finance the balance of 21 percent from its internal cash generation. To make this possible, however, would require measures to raise WPWAPDA's financial rate of return which is very low at the present time. The following table clearly brings this out, as well as other unsatisfactory aspects of WPWAPDA's operation in the 1965/66-1968/69 period.

Item		1965/66	1966/67	1967/68	1968/69
1.	kWh sent out (million)	2,754	2,847	3,520	4,294
2.	kWh sold (million)	2,089	2,098	2,486	2,939
3.	kWh sold as a percentage of kWh sent out	76%	74%	71%	68%
	Electricity sales:				
4.	Revenue (Rs. million)	229	243	280	324
5.	Annual increase, percentages	12%	6%	15%	16%
	Operating expenses:				
6.	Amount (Rs. million)	157	203	191	239
7.	Annual increase, percentage	15%	30%	(6)% 1/	25%
8.	Operating ratio (operating expenses to operating revenue)	64%	75%	61%	66%
9.	Net income (Rs. million)	14	(14) 2/	35	2
10.	Rate of Return	4.7%	3.5%	6.1%	5.2%

1/ Decrease
2/ Net loss

257. The data in the above table do not depict very successful operations. Especially significant is the percentage of kWh sold to kWh sent out, which shows a very unfavorable trend. 1966/67 was a particularly unfavorable year,

as indicated by the low rate of return of 3.5 percent, but this was primarily attributed to the aftermath of the Indo-Pakistan War.

258. Low rates of return have forced WPWAPDA to rely heavily on borrowings not only abroad, but also from the Central Government and the Provincial Government of West Pakistan where it has pre-empted a significant amount of scarce resources. This is but a particular example of the general inadequacy of past Government policy with respect to the pricing of public services. The proposed Government policy as announced in the Fourth Five-Year Plan Draft Outline is different: "The Government should issue directives to the public corporations to undertake a review of their investments and performance of past projects. A yardstick in the form of a minimum return of 10 percent (over and above debt servicing obligation) should be laid down". If taken, these measures would go far in improving the savings performance of the major public undertakings, which could make a substantial contribution to domestic resource mobilization, an area of critical importance in the next five years. However, there are already indications that the Government is not sufficiently aware of the implications of the proposed policy for the power sector where sizeable tariff increases are clearly called for to reach the objective of a minimum 10 percent rate of return.

3. East Pakistan

259. The East Pakistan Water and Development Authority (EPWAPDA) is practically the only supplier of power in the East Wing. Two independent systems are operated, one on each side of the Brahmaputra. Overall demand has been growing at 16 percent per year, with peak demands in 1969 of 40 MW and 170 MW on the west and east sides of the Brahmaputra, respectively. Inadequate expansion planning - stimulated by the liberal availability of bilateral credits - has resulted in over-investment in generating capacity which will amount to more than 700 MW when present projects have been completed. As a result, EPWAPDA's investment per KW of demand is one of the highest in the world.

260. The standard of service is poor owing to environmental conditions and to a shortage of transmission and distribution facilities. EPWAPDA's proposed Fourth Plan investment program concentrates on investments in transmission and distribution to correct this - the program includes an interconnector to link the systems in the East and West, and Canadian finance has been offered for this project - except for the $85 million 200-MW Rooppur nuclear plant proposed by the Pakistan Atomic Energy Commission (PAEC) to be financed by Belgian sources. There must be concern about this apparent misallocation of resources which cannot but result in a worsening of an already serious situation of excess generating capacity.

261. EPWAPDA's staggering debt burden is a result both of overinvestment in the past decade and of an unsatisfactory financial performance as evident in its getting hardly any financial return on its investment. This situation calls for urgent corrective action.

4. Energy Resources

262. About half of the electrical energy consumed in East Pakistan is generated in one hydro-electric plant (Karnaphuli), but this represents virtually full exploitation of the East's hydro-electric potential. On the other hand, although hydro power also supplies about half of the energy in the West, present capacity represents utilization of only about 10 percent of the estimated resources. When both Mangla and Tarbela are fully developed, this figure will rise to 30 percent. Further development of the West's hydro resources may not be economical because the potential capacity is mostly in the mountains in the north and in Kashmir, an area which not only presents political problems, but also is far from the major load centers. Future expansion of energy usage will therefore have to be based largely on resources other than hydro.

263. Natural gas represents the next major energy resource and is abundant in both East and West. Reserves in the West are estimated at 15 million million cubic feet, but some of this is not economically recoverable or transmittable over long distances because of poor quality or unfavorable location, but is suitable for generating power in the gas fields for economic transmission to load centers. Reserves in the East are estimated at 9 million million cubic feet, most of which should be usable. Even if no more gas is discovered in the East (and exploration has stagnated because of the present low rate of consumption as compared with the proven reserves) assuming 60 percent is allocated to power production this would be sufficient for 2500 MW for 30 years, or over ten times present demand.

264. Pakistan has some coal in both East and West but the deposits are either small, poor quality, or difficult to recover and therefore economical only if developed on a very large scale. At present, commercial use of Pakistan coal is limited to the mines which supply the small power plant at Quetta in the West (15 MW, now being expanded), and minor use in the East. Some oil is produced in the Punjab (about 15 percent of present consumption of petroleum in the country) but there is no indication that liquid-fuel reserves are substantial. However, significant amounts of refinery residuals (from either local or imported crude) are expected to be available for use in power production in the future and plans are in hand to use it.

265. Pakistan is now constructing its first nuclear plant (a 125-MW natural uranium heavy-water moderated plant of the CANDU type near Karachi), being built under Canadian aid and due for commercial operation early in 1971. Plant construction has progressed generally on schedule. Enough heavy water for the initial loading has been obtained despite the current world shortage of this commodity, but reliable arrangements for a continuing supply have yet to be made. Construction of a second nuclear plant is proposed, to be located at Rooppur in East Pakistan. Belgian aid is being considered for a 200-MW unit, but the technical and economic justification has not been fully established. Pakistan would be well advised to undertake a further study of the technical feasibility and economic consequences of operating such a plant in the East Pakistan system at this time, and to make a realistic assessment of the costs of such a

plant in view of the heavy demands that would be made on foreign exchange, technical manpower, and other scarce resources, and the heavy over-investment in existing generating plant. Pakistan may have to turn to nuclear energy in the future to conserve its own energy resources, but steps in that direction at this time seem premature.

266. This points up a recurrent constraint in Pakistan -- the lack of a comprehensive energy resources policy. Such a policy should (i) resolve the present indecision as to what portion of natural gas, say, could be economically utilized as feedstocks for fertilizer and petrochemicals and how much could be made available for power production, (ii) integrate the exploration program with forecast energy needs, (iii) rationalize the reserve projections (i.e., define reserves in terms of usable resources rather than absolute amounts, on a common base), and (iv) establish guidelines for the most economic utilization of commercial energy resources. Coordination could be provided by the recently-established Geological and Mineral Development Coordination Board, but a new commercial energy survey to update and expand the study made in conjunction with the IBRD-sponsored 1967 Indus Basin study (the Lieftinck report), is also needed. Energy policy should be clearly established by the time the next major power investment decisions are required (i.e. 1972/73).

E. TRANSPORT

1. Introduction

267. Over the past ten years, transport has become an important and dynamic sector in Pakistan's economy: transport, communication and storage now account for 6.5 percent of the Gross Domestic Product and over the past decade the sector has grown on average by 6.7 percent per year, as against 5.6 percent for the economy as a whole. Transport provides the bulk of services originating in this sector. The important growth elements relate to highway transport, port movements and air traffic. The contribution of railway traffic has been negligible in the recent past. Most of the transport growth occurred in West Pakistan, reflecting the fast growth of the economy in that wing and the increasing trend towards commercialization of the economy. In East Pakistan, transport growth did not exceed 4 percent per year.

268. The characteristics of the transport industry differ greatly between East and West Pakistan. East Pakistan has numerous waterways, and inland shipping - both by mechanized craft and traditional country boats - is a major transport feature. Highways which must be built on embankments to avoid flooding, are difficult and expensive to build and are made less efficient by numerous and inadequate ferry crossing. Railway operations suffer similar drawbacks. To these problems are added the fragmentation and limited capacity of the contracting industry in that wing. In the West, there is no inland shipping, and highways and the railway provide most transport services. The table below highlights some of these differences:

	West Pakistan	East Pakistan
Railroads		
ton-miles (1968/69)	4.7 billion	0.7 billion
passenger miles (1968/69)	6.5 billion	2.2 billion
Highways		
total road mileage (1966/67)	47,479	17,741
road mileage under Highway Department (1966/67)	18,543	3,297
petrol consumption by motor vehicles (long tons) (1968/69)	298,006	64,835
H.S.D.1/ consumption (1967/68) (gallons)	89.8 million	4.1 million
estimated ton-miles (trucks) (1967/68)	5.6 billion	n.a.
Inland Water Transport		
estimated number of boats	nil	over 300,000

1/ High Speed Diesel Oil

2. West Pakistan

269. All transport modes, ranging from camel train to jet aircraft, are represented in West Pakistan. The main traffic flows serve the thickly-populated area in the northeast centered on Lahore. This area generates flows southwest to the port and industrial area of Karachi some 700 miles away; west to the industrial and agricultural area around Lyallpur, Sargodha and Kushab; and northwest to the administrative centers in Rawalpindi and Islamabad, and to Peshawar and the Afghan border beyond. All these main routes are served by rail, road and air transport. For many years, the railways provided the main means of mechanized transport, but over the past five years an increasing proportion of transport has been carried by road, and railway traffic has shown little, if any, overall growth.

Road Transport

270. Over the years, use of highways has been growing rapidly, and data suggest that the increase in road traffic is related to an increasing intensity of vehicle usage as well as increases in fleet size. Between 1963/64 and 1968/69, the trucking fleet increased by about 6 percent a year while the number of private cars increased at slightly higher and buses at slightly lower rates. The total vehicle fleet stood at 147,000 in 1968/69, or one motor vehicle for every 330 persons. This compares to one vehicle for 130 persons in Iran, or one for 500 in India. During this period, use of high speed diesel (HSD) by motor vehicles increased by 15 percent per year - more than twice as fast as the growth in the number of buses and trucks, which use most of the HSD. The use of petrol, on the other hand, increased by 7 percent per year or at about the same rate as the growth in the number of private cars. Therefore, while total capital invested increased at about the same rate as the Provincial Domestic Product, this capital was used with increasing intensity.

271. Surveys carried out by the Transport Planning Cell of the West Pakistan Planning and Development Department have provided a good deal of information about trucks and buses (17 and 6 percent of the motor fleet respectively). Most trucks are individually-owned and are operated by hired drivers. About 90 percent of truck traffic is inter-city and very high load factors apply, averaging almost 95 percent. In the principal traffic direction, the average load is 134 percent of official capacity while back-hauls yield a 55 percent load factor. (The figures are slightly higher for inter-city trucking, lower for local movements). Trucks have an average lifetime use of 500,000 miles, running on average about 45,000 miles per year. The annual mileage figure would probably be higher if there were no shortage of repair facilities. The high cost of trucks (the effective ad valorem duty ranges from 40 to 45 percent) and the fact that investment funds typically originate from non-institutional sources where interest rates are probably in excess of 20 percent, provides adequate incentive for the intensive use of commercial vehicles.

272. Agricultural products account for almost one half of the volume of all inter-city truck shipments with fruits and vegetables comprising the largest category. Thus, a major portion of inter-city trucking deals with goods which require quick delivery, a feature in which trucking has a strong advantage over rail service. Local traffic consists of agricultural commodities (1/3 of the total traffic) with stone, ballast and petroleum products making up another significant portion.

273. About 80 percent of all buses in West Pakistan are owned by the publicly-owned Road Transport Corporation (RTC), the remainder by private owners. Like trucks, buses are operated with very high average load factors, as the following table indicates:

Percentage of Trips Full 1/ or more than Full

	Local	Inter-City
RTC	100	98
Private	99	90

1/ Refers to seating capacity.

The level of bus fares is an important policy issue. Financial rates of return for the publicly-owned RTC bus operations have been about 3-4 percent in recent years. The policy of low fares for the RTC causes chronic financial difficulties and to the extent that it artificially induces traffic demand, a misallocation of resources. It obviously places private bus operators in a disadvantageous position. RTC's rates, therefore, should be raised without delay, so as to achieve satisfactory returns.

Road System

274. The rapid increase in motor vehicle traffic in recent years has placed a heavy burden on an inadequate road system. While roads currently connect all important centers of operation and production, a large proportion are single-lane with a capacity quite inadequate for the large volume of motor-vehicle, animal, and pedestrian traffic. Traffic on these single lane roads often exceeds 500 motor vehicles per day, considerably in excess of the volume generally required to justify the widening of single-lane roads to two lanes. Studies have shown that the widening and strengthening of existing roads offers far greater economic benefits than new highway construction and the authorities would be well-advised to take the conclusions from these studies into account while designing an investment program.

275. There are about 48,000 miles of road in West Pakistan, or about 7 miles of road per 100 square miles. This compares to 4 miles of road per 100 square miles in India, and 1.6 miles of road per 100 square miles in Iran. Forty percent of these roads are maintained by the provincial highway department, with the remainder under the control of District Councils and other local authorities.

Road-user Charges

276. While precise figures are lacking, there is not much doubt that public revenues derived from road users exceed expenditures on the road system. The revenues are not, however, necessarily collected at the same government level as expenditures are disbursed, nor are the greater part of the receipts earmarked for road maintenance, improvement or construction. In 1967/68, the Government of West Pakistan (GOWP) spent about Rs. 182 million on the maintenance and construction of major roads and highways. In addition, other Provincial authorities and district and municipal agencies spent about Rs. 120 million, to yield an overall total of about Rs. 300 million.

277. Direct fuel taxes yielded a net return of about Rs. 245 million in 1967/68 which accrued to the Central Government, as did customs duties on fuel, vehicle and spare parts. These latter totalled Rs. 320 million inclusive of an indeterminate amount from imports of coal, kerosene and railway diesel fuel. The GOWP collected about Rs. 63 million in vehicle taxes, while the municipality octroi charges levied on goods traffic totalled Rs. 140 million, inclusive of rail traffic. Thus, identifiable road taxes yielded Rs. 308 million in 1967/68 - slightly in excess of expenditures on the road system - while other receipts, of which a substantial part was attributable to use of the roads, totalled another Rs. 460 million.

278. From the direct fuel taxes levied, the Central Government allocates 31 paisa per gallon to a Road Fund. Withholding 15 percent of Fund resources for research, testing and reserves, the Central Government allocates the balance to the highway authorities of the respective Provincial Governments for road construction on the basis of road mileage, population and Fund contributions. Between 1960/61 and 1967/68 East Pakistan contributed 20 percent of Fund revenues but received 28 percent of Fund allotments. West Pakistan contributed 80 percent but received 72 percent. Total funds allocated totalled Rs. 161 million during this period.

279. Of the expenditure by the GOWP Highway Department, construction accounted for Rs. 121 million, maintenance expenditures Rs. 53 million, and establishment expenditures Rs. 8 million. Expenditures by the GOWP on maintenance work have increased at roughly 14 percent per year from 1963/64 to 1968/69, while construction expenditures have increased by over 20 percent per year during the same time span. Maintenance expenditures are far below a reasonable level.

280. Proposals for the Fourth Plan call for increased investment in roads. About 1,250 million rupees has been requested by the Highway Department, which is planned to be enough for widening and reconditioning 1,500 miles of major roads, 750 miles of minor roads, and for building 169 miles

of superior highways. The political reorganization of West Pakistan surrounds all these plans with considerable uncertainty. Until political priorities are settled, it will be difficult to predict new developments in highway construction and maintenance.

Railways

281. The Pakistan Western Railway (PWR) is in a period of stagnation in terms of traffic, and of slow deterioration in terms of operating efficiency. From 1963/64 to 1968/69, passenger-miles have grown at less than 1 percent per year, in spite of disproportionate increases in passenger service, while freight ton-mileage has decreased slightly. Ton-miles per day per wagon have decreased from 408 in 1963/64 to 372 in 1968/69. The financial rate of return has declined from over 10 percent in 1963/64 to less than 8 percent in 1967/68.

282. The PWR receives substantial subsidies from the Government. Prior to July 1968, purchases of current imports were permitted at the parity exchange rate of Rs. 4.76 per US dollar rather than at the cash-cum-bonus rates pertaining to most industries (about Rs. 8-9 per US dollar), involving an effective subsidy of about Rs. 100 million annually. Since July 1968 this subsidy element has been eliminated, except that it continues to exist with respect to imports of capital goods. Government capital funds are required to yield interest at rates far below the opportunity cost of capital, ranging from 4 percent per annum (up to 1965) through 5 percent (1965-1969) to 6.25 percent at the present time. The subsidy element in these low interest rates has not been computed but it is substantial.

283. Against this, the PWR has traditionally been used as an instrument of national policy to subsidize the movement of some types of traffic (e.g. foodgrains) and to provide services considered socially desirable, whether economically justified or not. It is not known whether the uneconomic rates and services demanded of the PWR are balanced by the indirect subsidies outlined above, but it is certain that the rate-making, operational, and investment policies of the Railway are affected by its designated public service role.

284. The PWR's services are being challenged by road transport offering better service and in the case of trucking complete rate flexibility. While railway traffic registered practically no gains during the five-year period 1964/65 - 1968/69, the Gross Provincial Product increased over 6 percent annually, and the size of the motor vehicle fleet as well as the consumption of motor fuels increased at least as quickly.

285. While road transport has distinct advantages for short-haul, low-volume traffic, the railway can normally expect to attract long-haul movements or those involving high volumes of bulk traffic. If, however, the natural economic advantages of the railway are dispersed or distorted by the direct or indirect results of government policy, as in West Pakistan, road transport may encroach on the normal rail market, frequently resulting in an economic loss to the nation as expensive trucking replaces potentially cheap rail service.

286. A change in government policy towards the role of the PWR, to relieve it of its public service burden, and improved management to increase efficiency are the prime requisites of the PWR. At the present time, operating inefficiencies appear to relate more closely to techniques and procedures than to equipment requirements. This is clearly illustrated by an analysis of rolling stock movements which reveals that loading, unloading and shunting time account for 85 percent of the total for a specific movement, while only 15 percent relates to the actual running time over the route. Improvement in wagon turn-around, which has deteriorated to 11.3 days in 1968/69 from 9.3 days in 1963/64, is therefore more a question of management technique than the purchase of newer locomotives or additional wagons. Operations consultants are now employed to help improve technical aspects, particularly on the critical Karachi-Lahore route. The PWR is further committed to the appointment of management consultants at an early date. If, in the interests of transport coordination, the PWR, released from public service requirements, were required to pay realistic interest charges on borrowed capital, it would be placed on an equal status with the road transport industry with respect to service competition.

287. At the same time, a new outlook on marketing is required. Competition from highways is increasing, and it would pay the PWR to concentrate on those areas where it has a competitive advantage. Long-haul express goods trains, say from Karachi to Lahore, which could handle bulk shipments, would offer obvious economies over shipping by truck. If, however, the PWR continues to try to compete for short-haul, small shipment traffic, its economic position is likely to deteriorate.

288. Under present conditions it is estimated by the Planning and Development Department of the GOWP that highway traffic will become increasingly dominant in the next few years, as indicated in the following table:

Percentage Distribution of Traffic

	1967/68	1974/75 (estimated)
Passenger-miles		
highways	52	60
railroads	48	40
Freight (ton-miles)		
highways	46	56
railroads	54	46

Investment scheduled during the Fourth Plan includes Rs. 690 million for spillovers from the Third Plan and Rs. 810 million for new projects, for a total of Rs. 1,500 million. Of this total Rs. 550 million are planned for new rolling stock, Rs. 300 million for improvements in track, and Rs. 220 for improving signalling, marshalling yards, etc. The status of this plan is uncertain.

Ports

289. Karachi is the only sea-port in West Pakistan. Capacity at present is roughly in line with demands for service, but a severe shortage of facilities is likely to emerge within the next five years. There are now 21 berths, and 4 new ones are being constructed. Water depths can accommodate most ships (with the exception of the mammoth type bulk carriers) and compare favorably with those in most ports in developing countries. Ships up to about 30,000 tons can be handled. The access channel is sufficient at present. Delays in handling cargo because of sea and weather conditions are rare. The good weather has, however, encouraged the direct delivery of export commodities to ships by rail and truck. The lack of a more organized system of storage for export goods will likely cause delays in the near future as traffic increases. Import cargo is now stored in well-protected sheds, and a system of 7 days free storage followed by a fee that increases quickly with the passage of time encourages the smooth flow of import commodities.

290. Imports reached 5.5 million tons in 1968/69, with liquid bulk oil accounting for 60 percent. Other important imports are fertilizers, iron and steel. Based on expected increases in oil, fertilizer, iron ore and iron and steel, imports may well more than double their 1968/69 level by 1974/75. Exports of 2.9 million tons were handled in 1968/69, the major commodities being cement, cotton and cotton goods, rice, and liquid bulk (oils). Important increases are expected in exports of wheat, cement, and rice. This and other increases may cause total exports to reach 5 million tons in 1974/75.

291. There are several aspects of cargo handling which will become increasingly costly as congestion increases and which could be remedied. (1) The shortage of warehouses for export goods causes an inefficient loading procedure. (2) Crude oil is pumped to refineries 15 and 18 miles distant. The refined oil is then pumped back to the port area where it is loaded on rail or highway carriers. This causes considerable congestion. The process of distribution from the refinery need not impinge on scarce port facilities in this way. (3) Inadequate highway connections could be alleviated with by-pass routes around Karachi to the new Karachi-Hyderabad highway. (4) There are only three oil jetties, none of which are accessible to large tankers. Offshore storage and pumping facilities might greatly reduce turn-about time.

292. The major longer-term requirement is more berths. The port is currently exceeding 70 percent of its capacity which means that ship waiting time during peak periods is often of a long duration. A major expansion of the port would take about 5 years and is unlikely to occur in time to avert severe congestion in the future. A completely new port could be built at Sonmiani but this would probably take around 10 years. In either event, it is important that plans be formulated in the near future. This is being done.

3. East Pakistan

Highways

293. Motor vehicle transportation, while less important than in the West, has nonetheless increased at a more rapid rate than the East Pakistan economy as a whole. Registration of vehicles increased by 14 percent per year from 1963/64 to reach 64,700 in 1968/69. There are still, however, about 1200 persons per motor vehicle, roughly 4 times as many as in the West. The fleet is divided roughly in the same proportion as in the West, with buses accounting for 8 percent of all vehicles, trucks 13 percent, cars 33 percent and motorcycles 32 percent. Vehicle use, as indicated by fuel consumption, is difficult to gauge as no time series exists for the consumption of HSD. Petrol use, however, has increased by only 6 percent yearly - far lower than the increase in the number of vehicles - suggesting that a growing proportion of new vehicles consume diesel fuel. One half of all vehicles are registered in Dacca, with 20 percent in Chittagong and most of the remainder centered on Khulna and Sylhet.

294. The road network currently consists of about 18,000 miles, with about 3,300 miles of these maintained and controlled by the provincial government's Roads and Highways Directorate as the main trunk highway system. Only about 2,300 miles are paved and most of this mileage is 8-10 foot single lane construction. Road construction is expensive because of the necessity for substantial embankment work to prevent flooding during the monsoon, and also because of the shortage of road-building materials, such as stone and gravel.

295. Inter-city road movements are hampered by inadequate crossing facilities at a large number of rivers cutting the main routes. The economic effects of improving these crossings by building bridges or installing adequate ferries is to be studied under an IDA Credit in the near future. It seems clear, however, that elimination of the uncertainties of travel, or the loss of travel time currently resulting from the inability to effect crossings quickly and safely, will yield important net benefits and increase the scope of road transport throughout East Pakistan substantially.

296. Investment expenditures on highways have varied greatly from year to year, but a general upward trend is visible. For 1969/70 Rs. 96 million are budgeted, compared to Rs. 78 million in 1965/66. Maintenance expenditures have increased consistently, from Rs. 12 million in 1965/66 to Rs. 27 million in 1969/70. Their level, however, remains far below maintenance needs. Proposals for the Fourth Plan call for expenditures of Rs. 1,450 million, of which schemes thrown-forward from the Third Plan will take up as much as Rs. 1,250 million. This means that few new projects can be approved and implemented during the next five years. As with West Pakistan, the status of Fourth Plan investment is uncertain.

Railways

297. The Pakistan Eastern Railway (PER), consisting of trunkated sections of the former Indian railway system serving both Bengal and Assam, is beset with the technical problems of operating on two track gauges (broad and meter) over its 1,781 system miles, and maintaining a connection between the two gauge systems via railway ferries across the notoriously unstable Brahmaputra river. These problems are aggravated by an outdated rate and fare structure and inefficient and inadequate managerial procedures.

298. As a result of these difficulties and shortcomings, combined with the fact that distances are short in East Pakistan and hauls of more than 300 miles are rare (the average is 150 miles), the PER is susceptible to competition, particularly from road transport. Between 1963/64 and 1968/69, while the Gross Domestic Product of East Pakistan grew by about 3-4 percent annually, railway freight traffic (net ton miles) declined 5.5 percent annually and passenger traffic (passenger-miles) increased only about 2 percent per year. Clearly, the PER has been failing to maintain its position as the dominant carrier. While road transport statistics are not available, there is evidence that most of the short-haul import-export traffic has been diverted to trucks. The growth of road transport is presently hindered by the gaps in the main road system caused by inadequately bridged river crossings. The PER's competitive position will be substantially weakened in a few years when road traffic can move over the main road system without interruption and delay.

299. There is little doubt that the PER's future as a profitable prime carrier is precarious and that important decisions must soon be reached with respect to management and operational policy in the light of growing competition. Emphasis must be placed on specialized high-volume movements of bulk commodities instead of extensive coverage of the entire network, providing many services which could be better served by road transport. Planning should stress improved efficiency of service over existing high-volume routes rather than on continued extension of routes into new areas (e.g. Faridpur - Barisal route), where traffic is light or at best, modest. The schedule of rates and fares should be restructured to reflect these policy decisions, and operational techniques and investment plans should be tailored accordingly. Even with profound efforts in these directions, however, the PER would be hard-pressed to maintain a viable financial and economic position in the face of competitive services because of the inherently short-haul nature of most traffic and the low overall volume of traffic available in East Pakistan. The authorities would be well advised to include a study of the future role of the PER as a key element in the proposed transport study to be financed by the United Kingdom and to be carried out by the Economist Intelligence Unit.

300. The PER is subsidized in the same manner as the PWR, with the same rationale of public service applicable. As a function of revising the role of the PER vis-a-vis the transport market in the province, these subsidies and the public service demands on the railway should be reconsidered.

301. The Third Plan called for expenditures of Rs. 915 million, which were to entail 528 miles of rail renewal (1/3 of existing mileage) and renewal of 890 miles of sleepers. During the first four years of the Plan, 159 miles of rail and 308 miles of sleepers were renewed. Purchases of 67 broad gauge passenger carriages and 100 meter gauge passenger carriages have also lagged behind schedule. For the next five years, requirements have been estimated at Rs. 1,200 million, of which Rs. 650 million will be for schemes carried over from the Third Plan. This plan is not firm, particularly as it will be affected by the outcome of the proposed transport study.

Inland Waterways

302. The numerous waterways of East Pakistan provide an ideal setting for transport operations, both local and arterial in nature. Two broad categories of vessels exist, country boats and the mechanized fleet. Country boats are privately-owned and for the most part comparatively small (5-50 tons). They are powered by sails, supplemented by oars. It has been estimated that there are over 300,000 of these craft, but little is known about their precise numbers or the quantity of the transportation services provided. By sheer weight of numbers, they must be one of the most important transport modes in East Pakistan. The most important commodities handled are jute, foodgrains, fruits, and housing materials. Information about the mechanized fleet and associated barges is essentially limited to a census conducted in 1965/66. This census indicated that there were 133 steam-powered boats (97 privately-owned), 1,296 motor launches, (1,043 privately-owned), and 837 barges (749 privately-owned). Ton-mileage was about 350 million, and more than 600 million passenger miles were reported, but as these figures were used for tax purposes, severe under-reporting may have occurred.

303. The inland mechanized fleet is primarily concerned with the movement of jute to and through Khulna and Chalna anchorage which after Independence replaced the Calcutta area as the distributing and export centres for the jute and jute products of East Pakistan. Imports through Chalna handled by the inland fleet consist primarily of foodgrains, coal and fertilizer. Oil products originating internally from the Chittagong area are carried inland by a fleet of small tankers, while some general merchandise items are handled from Chittagong to the Dacca-Narayanganj area by a small fleet of ocean-going lighters which offer limited competition to the railway for import traffic. While the country-boat movements extend to every navigable waterway of the Province and the motor launches offer passenger ferry services along most of the main rivers, the heavy freighting activity is largely confined to the southern areas bounded by Chittagong, Khulna, Chalna, and the Dacca area.

Ports

304. There are two important ports: Chittagong which handles about 70 percent of the tonnage, and Chalna anchorage, a lighterage port. There is a severe imbalance between the two, with Chittagong having a large excess of imports over exports, while the opposite, though to a lesser extent, occurs at Chalna. Until Independence, Chittagong was a small port serving the local

needs of East Bengal and it was overshadowed by Calcutta. Capacity in 1947 was in the neighbourhood of 500,000 tons, and there were only 4 jetties. A rapid expansion followed and capacity is now about 4 1/2 million tons. From 1963/64 to 1968/69, imports increased at 4 percent per year, just exceeding 4 million tons in 1968/69. Exports during those years declined and fell below 500,000 tons in 1968/69, as a result of a decline in the volume of jute exports. Important imports are bulk shipments of petroleum, oils and lubricants (32 percent), foodgrains (18 percent), cement (14 percent), and coal (7 percent), and much of the increase in total tonnage has been due to oil products and foodgrains. Since port traffic exceeds 90 percent of capacity, resulting in many delays and long queues, an expansion program to construct 6 new jetties is planned, possibly with assistance from USAID.

305. Sixty percent of imports go to Dacca, 15 percent are used locally, and the remainder go to North Bengal, Mymensingh, and Sylhet. About 30 percent of the import traffic is handled by PER, 40 percent by road, and the remainder is shipped by boat or used locally. Exports are brought to Chittagong in the following proportion: rail 35 percent, road 50 percent, river 15 percent. The imbalance between imports and exports causes severe difficulties for the PER, as many southbound wagons are empty. This problem could be eased by specifying that more Government imports of bulk commodities go to Chalna for delivery by the inland water transport fleet.

306. Chalna anchorage was established as a jute export center after Independence, to replace the traditional Calcutta outlet. Jute is carried to Chalna from the Dacca area, Khulna and other collection points by the inland fleet and loaded into ocean-going vessels directly from the barges, which serve as floating warehouses when ships are unavailable. The emphasis on this traffic results in an unbalanced traffic flow since back-haul movements are very light. In recent years, as congestion threatened Chittagong and the rail and road arteries north of that port, there has been increased emphasis on imports of bulk items through Chalna, such as foodgrains and coal, but the port still operates far below the capacity of the anchorage itself and the inland fleet.

307. Work is underway to build a permanent port near Chalna anchorage at Mangla with Yugoslav financial and technical assistance. However, the development of large-scale permanent port facilities may be premature since the ultimate utility of the location depends on the prospects for economically dredging the estuary bar and channel of the Pusar River to permit vessels of at least 30-32 feet draft to enter freely. At present, drafts are limited to 25-28 feet - the same as at Chittagong. The Chalna anchorage provides the logical access route for imports to the provincial districts lying west of the Brahmaputra River which are effectively separated from the transport services centered on the Chittagong and Dacca areas by the river itself. At the same time, through the inland fleet (most of which cannot negotiate the open-sea passage to Chittagong) Chalna offers direct cheap transport to

the central Dacca area, which is the final or intermediate destination of most import traffic. In 1968/69, Chalna handled about 2 million tons of traffic, nearly one-half of which consisted of jute exports. Imports consisted largely of foodgrains, coal and fertilizer.

4. Pakistan International Airlines (PIA)

308. Air transportation plays a particularly important role in Pakistan. It is a matter of national policy to encourage quick and efficient transportation between the two wings of the country. From 1963/64 to 1968/69, revenue passenger miles increased by 14 percent per year to 961 million in 1968/69, while revenue ton-miles also increased by 14 percent per year to 224 million. Load factors in both categories are now between 55 and 60 percent, a decline of about 10 points from five years ago. This decline was planned - higher load factors mean a longer than optimal waiting time at peak hours for goods and passengers. Total passengers using the airline has increased from 678,000 to 1.2 million from 1963/64 to 1968/69, at a rate of 12 percent per year.

309. Domestic travel accounts for about 80 percent of the total and has been increasing over the last 5 years at 13 percent annually, the main routes are Karachi-Dacca (15 percent of total), Karachi-Lahore (16 percent of total), followed by Dacca-Chittagong (9 percent), Dacca-Jessore (8 percent) and Lahore-Dacca (7 percent), Karachi-Rawalpindi (6 percent). Interwing passengers thus account for 38 percent of the total, while intrawing passengers account for 52 percent of the total. The major international route is to London, and passengers on this route account for almost 9 percent of the total.

310. The fleet has increased substantially and operations now revolve around 707/720-b's (essentially for international flights), 4 Trident 1-E's for interwing and long intrawing flights, and 11 Fokker Friendships for shorter intrawing flights. The Fokker Friendships are apparently very efficient, but plans are firm for replacing the Tridents in the near future when they will be delivered to Mainland China, which has recently purchased these planes. Replacement of the 707's is less definite, and will depend on finding a suitable substitute. PIA is investigating the possibility of purchasing a wide body plane, but this may be costly. Other probable changes in the fleet include the purchase of short take-off and landing aircraft (STOL's) for use in East Pakistan. In addition, the airport at Rawalpindi has been enlarged and if (as expected) it is declared an international airport, it may attract 5 or 10 percent of the stop-over flights presently going to Karachi.

311. PIA has shown a profit for all but a few early years of operation. However, until 1965 no import duty was placed on fuel, and after 1965, only fuel used for domestic flights was subject to this tax. In addition, PIA receives a subsidy for each interwing economy-class passenger trip. This is to make up for charges below cost for these services. The airline showed a return of 7 percent based on the depreciated book value of assets and financial costs and returns.

5. Inter-Wing Transport

312. Reflecting the small degree of integration between the regional economies of East and West Pakistan, inter-wing trade has so far played only a very limited role in Pakistan's economy. The value of goods exchanged between the two wings came to about Rs. 2,250 million in 1968/69 - equivalent to 3.5 percent of GNP and roughly one fourth of external merchandise trade, allowing for price differentials between external and inter-wing trade. Expansion of inter-wing trade - and, consequently, movement towards closer economic integration - at present faces severe obstacles. These stem in part from the present exchange regime which for a wide range of goods makes it more attractive for either region to obtain goods, which it does not produce itself in sufficient quantities, from abroad than from the other region. However, they also exist in the movement of goods: shipping space is scarce and often difficult to obtain; regulated freight rates are roughly equivalent to those between the United Kingdom and Pakistan, and effective rates are often a multiple of regulated rates.

313. Sheer distance between the two regions will inevitably restrict the scope for inter-wing trade, and the imbalance in the movement of goods to and from East Pakistan that exists now and is likely to persist, adds further to cost. Yet, it is doubtful that the possibilities for improving traffic conditions have been exhausted. Whether they have or whether there is scope for significant improvements in service and reduction in cost is, in fact, an important question in connection with planned efforts to reduce the economic imbalance between East and West Pakistan. Large shipments of goods from West to East Pakistan could become an important vehicle for achieving a greater net transfer of resources to the East wing. In fact, from the point of view of the economy as a whole, there may be considerable economic advantages in shifting part of the burden of adjustment to inter-wing trade rather than assign the whole task to foreign trade. However, this approach would clearly not be feasible if present traffic conditions continued. A thorough examination of inter-wing trade is therefore urgently needed.

F. THE SOCIAL SECTORS 1/

1. Housing

314. Like most developing countries, Pakistan faces a tremendous housing shortage. Though few people actually live in the streets, a very considerable housing shortage exists in terms of sub-standard structures and conditions. On this basis, a survey conducted in 1960 estimated the housing shortage at 600,000 units, and for 1970 that figure reached 1.6 million. These figures would appear very much on the low side. Two contributory factors to the housing shortage are rapid urban population growth and extreme poverty. Pakistan's urban population grew by some 6 percent per annum over the past decade - by roughly double the overall population growth rate - and increased from 12.6 million in 1960 to 21.5 million in 1970. Most of the increase in urban population took place in the form of migration from the rural areas and was stimulated by expectations of job opportunities and other amenities of urban life. These job expectations were, on the whole, frustrated, and most of the present city-dwellers are too poor to afford housing of reasonable quality.

315. Performance in the housing sector during the last five years was poor: targets were set at very low levels relative to actual needs and these targets were not achieved. Often the shortfalls were sizeable. This was true for the public as well as the private sector. Total housing needs for the Third Plan period were estimated at 1.6 million units. While this by itself was an underestimation, it was not considered possible to build that many units anyway; instead, a lower target of 292,500 units was set, of which 80,000 would be built in the public sector. Actually, only 30,000 units were built in the public sector - an achievement of only 38 percent of the target. For the private sector an official estimate is that only 40,000 units were built - an achievement of only 19 percent of the target.

316. The disappointing performance of the public sector reflects primarily the low priority given to public housing: when cutbacks were required, housing was one of the first sectors to be affected. There were also organizational weaknesses: responsibility for implementing plot development (land acquisition, leveling and providing utilities) and house construction is diffused among some half-dozen agencies within several departments at the Provincial level, and several ministries at the Central level.

317. The urban housing strategy for the public sector consisted of three parts, whose allocations and achievements are as follows:

1/ Education is dealt with in a separate volume of this report (Volume III).

	Expenditures for 1965-70 (Millions of Rupees)	
	Planned	Actual, Estimated
(i) Slum improvement and low-income housing	513	167
(ii) Public Servants Housing	239	239 1/
Sub-Total	752	406
(iii) Industrial Workers Housing (Public/Private)	350	n.a.
Total	1,102	n.a.

1/ Mission Estimate

318. Overall, the financial targets were not achieved. The industrial Workers Housing Corporations which were to have been financed by the private sector (though to be organized at the initiative of the Central Government which would also provide some "seed capital") never came into being. The public servants housing allocation was fully met, but it fell short of its original intent in that a large number of units went to middle and upper income public servants, whose needs could have been met by the private sector.

319. The slum improvement and low-income housing program consisted of three parts: (i) slum improvement in the sense of ameliorating the environment, i.e. improving water supply and sanitation facilities, (ii) low income housing, mainly for the resettlement of refugees and (iii) self-help low-cost houses on 10 percent of the plots, and allocate the remaining 90 percent to families who would construct their own dwellings. No breakdown of the planned and actual spending or of the physical achievements of these three activities is available. However, the large shortfall in implementation of the already meagre target for the program as a whole indicates that very little was accomplished.

320. An important factor which explains why private sector performance also fell short of its target is that it was fiscally unattractive to rent houses. The Draft Outline argues that at the present time such investments are subject to double taxation - to income tax as well as to Provincial and Central property taxes - making the rate of return in a typical case as low as 4.5 percent per annum. There must have been other factors at work: a lack of effective demand for new construction and a lack in supply of reasonably priced dwelling units.

321. On the demand side, there is a lack of adequate mortgage financing. The House Building Finance Corporation (H.B.F.C.) a Government agency and virtually the only institution active in house construction financing, made loans amounting to about Rs. 235 million in the 1965-1970 period. The annual rate of lending dropped from about Rs. 60 million in 1965-66 to Rs. 40 million in 1968/69. The drop in real activity is even more pronounced when account is taken of the sharp rise in the prices of building materials, estimated in East Pakistan at 50-60 percent since 1965. It reflects the curtailment of financing by the Central Government and more recently, the lack of demand for loans associated with the recent drop in economic activity. Out of the total of Rs. 190 million allocated by the Central Government for the 1965-70 period, only an estimated Rs. 65 million was provided. The lending rate of $7\frac{1}{4}$ percent effective in April, 1970, represents a moderately subsidized rate.

322. The major criticism of the H.B.F.C. is that its loans went mainly to the upper income group. For 1965-70 the average loan was about Rs. 19,000. Modifications in the existing system are presently being considered. One alternative is that the present system be modified to reach a greater segment of the middle income groups - families earning from Rs. 300 to 500 per month. A second alternative which is being considered is the creation of savings and loan type institutions. A third alternative would be to allow commercial banks a limited participation in this form of lending, though with adequate safeguards to insure liquidity - such as discounting facilities with the State Bank of Pakistan. The entire question of housing financing requires careful consideration. Even without major institutional changes much can be done. The formation of cooperative societies for carrying out housing construction would help.

323. On the supply side, there is an absence of large-scale construction companies which specialize in constructing moderately-priced housing, whether in vertical structures or on individual plots. Construction companies face financing problems. Unlike firms in other industries they cannot finance capital equipment through organizations such as the Small Industries Corporation Facilities for financing buildings under construction are also severely limited. Thus the absence of demand as indicated above severely limits the market and there were supply difficulties. There is a vicious cycle here: a narrow market limits cost reductions made possible by large-scale construction, while the high cost of house construction and the lack of mortgage financing limit the size of the market.

324. In short, the performance of the public sector in the housing sector has been unsatisfactory, both in terms of its own construction program - which failed to meet the needs of the lower-income people - and in terms of policy measures designed to involve the private sector more actively in undertaking housing construction programs. New policies and programs are needed to make at least a dent in Pakistan's very serious housing problem. The draft Outline of the Fourth Plan makes some proposals to achieve progress with housing programs.

New Policies and Programs

325. The strategy prepared for the housing sector in the next five years resembles in many ways the one adopted for the Third Plan. The specific activities proposed and the amounts allocated are remarkably similar:

Activity	Proposed Allocation (Million of Rupees) 1965-70 1/	1970-75 2/
Low-cost housing and slum improvement	513	480
Industrial workers' housing	350 3/	400
Public servants' housing	239	332
Plot development	292	223
Total public sector	1,394	1,435
Total private sector	3,650	4,000
Grand Total	5,044	5,435

1/ Third Five-Year Plan
2/ Fourth Five-Year Plan
3/ Taken out of the private sector

326. Individual allocations as well as the totals do not differ much. When the price rise of about 30 percent of labor and materials is taken into account, the Fourth Plan allocations appear even lower. In addition, as was discussed earlier, the Third Plan performance was disappointing, thereby increasing the needs. Thus, the Fourth Plan proposals do not represent an ambitious program in financial terms.

327. Second, the announced objective of implementing a dual strategy whereby the private sector will be counted upon to supply the housing needs for the 28 percent of urban families whose monthly income is above Rs. 300, while the public sector will concentrate on supplying the housing needs for the remaining urban families, is also not new.

328. Third, in terms of physical targets the draft Outline of the Fourth Plan is even less concrete than the Third Plan. The Third Plan cited the following goals:

Activity	Physical Targets (in dwelling units)
Low-cost housing	80,000
Housing units built by plot development agencies 1/	15,000
Private sector	212,500

1/ The Improvement Trusts and Development Authorities

While the Third Plan gave at least some guidelines, the Fourth Plan has provided no physical targets. The targets can, of course, be calculated from costs for standard dwelling units; but in the case of "low-cost housing and slum development" the allocations for these two items are lumped together making it difficult to arrive at the physical targets for low-cost housing units. 1/ This ambiguity reflects conditions at the time of plan formation, and afterwards.

329. A fourth similarity is that both plans begin without a truly low-cost design on which an effective massive housing program could be based. Accepted urban low-cost housing designs that have been and continue to be used include about two rooms, a kitchen, and piped water and sewerage facilities. At present, such units cost about Rs. 10,000 including land. 2/ Such units have been designed for families who could afford to pay only one-fifth of the true economic rent. This indicates that a design of a unit costing Rs. 2,000 could serve a large segment of the urban population on a self-financing basis. Yet, no such designs have been proposed. This matter requires intensive investigation.

330. Fifth, with respect to public servants housing, as in the case of the Third Plan, the draft Outline of the Fourth Plan emphasizes that dwelling units should be built for low income public servants. Yet, this objective was not achieved during the Third Plan with a large share of the constructed public servants housing units going to middle and upper income groups. Also there is no clear indication of how this objective will be achieved during the Fourth Plan.

331. Sixth, both plans make provisions for industrial workers housing. It appears that the plans for the Fourth Plan are more concrete. In the Third Plan this activity was left entirely to the private sector, and how much came of it is not known. Presently, the Central Government is taking a more active role in this area. The proposal is that workers' housing be financed by a tripartite group consisting of industry, workers' organizations and the Central Government.

1/ Slum improvement represents urban overhead expenditures designed to ameliorate the environment, e.g. making parks, improving existing water and sanitation facilities, etc.

2/ This value is a rough average for East and West Pakistan. In East Pakistan where costs of both land and building materials are higher, the total cost may be about 30 percent higher. For vertical construction the cost of materials (including the inputs of reinforced concrete, iron rodding and cement) are relatively higher than land; for horizontal construction - where bricks alone suffice for single-storied dwellings - the opposite is true.

Some Critical Comments

332. There are no doubt large sums associated with any program that aims at relieving Pakistan's present and prospective housing shortage. Not everything can be done at once, and any program of subsidized public housing has its built-in inequities: those fortunate few who are helped will be envied by those who have to go without. Yet, from the social point of view, it is important that public funds go where the need is greatest. In addition, much can be done in the way of reducing costs. From the social equity point of view, the entire concept of public servants housing should be re-examined. It is highly questionable whether the Government should provide for low income public servants to the exclusion of others, not in the Government service. There is evidence that low income public servants are underemployed. The fact that they have a job with the Government already represents a subsidy.

333. Government efforts in low income urban housing would go further if there were concentration on lowering the costs of construction. The Government should therefore concentrate on research and pilot projects with a view to lowering the costs of providing housing, and this research should not be narrowly directed at finding low-cost building materials. Rather it should attempt to find suitable designs based on large-scale construction. At the same time, more pilot projects should be carried out. These should investigate the feasibility of such cost-reducing features as (i) reduction of plot size, (ii) increasing the amount of self-help construction and (iii) increasing the use of community water and sanitary facilities.

334. Finally, construction should be carried out as much as possible by private construction firms. At the present time, the government - central or provincial, as the case may be - carries out these projects, but there is evidence that if this activity was entrusted to the private sector it could lead to cost reductions and greater efficiency.

2. Urban Water Supply, Sewerage and Drainage

335. Water service in urban areas is very limited,creating serious health hazards for the population at large as well as for those without access to piped water. In 1965, only 11 percent of the urban population received piped water, 7 percent from individual home connections and 4 percent from community standposts. It has been estimated that from the Rs. 233 million allocated to water supply systems in the Third Plan, 2.4 million persons were served, raising the urban population served from 11 to 19 percent of the total. While this may be too optimistic an estimate, the figure indicates that roughly 80 percent of the urban population used water from streams which are frequently polluted and from stagnant ponds.

336. The sewerage and drainage problem is also a very serious one in Pakistan. A 1965 survey of 25 cities in West Pakistan indicated that only 7 percent of the population was served by a piped sewerage system, some 65 percent by an open sewerage system and some 28 percent was without service at all. There are few programs to alleviate the seriousness of this situation and it appears that a major improvement in sewerage and drainage systems will be postponed until later Plan periods.

337. While urban population growth in Pakistan has been high, 82 percent of the population is expected to remain in the rual areas. Here, too, inadequate provision of water, sewerage and drainage services presents a major health hazard to the population. The draft Outline of the Fourth Plan allocates for rural areas an amount that is three times higher than the total spent in the past five years, but the total amount of Rs. 150 million is only 13 percent of the all-Pakistan total. This allocation represents too much of an imbalance to the detriment of the rural areas, and it is hardly consistent with the goal of upgrading rural village life and with the objective of slowing down migration to the urban areas.

3. Health

338. The Third Plan provided Rs. 901 million for programs in the field of health, including Rs. 272 million for the Malaria Eradication program. Major programs for which these amounts were earmarked included hospitals, rural health centers, tuberculosis control and medical education and training. Only 45 percent of the financial targets were achieved (i.e. of the non-malaria control part) due to financial cutbacks and administrative constraints.

339. The most disappointing feature has been failure in the implementation of the rural health program. It was estimated that by the end of the Third Plan period 860 rural health centers and 2,400 sub-centers would be functioning; actually, only 203 rural health centers have been commissioned and a few more are under construction, but it is not known how many of them are fully staffed and functioning. In East Pakistan, only the rural health centers carried over from the Second Plan could be completed and no new scheme was started. In West Pakistan, rural health programs remain almost at a standstill.

340. There is no doubt about the need for new programs in the health sector, particularly in the rural areas. It appears that more resources are needed to make progress in this sector. The draft Outline of the Fourth Plan indeed allocates more funds for the various health programs and rightly puts emphasis on the rural health programs. The latter would also be essential from the point of view of population control which would benefit from an increased exposure of the rural population to general health care.

G. FAMILY PLANNING

341. The analysis in the introduction to this chapter of the constraints, under which Pakistan's economic and social development will labor over the next several years, and of the prerequisites of effective management of the economy in these circumstances, clearly indicates the need to pursue with determination efforts to reduce the rate of population growth. Pakistan is still a desperately poor country, it will require rapid, sustained economic growth over a long period of time before the great majority of its population can be said to enjoy a reasonably decent standard of living. At present, the rate of population growth is high in relation to attainable expansion of GDP - nearly half. As long as it remains so, not only will improvement in living standards directly be slowed down considerably, but also the scope for saving out of additional income as the basis for accelerating future growth of incomes will be circumscribed severely. These arguments apply particularly to East Pakistan where population is apparently growing even more rapidly than in the West wing, probably by closer to 3 percent a year. It is difficult to see how the economic base of East Pakistan can be broadened fast enough to prevent, in the absence of a significant reduction in the birth rate, further declines in acreage per farmer and further fragmentation of holdings, with all that such deterioration would entail for the prospects of increasing incomes through rising labor productivity. Moreover, Pakistan as a whole is not richly endowed with natural resources so that sustained improvement in economic conditions in the longer run will be highly dependent on the training and skills of its people. Yet at present, Pakistan has one of the lowest adult literacy rates in the world and even today only a small fraction of its population of school age can be educated and trained effectively.

342. Obviously, these arguments, if carried too far, lead to a conclusion which is patently absurd, namely that the objective of family planning efforts in countries like Pakistan should be to reduce the rate of population growth to zero and that actual performance should be measured in relation to this objective. It is equally obvious, considering the complexity of factors involved in reducing the birth rate, and the uncertain linkage between family planning programs and individual decisions to limit the size of family, that the effectiveness of family planning efforts needs to be judged in long-term perspective. In the short span of five years usually adopted as the time horizon for planning, there are in practice fairly narrow limits to the possibility of reducing the birth rate, regardless of the amount of resources put into the family program. Two corollaries follow from this line of argument: First, over any Plan period, it would not be realistic to regard rates of growth of population and of GDP as policy objectives that are substitutes for each other over a significant range. Second, in terms of efficient use of resources, allocation of resources to family planning is also subject to diminishing returns so that beyond a certain amount it will be more efficient to try to achieve a desired increase in per-capita incomes through growth in GDP rather than through additional outlays towards reducing the rate of population growth. Nonetheless, when all these qualifications have been stated, it is clear that Pakistan is still a long distance away from any of these limits.

343. In mid-1970, Pakistan's population is estimated to be 132 million, of which 71 million are in East Pakistan and 61 million in the West wing. This estimate suggests that Pakistan added 18 million people to its population during the Third Plan period, 10 million in the East and 8 million in the West. It is estimated further that at present the population is growing at an annual rate of 2.8 percent, comprising a birth rate of 45 per thousand and a death rate of 17 per thousand. In the light of present knowledge, these estimates seem reasonable. However, they need to be treated with caution since they are based on the 1961 census, adjusted for under-numeration, and, in the absence of a reliable system of vital registration, on sample surveys.

344. It was only in the mid-1960's that the extent of Pakistan's population growth began to be recognized. The First and Second Plans had, on the basis of the 1941 and 1951 census, projected population to grow by 1.4 percent and 1.6-1.8 percent, respectively, a year. In the light of the 1961 census, the projected annual rate of growth was raised to 2.6 percent in the Third Plan. Even this must be considered an under-estimate - explainable in part by the desire to maintain credible continuity with earlier projections - because information now available suggests that the rate of growth of Pakistan's population increased to over 3 percent in the 1960's. In any event, these estimates prompted the Government to launch a country-wide scheme to provide information on family planning and services to the population. Its objectives were to reduce the birth rate from 50 to 40 per thousand and thereby, assuming a concurrent decline in the death rate from 20 to 15 per thousand, to lower the rate of growth of population from 3.0 percent to 2.5 percent. The program was allocated Rs. 284 million, equivalent to just less than 1 percent of total public development outlays.

345. Present indications are that, in contrast to all other programs which were cut back - some of them severely - because of the stringency of resources that developed, the amount spent on the family planning program exceeded the original allocation by a considerable margin - Rs. 357 million as against Rs. 284 million. It is doubtful that this fact by itself can be taken as an indication of the priority accorded the program by Government. Perhaps at least as important has been the large measure of external support that the program attracted during the Third Plan period. Indeed, there have been instances where, in the face of delays in the release of budgetary funds, the program was able to carry on only because of such external support, and where there was reason to doubt that Pakistan's officialdom was fully convinced of the priority of the program. Nonetheless, there can be no doubt that the program enjoyed the full personal support of the then President, Ayub Khan, and was headed by an aggressive and dynamic administrator who, open to criticism as some of his methods may have been, succeeded in building up an organization from nothing and was bent on making the program a success.

346. As it turns out, the program did not meet its targets, although achievements are impressive in terms of the volume of contraceptive utilization: 2.1 million IUD insertions, 660 million units of conventional

contraceptives and 1.2 million sterilizations. Lack of a reliable system of vital registration makes it impossible to measure with any accuracy the performance of the program in terms of a reduction in the birth rate. However, best available estimates indicate that in 1969/70 the birth rate has been 45 per thousand, down at least 5 per thousand from the level prevailing in the mid-1960's. This is equivalent to only half the target; moreover other factors, in particular changes in the age structure of the population and rising age at marriage, have probably contributed to the decline. Even so, this is no mean achievement and by comparison with most programs the program in Pakistan has been remarkably effective.

347. Whether it can be expected to continue to be so is another matter. The targets of the Family Planning Division remain ambitious: it aims at reducing the birth rate to 33 per thousand by 1974/75. However, this target is based on an assumed birth rate of 41 per thousand in 1969/70 which is certainly too low. In this respect, the draft Outline of the Fourth Plan seems more realistic: it places the present birth rate at 45 per thousand and aims at reducing it to 40 per thousand which, together with an assumed death rate of 14 per thousand, would mean lowering the rate of natural increase of the population from 2.8 percent to 2.6 percent by 1974/75. Such a reduction, if attained, would represent a very creditable achievement. The question is whether the Fourth Plan Scheme as proposed can be expected to attain this objective, particularly in light of the marked slow-down in performance of the program since 1969. For an answer to this question, the program may be examined under three headings: organization, leadership and management, and financial allocation.

348. As for the first aspect, major organizational changes are at the core of the Family Planning Division's program for 1970/71-1974/75. The most important among them is the replacement, within the next three years, of about 50,000 village midwives by 17,000 full-time family planning workers who will operate as man-woman teams, each team being assigned to 1500 - 2000 fertile couples as an operational unit. Family planning workers will be paid a salary plus a bonus tied to the number of births prevented. There will also be changes in the organization of supervisory and administrative functions with the general objective of streamlining and tightening them. A second important change concerns the clinical aspects of the program - IUD insertions and sterilizations. The program had already begun during the Third Plan period to move away from its original approach to family planning as an 'administrative function', which emphasized non-clinical methods and understood its objectives largely in terms of getting contraceptive supplies to couples. The Fourth-Plan Scheme implicitly recognizes that, contrary to this original concept, clinical methods of birth prevention have in fact become the heart of the program. It, therefore, provides for further expansion in para-medical personnel and, for the first time, the construction of family planning clinics.

349. Although these proposals represent major changes in direction and emphasis, they are essentially a logical out-growth of the Third Plan Scheme and intended to correct deficiencies which became evident towards the end of the Third Plan period. One might question some detailed aspects of

the proposals. However, in general there can be no doubt that the Fourth Plan Scheme correctly argues that the present organization, valuable as it was during the initial phase of the family planning program, has outlived its usefulness and that the emphasis it places on strengthening the organization is right. In particular, the decision to replace village midwives by full time family planning workers seems a commendable move as these workers will be literate and susceptible to motivational instructions and administrative guidance as well as able to transmit information on local conditions. The changes in the organization of supervisory and administrative functions should strengthen control over program performance. Ultimately, of course, it will be essential to have a reliable system of vital registration as the basis for both accurately assessing the demographic situation and evaluating the performance of the family planning program. Steps towards establishing such a system need to be taken as a matter of urgency. Yet even with the best efforts it will take some time before such a system can be made fully operative. It is therefore essential that adequate provisions are made for control of performance and evaluation in the meantime. It is doubtful that this function is adequately provided for under the proposed reorganization of institutions engaged in research, training and evaluation.

350. The second aspect which needs consideration concerns management and leadership. As regards management, the obvious point to make is that recruitment, training, deployment and supervision of the new cadre of family planning workers represent an organizational and administrative task of very large dimensions and that the performance of the program in the years to come will be determined in large measure by the success of management in coping with this task. Little more can be said now, except that the new management appears to be tackling its job with resourcefulness and determination. Equally important as the management of the program itself, however, is the question of leadership, that is the degree of commitment of the Government as a whole to the program and the role it is prepared to play in instilling in the population a sense of urgency. There is no question that strong public support at the highest political level contributed a great deal to the performance of the family planning program during the Third Plan period. Because of its close association with the former regime, the family planning program also came under attack during the disturbances last year. Since then, the Government's approach to family planning has been noticeably low-key. Even the draft Outline of the Fourth Plan refers to reduction in the growth of population only as one among twenty specific targets for the Plan period, omits any mention of it in the section dealing with the general framework of the Plan, and deals with the program itself only briefly in the sectoral part of the document. None of this can seriously be taken as an indication of diminishing support for the program, and degree of commitment and public posture are obviously not necessarily related, and tactical considerations may make it advisable temporarily to refrain from public announcements on the subject. Yet it is clear that in order to succeed the family planning program will need public support at the highest political level. Otherwise, doubts about the Government's attitude to the program will persist, particularly as it appears that Pakistan's officialdom as a whole has not yet come to regard reduction of the birth rate as a matter of highest national priority.

351. The final aspect needing consideration is the financial allocation. According to the draft Outline of the Fourth Plan, Rs. 607 million are allocated to the family planning program, as compared to estimated expenditure under the Third Plan of Rs. 357 million. However, such broad comparisons are misleading, because Pakistan had an operative family planning program only for four years during the Third Plan period. In comparison with the 1969/70 budget, the amount of Rs. 121 million allocated for the Fourth Plan period on an annual average is only 11 percent higher. This appears inadequate for several reasons. First, there are specific parts of the program for which the adequacy of financial provisions is open to serious doubt. The Training, Research and Evaluation Centers are one example. Unquestionably, re-organization leading to removal of duplication and overlapping of functions will bring savings in outlays. However, it is to be feared that a reduction in outlays by nearly one-half will entail a serious curtailment of activity in a field that will continue to be essential to an effective family planning program. Another example relates to fees and incentive payments which have been reduced, apparently on the grounds that the shift towards full-time family planning workers and family planning clinics will make the expensive piece-rate apparatus unnecessary. The validity of this view is open to question, and the matter needs to be kept under close review.

352. Beyond these specific questions, however, there is the much broader question whether the allocation in toto is consistent with the size of program envisaged. As mentioned before, total outlays are projected at an average annual level 11 percent above that of 1969/70. At the same time, the average target population of women in the fertile age group will increase by 12 percent: in fact, the increase may be considerably more if, as some demographers claim, the number of women in the fertile age was unusually small in the mid-1960's as a result of events that reduced the birth rate in the 1940's. Thus, any expansion of coverage within this group would be dependent solely on improved efficiency through better organization. There is certainly scope for such improvement and the organizational changes proposed should work in this direction, but it is open to serious question whether efficiency can be increased anywhere near as much as is implied. To illustrate: the Fourth Plan Scheme aims at inducing two-thirds of all women in the reproductive age group to accept contraception, suggesting an increase from 7.7 million in 1969/70 to an average of 18.9 million over the next five years. In addition, an increasing number of participants will have to be replaced as they pass out of this age group. Such a rapid expansion is probably well beyond the reach of the family planning organization, no matter how well it is managed and financed. That is why it has been suggested above that the program targets are unrealistically high. However, even the more modest target suggested above, i.e., a reduction in the birth rate by 5 per thousand rather than the program's 8 per thousand, will require massive expansion in coverage. As the Family Planning Division gears up to coping with a task of this magnitude, finances, within the present allocation, are likely to become the dominant constraint on developing a family planning program of optimal effectiveness such as Pakistan will need for the reasons outlined at the beginning of this section. Therefore, careful watch needs to be kept over the adequacy of financial provisions. Even during the initial phases of the Fourth Plan Scheme the Family Planning Division will have to be assured that it will receive funds as necessary to support a program of the size envisaged, lest they feel constrained to tailor their plans, particularly in respect of recruitment, to the financing in sight.

V. A POSSIBLE ECONOMIC FRAMEWORK

353. A number of major issues emerged during the Third Plan period - particularly towards its end - which now require resolution, and the need for a new development strategy is widely acknowledged in Pakistan. The Government has expressed its general position with respect to these issues there must be acceleration of production and income growth in East Pakistan in order to bring about rapid reduction in the disparity in incomes between the two Wings and there has to be more emphasis on the social aspects of economic growth. While not new, these objectives have now been given such priority that they amount essentially to new elements in Pakistan's overall objectives. Under any circumstances, such re-ordering of objectives would have entailed profound changes in the structure of economic policies and programs; against the background of the stringent resource constraint under which Pakistan labored through the end of its Third Plan period, dramatic changes will be needed. Increased external assistance could ease greatly the process of adjustment. However, as explained in paragraph 152, just maintaining net transfers from abroad to Pakistan will require major changes in external assistance policies towards Pakistan. Thus, the task is almost entirely Pakistan's.

354. Prolonged debate about the allocation of resources as between East and West Pakistan has delayed thorough examination of the macro-economic framework within which to formulate policies. The draft Outline of the Fourth Plan contains some elements of such a framework, but it is far from complete and some of its assumptions have been superseded by subsequent decisions. Therefore, very little in the way of concrete policies has yet been made explicit. Thus, the attempt, that is made below to construct a macro-economic framework for the next five years, is not to be seen as the quantitative expression of an evaluation of policies already decided upon, that is, as a forecast of a course of events considered likely. It was drawn up rather with a view to exploring how the various objectives might be reconciled within a reasonably comprehensive framework, and to identifying points of pressure within such a framework which would indicate the need for policy action.

355. The first principal element that went into the framework is the rate of economic growth. Various considerations - discussed in some detail in Chapter IV and essentially having to do with the low and declining rate of fixed investment over the last five years, the absence of any prospect for a sharp, immediate jump in the investment rate, and the relatively large share in future investments likely to go into areas where returns will take some time to make themselves felt in increased output (transport, water, the social sectors) - suggested that use of an investment-growth approach was inappropriate. Possible rates of economic growth were therefore estimated essentially on the basis of judgements about the potential for increasing output from existing assets, particularly in the two principal commodity-producing sectors, agriculture and industry. The conclusion was that, with appropriate policies, it might be possible for GDP to grow by about 6 percent a year over the period through 1974/75. Moreover, it appears possible for both East and West Pakistan to achieve this pace. For East Pakistan this would imply an acceleration by roughly one half, from an annual rate of about 4 percent in the second half of the 1960's; in terms of per-capita income, it would, after a long period of

near-stagnation, provide for significant improvement. West Pakistan, on the other hand, would more or less maintain the pace at which it has grown throughout the 1960's.

356. Such a regional pattern of growth would not, of course, result in a reduction in the disparity in regional incomes from its present level, but merely stabilize what has so far been a trend towards an ever widening gap between income levels in the two wings. The question was whether it might not be possible, within the next five years, to take a greater step towards the objective of approximate parity in incomes, specifically whether it might not be possible, through appropriate policies to accelerate growth in East Pakistan beyond 6 percent a year. It is difficult now to see how this might be done, for the key to the pace of growth in East Pakistan is held by the commodity-producing sectors. Here, manufacturing - now contributing some 7-8 percent to regional product - is dwarfed by agriculture's share of nearly 60 percent. Moreover, there are limits to the pace at which the manufacturing sector can grow - set by organizational and managerial problems in the public sector, that are yet to be overcome, and, in the private sector, by concern over domination from outside East Pakistan which will presumably dictate keeping the rate of growth of the sector as a whole roughly in line with the pace at which entrepreneurial talent in East Pakistan can be attracted to industry. In any case, the growth possibilities in agriculture dominate. Here, there is indeed the promise of marked acceleration from the slow growth - about 3 percent per annum - of the 1960's. This promise centers on rice where new varieties could become the vehicle for a major break-through. In fact, achievement of a rate of growth of 6 percent in regional product is predicated upon this promise materializing, and it is assumed that whatever is necessary - in the way of inputs, services, etc. - will be made available. However, here again, despite its dominant position, rice alone cannot carry the whole sector, let alone the whole regional economy, to rates of growth much beyond 6 percent a year. Although there appears to be the potential to spread improvement to other crops and to areas now suffering from severe physical handicaps, it is as yet difficult to see how these can be overcome sufficiently rapidly - no matter what resources are made available - to have significant impact on growth over the period as a whole.

357. The opposite question applies to West Pakistan, namely could the rate of growth there be kept below 6 percent a year, with significant benefits to East Pakistan. Consideration of the implications of such a course of action suggests, on balance, a negative answer. There is no question that growth in West Pakistan could be held down by withholding the resources necessary to support growth at 6 percent, particularly in exchange that is needed to supply inputs to agriculture and manufacturing, and that in this way additional resources would be made available to East Pakistan. The argument against such a course of action is essentially that, while it would undoubtedly slow down growth in the West, it is unlikely to accelerate growth in the East over the next five years. It would make it possible there to step up investment more rapidly than envisaged but, questions of capacity for efficient

absorption apart, its benefit would lie essentially in strengthening the basis for growth in subsequent Plan periods. Implicit in this argument is, of course, the notion that - within the margin that is at issue - growth now, even if it occurs in West Pakistan, is better than growth several years hence in East Pakistan.

358. From the overall economic point of view, there is considerable support for this argument. There is, first of all, the consideration of overall efficiency in the use of resources by Pakistan's economy. A good deal of the potential for obtaining growth through more productive and fuller use of existing assets is located in West Pakistan. Withholding imported raw materials from industry or fertilizer and other imported inputs from agriculture, in the interest of creating new assets in East Pakistan, would make questionable economic sense at a time when Pakistan as a whole is extremely short of resources. The second consideration is that until East Pakistan has gained some ground in catching up with the West wing in terms of per capita income and of building up its economic structure, the task of generating the resources, in exchange and savings, necessary to support an expanding scope of Government activity and a rising investment rate will fall primarily on West Pakistan. It is here that a fast growing exportable surplus has to be produced and that a high marginal savings rate has to be achieved. Any deliberate depression of the rate of growth towards that of population will disproportionately narrow the scope - in terms of both productive capacity and saving capability - and thereby lead Pakistan as a whole into a vicious circle from which East Pakistan, too, is bound to suffer. However, this already anticipates a point that will be made more fully later, namely that this argument in favor of high growth in West Pakistan can be sustained only if in fact policy action is taken to ensure that West Pakistan will fulfill the role as the economy's main generator of resources.

359. The second principal element that went into the framework was the investment rate. Here, the argument proceeded from the general proposition that an economy at Pakistan's state of development cannot be expected to be able to sustain economic growth at a pace sufficiently higher than that of population to produce visible improvement in living standards with an investment rate as low as 13 percent, the approximate level in 1969/70. The question then was how fast it could be raised. It was assumed that the net transfer of resources from abroad in 1974/75 would be roughly the same as in 1969/70 - around US$500-550 million. However, as discussed in Chapter III, realization of this amount can by no means be considered assured, as in the absence of major policy changes by those providing assistance to Pakistan and with continuation of present amounts and terms of assistance the net transfer of resources would have declined sharply by 1974/75. As for savings, it was assumed that West Pakistan could achieve a marginal savings rate of 22 percent; East Pakistan, allowing for a somewhat higher rate of population growth and the need there for more rapid expansion of Government current expenditures, one of 15 percent. For Pakistan as a whole, the marginal savings rate would come to 19 percent. Going by experience in the early 1960's, this

rate does not look impossible of achievement. However, it is very high compared to the recent record (6-7 percent), and would require that roughly one third be saved out of the increment in per-capita incomes. The difficulties of reaching the rate assumed can be illustrated further by the tax effort that is implied: rough calculations suggest that, in order to be able to contribute adequately to overall savings required and to play the leading role in raising the investment rate in East Pakistan, the Government will have to raise additional resources through new measures in the order of Rs. 10 billion, over the five-year period through 1974/75, one and a half times the amount actually raised in 1964/65-1969/70.

360. Even with such efforts, however, the total investment rate could only rise to 14.5 percent of GDP by 1974/75. Moreover, even this modest improvement is very fragilely based, as becomes apparent when one realizes that it would be practically wiped out if the amount and terms of external assistance were not in fact improved as indicated above.

361. The possible macro-economic framework suggested by these considerations is depicted in the table below:

	1969/70			1974/75		
Unit: Rs. 10 million	All Pakistan	West	East	All Pakistan	West	East
GDP	7,800	4,300	3,500	10,450	5,750	4,700
Gross Investment	1,000	650	350	1,525	820	705
Domestic Savings	745	495	250	1,250	820	430
Net Imports of Goods and Services	255	155	100	265	-	265
Abroad	(255)	(205)	(50)	(265)	(140)	(125)
Interwing	(-)	(-50)	(50)	(-)	(-140)	(140)
Exports	430	290	190	660	550	250
Abroad	(430)	(240)	(190)	(660)	(410)	(250)
Interwing (net)	(-)	(50)	(-)	(-)	(140)	(-)
Imports	685	445	290	925	550	475
Abroad	(685)	(445)	(240)	925	(550)	(375)
Interwing	(-)	(-)	(50)	(-)	(-)	(140)
Consumption	7,055	3,805	3,250	9,190	4,930	4,270

- Continued -

Some Parameters	1969/70 All Pakistan	West	East	1974/75 All Pakistan	West	East
Rate of Economic Growth (p.a.) 1/				6	6	6
Investment Rate 2/	12.8	15.1	10.0	14.5	14.3	15.0
Average Savings Rate 2/	9.6	11.5	7.1	12.0	14.3	9.1
Resource Gap 2/	3.2	3.6	2.9	2.5	-	5.6
Marginal Savings Rate 1/				19.1	22.4	15.0
Rate of Export Growth 1/				9.0	12.0	5.5
Abroad 1/				8.9	11.3	5.5
Rate of Import Growth 1/				6.2	4.0	10.4
From Abroad 1/				6.2	4.0	9.3

1/ Compound Annual Rate 1969/70 - 1974/75

2/ As Percentage of GDP

362. Perhaps the most important - and certainly the most complex - issue, the regional division of resources, remains to be considered. Much of the debate in Pakistan on this issue has centered on the problem of financial transfers. Undoubtedly, this is a very important aspect of the problem, particularly for two reasons. First, private capital has so far probably tended to move from East to West Pakistan, or at best been a neutral factor. Clearly, unless very strong efforts, backed up by specific policy measures, are taken, it will remain in this position, but, even with such action, private capital can be expected to play only a fairly minor role in supplementing East Pakistan's own financial resources. Therefore, the main burden of effecting the transfers necessary to raise the level of investment in East Pakistan significantly must fall on the public sector. That means that resources must be raised in West Pakistan, in excess of requirements there, to be transferred to the East. Although no precise estimates have been made, rough calculations suggest that net transfers through the budget in the order of Rs. 1-2 billion will be required by 1974/75, equivalent to 2-4 percent of West Pakistan's regional product and some 20-40 percent of taxes and revenues presently collected in the West. This indicates how crucial effective action to raise additional resources for the public sector is to the whole effort to raise investment and development outlays in East Pakistan.

363. The other aspect of this problem, which has so far received very little attention, is that of the real transfer of resources. This arises because the regional economies of East and West Pakistan are geographically separate, that is, economic relations between them are characterized by little movement of capital and labor. It follows that financial flows between them must be accompanied by corresponding flows of goods if inflation is to be avoided in the region receiving net financial flows, and deflation in the other. This introduces a further constraint on the pace at which total resources available to Pakistan for investment can be re-allocated as between the East and West wings.

364. These resources consist of the savings originating in each of the wings plus the net transfer of resources from abroad to Pakistan as a whole. However, the savings of either province can be supplemented by means of running a deficit on its goods and services transactions with foreign countries and for the other region. Thus, if East Pakistan's savings are to be supplemented in order to enable it to step up its investment faster than it can raise its savings, it must receive a net transfer of goods and services either from abroad or from West Pakistan. Given West Pakistan's savings, the constraint arises out of two considerations: first, its ability to raise its earnings of exchange from sales abroad fast enough to reduce its net dependence on exchange transfers from abroad, while still meeting its import requirements; second, its ability to expand its sales of goods in East Pakistan faster than its purchases from the East so as to increase its trade surplus. In practice, there appear to be limitations on both scores.

365. On external account, it has been assumed that West Pakistan will be able to expand its exports by 11-12 percent a year which, if achieved, would represent a very creditable performance indeed. Imports from abroad have been assumed to grow by 4 percent annually, that is, by two percentage points less than regional product, which it would appear difficult to reduce any further without depriving agriculture and manufacturing of the inputs needed to achieve fuller use of existing assets and/or without causing a precipitate fall in the investment level. If these assumptions are accepted, it follows that the only element of flexibility is in inter-wing trade. Use of this trade as a major vehicle for shifting the balance of resources in favor of East Pakistan would seem highly desirable from the overall economic point of view. In support of its investment program, particularly in agriculture, water and transport, East Pakistan will need investment goods that can be produced in West Pakistan and, especially, because of the high wage content, it will require consumer goods to supplement its own production which, again, it might be possible to produce in the West, largely from existing capacity. Alternatively, these goods could, of course, be imported, but unless production in West Pakistan and shipments of goods to the East are vastly inefficient economically, scarce foreign exchange could be used more efficiently, from the point of view of the economy as a whole, to finance imports of raw materials to West Pakistan for conversion into finished goods for the East than to finance the import

of finished goods from abroad into East Pakistan. Yet, the extent to which this can be done in practice is difficult to gauge. As noted in Chapter IV there are obstacles in inter-wing transport. Also, looking at the present composition of exports by West Pakistan to the East, it is difficult to identify commodities that might be capable of supporting an expansion of such exports at an annual rate much beyond, say 12-15 percent.

366. This is the estimate that has been built into the framework depicted in the table above. It suggests that by 1974/75 East Pakistan could receive a net transfer of resources from the West in the order of Rs. 1.0-1.5 billion, roughly equivalent to its share in the total net amount of resources transferred from abroad to Pakistan as a whole. As a consequence, West Pakistan would by 1974/75 no longer receive any net transfers, that is, would have to rely solely on its own resources for its development effort, while East Pakistan would in effect obtain all of the net resources transferred to Pakistan from abroad. Even so, total investment in the East in 1974/75 would still be somewhat less than in the West. Nonetheless, it would grow very rapidly - by about 15 percent a year, as against 5 percent in West Pakistan, and by 1974/75 the investment rate would in fact be somewhat higher than in the West. Thus, substantial progress towards parity would have been made.

367. Furthermore, these calculations suggest that over the next five years as a whole, Pakistan might achieve total investment in the order of Rs. 65,000 million, as compared with about Rs. 47,000 million in 1965-1970.[1] Of this amount, roughly Rs. 27,000 million could be spent in East Pakistan, about twice the amount actually invested during the past five years. Allowing for private investment and for the non-investment content of development outlays, it should be possible to mount a public development program for East Pakistan in the order of Rs. 22-25,000 million, including outlays by the Center for the benefit of that wing, or more than twice the amount of Rs. 10,500 million actually spent during the Third Plan period.

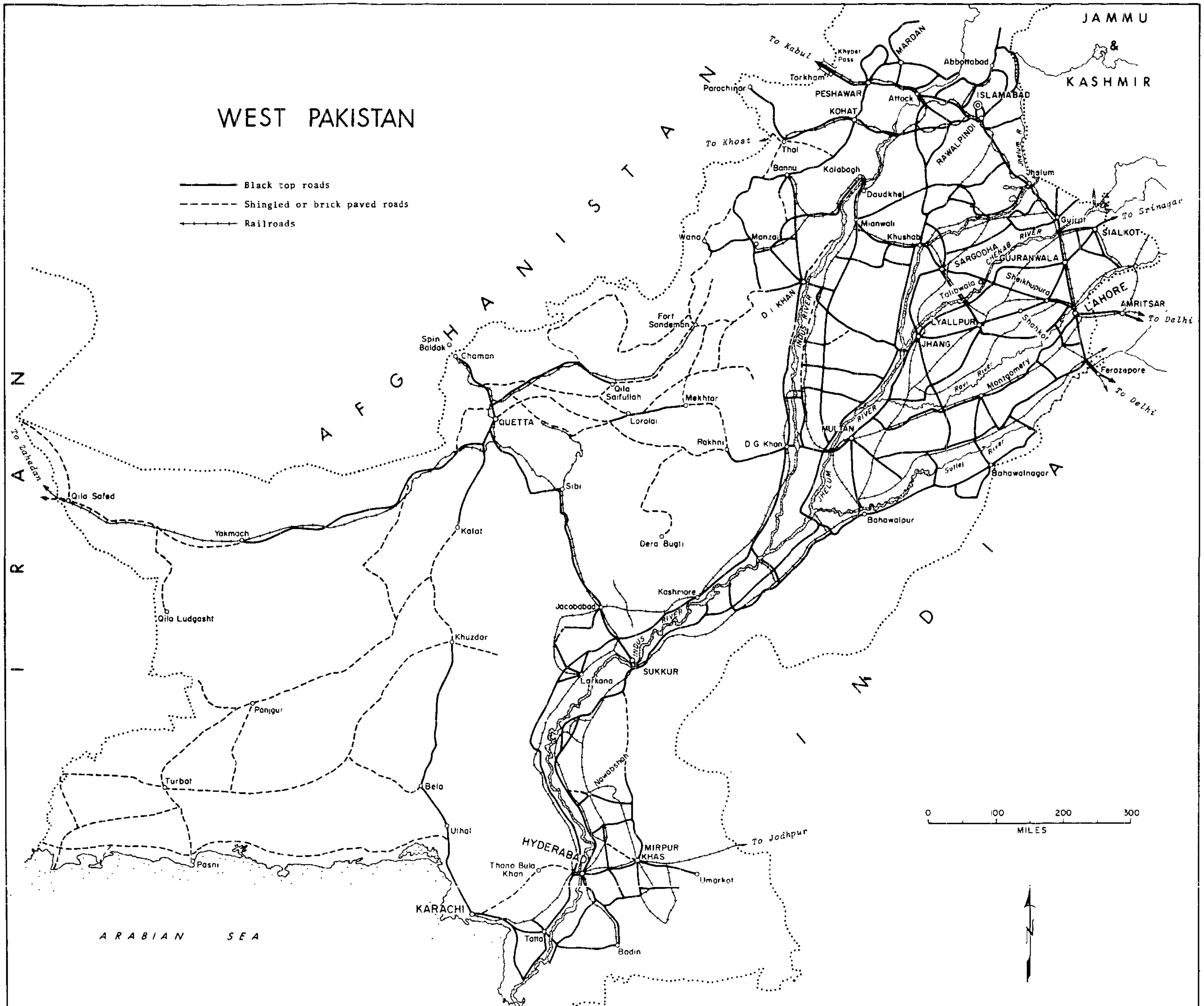
368. In conclusion, however, it cannot be stressed too strongly that achievement of anything like the objectives set forth here - in terms of economic growth, recovery of investment and the shift in the allocation of resources towards East Pakistan - is crucially dependent upon action in the realm of policy.

369. As far as the Government is concerned, there is an urgent need to break through the stifling resources constraint that has developed over the Third Plan period. On the domestic front, this pertains particularly to Government revenues and the whole range of subsidies that have come to form a quantitatively significant part of the public revenue and expenditure systems; and in the context of such action considerable importance attaches, for economic as well as social reasons, to increasing reliance on direct taxation. The estimate above of about Rs. 10,000 million having to be raised through new measures gives a rough indication of the dimensions of the task

1/ Translated into development outlays, the total would be higher and come close to Rs. 70,000 million, some 50 percent higher than the amount actually spent in 1965-1970.

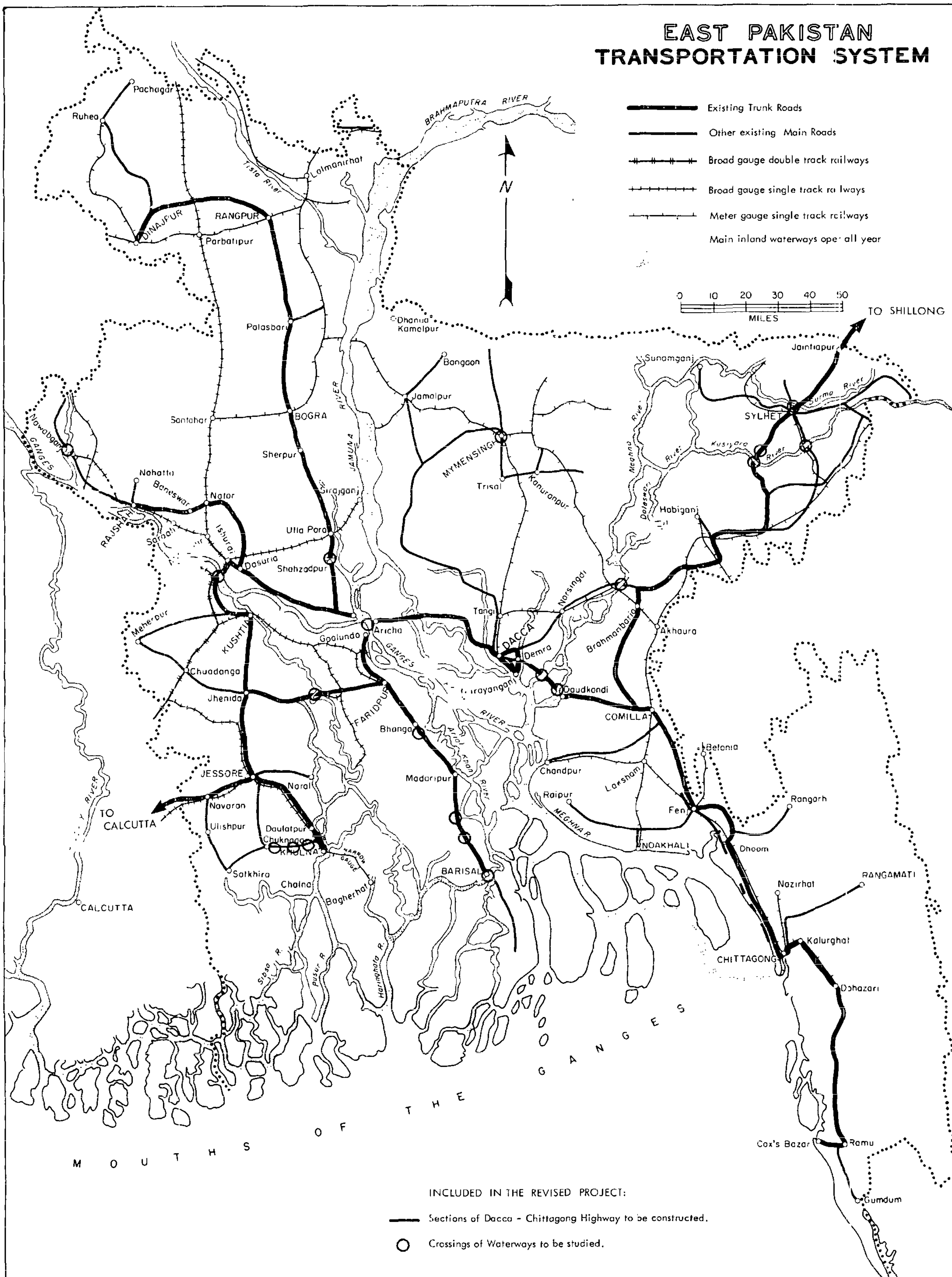
that needs tackling. On the external front, substantial action will be needed to provide the impetus to fast growth of exchange earnings and to ensure effective use of exchange resources. Production-related policies require adjustment to bring them into line with the twin objectives of obtaining growth of output primarily from better utilization of existing assets and of channelling a significant portion of additional output into export, particularly in West Pakistan. Measures remain to be worked out to give substance to the Government's announced intention of improving social conditions in the country. Finally, much needs to be done to improve efficiency in the use of resources for public development programs - in terms of tailoring approval of new projects more closely to a realistic appraisal of resources likely to be available and in terms of strengthening procedures with a view to narrowing the gap that has tended to exist between stated macro-economic objectives and the selection of projects for execution.

370. As said once before, the task of bringing about the structural changes that achievement of Pakistan's national objectives in the area of economic and social development calls for, is essentially the Government's. Nonetheless, there is a significant contribution that those providing assistance to Pakistan can make. Analysis in this as well as earlier chapters of this report has shown how strongly achievement of several of Pakistan's major objectives depends on external assistance policy responding to Pakistan's need for more room for maneuver than is built into the present pattern of aid. This applies, above all, to need to so adjust aid policies that the absolute decline in the net amount of resources transferred from abroad, that would follow from continuing assistance in present amounts and on current terms, does not occur and that net transfers are, at least, kept at their present level of US$500-550 million a year. However, it also applies to the composition of assistance as between project and non-project assistance. Without the share of the latter in the total being increased significantly, the scope for Pakistan moving in the direction of both using existing assets more productively and shifting the regional allocation of investment resources towards East Pakistan (where most projects will have a high local currency content) will be circumscribed severely. This is particularly so for the immediate future where structural rigidities - in the economy and in the aid pipeline - present strong obstacles to changing the pattern of resource allocation, regionally as well as sectorally.



NOVEMBER 1968

IBRD - 2417



APRIL 1970

IBRD-2954