

The Balance of Payments and External Resources in Pakistan's Third Five Year Plan

by

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Attainment of the goals in the international sector of her economy is essential for the achievements of Pakistan's growth goals for the Third Five Year Plan. The Plan's growth goals are ambitious, as is well known: whereas the increase in gross national product during the overfulfilled Second Five Year Plan was Rs. 9,725 million, the increase in GNP planned for 1965/66 through 1969/70 is to be Rs. 16,035 million¹.

So are the goals in international trade and finance ambitious: in the Second Plan period, Pakistan's foreign exchange earnings were Rs. 13,252 million [10, p. 96]. They are planned at Rs. 20,000 million for the next five years. At the same time, foreign exchange requirements are to grow (absolutely speaking) even more than earnings. Total international payments by Pakistan during the Second Plan period were an estimated Rs. 21,260 millions [10, p. 96]. In the Third Plan period they are expected by the planners to be Rs. 35,500 million [10, p. 98]. The widening gap between earnings and foreign exchange requirements must somehow be met. This means increasing exports, increasing foreign assistance, or both. The Government of Pakistan has chosen both, but to attempt to accelerate Pakistan's own earnings to a rate of growth greater than that of foreign aid, so as to end the Plan period with a reduced proportional weight of reliance on other nations.

This article will examine the implications of this goal without questioning its validity as a goal. This is not to say that it is not subject to question. Indeed, the objective of gradually increasing the nation's own share of the foreign exchange burden has been doubly questioned. Critics of such heavy reliance on

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¹ Calculated from [9, Table 2.2], and [10, Table 1, p. 62]. The latter table compares resources and expenditures over the years 1959/60 to 1969/70 in "current prices", although price changes are not projected for the Third Plan period. Therefore, I have "deflated" the Second Plan increase by "reflating" the 1959/60 current price GNP, using the GNP deflator from [9, p. 100]. The table on page 62 of the Plan understates the degree of acceleration of real GNP by comparing constant value figures with current price figures.

foreign assistance demand a more stern policy of mobilization of Pakistan's own resources. Those who see massive foreign aid as the obligation (rather than the political tool) of the wealthier nations see economic folly in sacrificing possible internal growth possibilities for the sake of increasing foreign exchange earnings. The Government of Pakistan appears to be treading middle ground. At all events we will accept the strategy and will scrutinize the specific requirements called for to accomplish the goal.

The Third Plan document chooses to put the balance of payments management problems in a favorable light. The Plan states:

"One of the outstanding features of the Second Plan has been its success in stabilizing and improving the balance of payments situation in the country. Export earnings have been higher than the Plan estimates, import requirements have been less than originally projected and the country has been able to exceed the investment targets of the Plan without requiring as much external assistance as was anticipated earlier. This improvement must be consolidated and accelerated during the Third Plan." [10, p. 79].

This is, in the author's opinion, the most remarkable paragraph in the entire Plan document—because of what it fails to say. The "stabilizing and improving" which is referred to is entirely with reference to Second Plan balance of payments goals. The goals themselves, however, were extremely modest (no doubt appropriately so in view of what seemed possible five years ago); but the performance of the international sector of the economy during the Second Plan period cannot be considered one of improvement in any more relevant sense. As Table I shows, the gap between the country's foreign exchange earnings and payments for imports grew, both in absolute terms, and as a proportion of Pakistan's gross national product. In the Third Plan period the absolute growth will continue, but the payments gap will (if the Plan is fulfilled in this respect) fall back to the proportion of GNP which obtained at the outset of the Second Plan period, or slightly less than that.

Exports

The basic requirement of the Plan balance of payments strategy is that the volume and value of exports be markedly increased absolutely and as a proportion of total output. The Planning Commission estimates Pakistan's foreign exchange earnings to have been Rs. 3,050 million in fiscal year 1969/70 (the final year of the Third Plan period) [pp. 96, 98]. This implies a compound annual growth rate of approximately 9.5 per cent, as compared to a projected

TABLE I
PAYMENTS AND EARNINGS IN THE SECOND PLAN PERIOD

	1960/61	1961/62	1962/63	1963/64	1964/65	Col.(5)/(1)
	(1)	(2)	(3)	(4)	(est) (5)	(per cent) (6)
1. Total imports and payments	3,287	3,566	3,904	4,701	5,802	
2. Own earnings	2,286	2,384	2,748	2,785	3,050	
3. Earnings gap Rows (1)-(2)	1,001	1,182	1,156	1,916	2,752	[274.92
4. Earnings gap as proportion of GNP (per cent)	2.9	3.3	3.0	4.7	6.3	

Sources: Imports and Exports: [10, Annexure I, p. 96].
 GNP: [9, table 2.2, p. 100].

Note: It would appear that all data in the above table are in current prices and are comparable although the two sources cited do not both indicate so specifically. The GNP figures from [9] are explicitly in current prices, and the figures in row 2, above, are (with a minor exception) identical with the "Exports" row of Table 2.2 of [9], from which the GNP data came.

cent for the same period. This means, of course, that domestic consumers and investors must be induced somehow to give up an increasing proportion of commodities produced at home, and to send them abroad to earn foreign exchange. At the same time, as a subsidiary goal, smaller proportions of total foreign earnings are to be derived from traditional sources, namely, raw cotton, raw jute, and other "primary" commodities².

This combination of goals places a heavy burden on the rapidly growing manufacturing sector. Whereas annual exports of primary commodities are to grow only 24 per cent (a modest 4.5 per cent per annum), earnings from exports of manufactures are to increase by 145 per cent, or nearly 20 per cent per annum [calculated from 10, Table I, p. 84]³.

Reasons for this desire to transform the composition of exports are a firmly established literature of economic development, to wit: the need for diversification as a stability of earnings, and the need to shift from sale of commodities for low income elasticity of demand to those with high elasticity, as a means of earnings. This explains the cheerfulness with which the Economic of Pakistan contemplates the decline of earnings of primary commodities while (in the same chapter) expressing concern over the failure [74 and 82].

³ is expanding from a smaller base, of course—about 1964-65. By 1969/70, the two will virtually pull up even,

These targets bear careful examination, for they are, in many respects, in sharp contrast to performance in recent years. The very respectable overall average growth rate of export earnings during the Second Plan period is slightly better than 70 per cent of that of the Third Plan target⁴. The Second Plan rate exceeded the Second Plan target, furthermore, primarily because of *i*) a sharp upturn in mid-plan in the production of raw cotton and cotton manufactures and *ii*) a continuation of the rapid growth of gross earnings from invisibles. In no year other than 1962/63 (the year of the spurt in cotton exports) did merchandise export growth reach the achieved overall Plan period average; and only twice (1962/63 and 1964/65) was the Second Plan's growth rate goal exceeded [7, p. 74]⁵. Figure 1 shows the sharp recovery of cotton exports. In short, the Second Plan performance in exports is an extremely shaky base from which to project—and particularly shaky for projecting an acceleration.

Much of the hope for exports of primary commodities stems from projections of growth in agricultural production in West Pakistan. Cotton production is expected to expand nearly 10 per cent per year⁶ while raw cotton exports are expected to grow at a slightly slower rate (7.5 per cent per annum, approximately). Given the optimistic outlook for groundwater development and fertilizer utilization in the former Punjab, cotton seems likely to generate the hoped-for export surplus—and particularly so if raw cotton is brought under the export bonus scheme, as has been suggested.

The other major primary commodity on which hope is pinned to accelerate exports is rice—particularly the fine rice of West Pakistan. The Third Plan calls for a doubling of the value of rice exports over the Plan period—or an average compound growth rate of 15 per cent per annum. While even a conservative extrapolation of past growth rate performance (on a very low base) yields extremely high earnings, Hussain's analysis of the potential for fine rice exports suggests that the Plan projection is optimistic [4, pp. 683-684].

⁴ The Plan document says "about 7 per cent per annum against only 3 per cent in the Plan" [10, p. 81]. I calculate almost precisely 6 per cent per annum over the Second Plan period, using Central Statistical Office data, reported in [7, p. 74]. But the latter exports rather than payments, which may account for the difference.

⁵ Actually, the 1962/63 spurt was essentially a recovery in cotton exports of raw cotton alone exceeded (in value) the total of cotton and cotton manufactures in 1962/63. At the outset of the Second Plan, exports of cotton and cotton manufactures reached a trough at about 55 per cent of 1962/63 value.

⁶ These are physical production figures, and are based on comparisons of the final-year Plan levels [see 10, p. 81]. It appears to be in error in its computation of the proportion of the final column shows a 50 per cent increase from the "Third Plan target", whereas the production figures in the table show a 9.6 per cent annual rate. In an attempt to show a still higher rate for unginned cotton—but from the Second Plan period totals [1, Table 13].

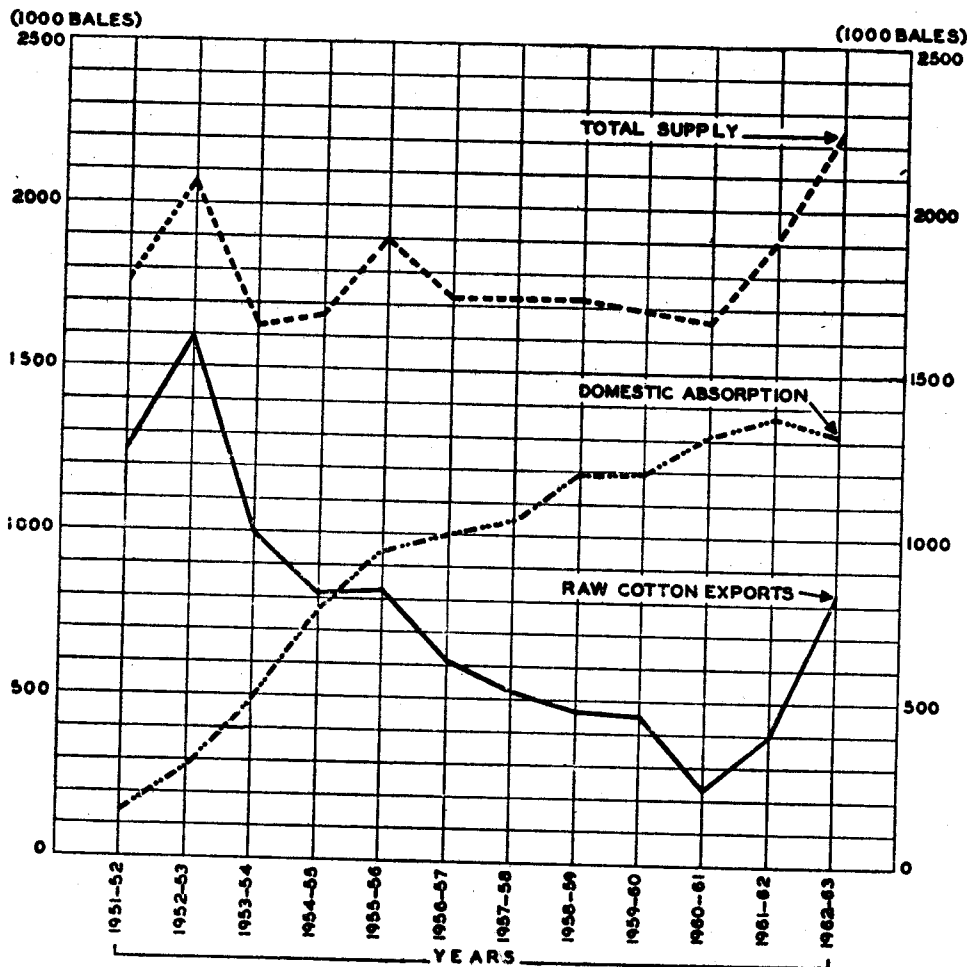


Figure 1. Consumption and Exports of Cotton

Source: [20, p. 521; 10, p. 83; 9, p. 117].

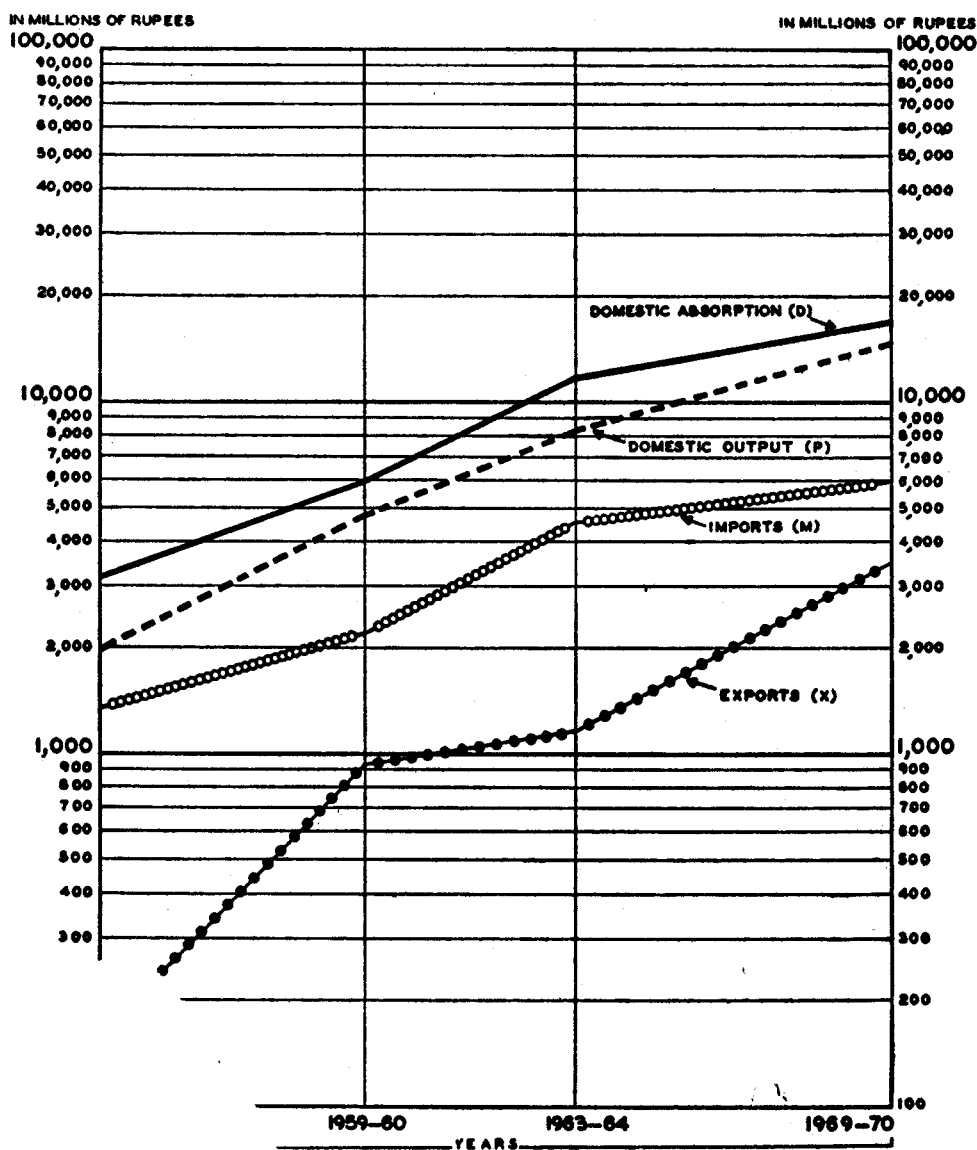
But, to repeat, the greater part of the increase in exports during the plan period is expected in manufactures. The hope of generating an increase in export earnings from manufactures of one-fifth per year is based upon the hope for a continuation (indeed, some acceleration) of a very high Second Plan growth rate in manufacturing, plus the policy of diverting manufactures from domestic absorption to foreign markets. The former is not inconsistent with recent performance from all indications⁷; the latter, however, will be a turnabout, for exports of manufactures grew much *less* rapidly than manufacturing output during the Second Plan period, while domestic absorption grew somewhat more rapidly. Figure 2 shows this graphically, though crudely. The line segments are plotted on a semi-logarithmic scale so that their slopes indicate relative growth rates. It can thus be seen that exports did make a relative gain on output in the First Plan period, but lost substantially in that race in the first four years of the Second Plan period. The Third Plan growth rates (the third set of segments) call for a distinct switch-back to the pattern of earlier years. To do so will not be easy. It will call for curtailment of growing domestic demand for jute and cotton manufactures, sellers of both of which have succeeded very well in exploiting local markets. Insofar as curtailment of domestic sales coincides with constraints on consumption, such a policy is consistent with growth stimulation. But diversions of cotton yarn and jute goods would hamper domestic industry.

Substantial support for earnings is also expected from continued growth of "invisibles"—sales of services abroad plus remittances to resident nationals by persons (mainly non-resident nationals) holding balances of foreign exchange. This set of sources contributed Rs. 216 million to the *increase* in annual earnings over the Second Plan period, and is expected to contribute another Rs. 150 million over the next five years. This relatively small increase constitutes a substantial reduction in the annual rate of growth (from 11 per cent to 5 per cent) [10, p. 84; 9, p. 117]. Much of this growth will have to be in transportation services and remittances, as it has been in the past (*see* Table II)

Imports

The large and widening trade and payments deficit is a direct attempt to develop with heavy dependence upon foreign assistance. beset with extremely low per capita income and a low income level, it will find rapid economic growth difficult or impossible without foreign aid. because, under these circumstances, the requisite capital and industrial development cannot be generated internally. large international grants and loans is thus the unpleasant

⁷ Although it may be optimistic in view of plans to reduce the inputs of manufacturers. *See* below.



Domestic Absorption, Output, Exports and Imports of Manufactures

1959/60 and 1963/64 are from [5, Tables A-2, A-3, and A-4, pp. 122-123]. The 1963/64-1960/70 are projections of the Lewis-Soligo 1963/64 values used in the Plan. The growth rate for domestic output (10 per cent) is that for exports is implicit (Table I, p. 84). The import growth rate is implicit [10, p. 98], and the domestic absorption segment is the sum of the other three ($P + M - X$).

TABLE II
INVISIBLE EXPORT EARNINGS OF PAKISTAN
(in million rupees)

	First Plan			Second Plan		Share of total earnings 1963/64 (per cent)
	1954/55	1959/60	growth rate (per cent)	1963/64	1959/60-1963/64 growth rate (per cent)	
New monetary gold	0.5	12.9	— ^a	1.5	— ^a	0.3
Foreign travel	2.4	4.3	12.4	8.0	16.8	1.4
Transportation and insurance	32.4	80.9	20.0	107.3	7.5	18.8
Investment income	19.5	34.8	12.4	36.1	0.9	6.3
Government expenditure	21.5	67.6	25.7	107.4	12.3	18.8
Miscellaneous	52.6	138.0	21.2	199.2	9.6	35.0
Private remittance for and migrants transfer	9.4	30.9	27.0	110.5	37.5	19.4
Total:	138.3	369.4	21.7	570.0	11.5	100.00

^a) excessive fluctuations; rate not computed.

Source: [15]

stern measures to raise the internal rate of saving at the expense of consumption standards⁸. Pakistan in her Plan has chosen, instead, to raise income via infusion of foreign investment goods and to guide the largest possible proportion of the income gain back into saving (and investment). Eventually⁹ the growth of output will be sufficient to afford the export surplus which will be required to eliminate or even reverse the net capital flow—*i.e.*, to meet the servicing requirements of the debt incurred during the early development period.

As we have seen, the Third Plan is designed not to reduce the absolute magnitude of the payments gap, but rather to bring its rate of growth down sharply. In order to accomplish this, not only must the shaky export growth picture be substantially improved (as discussed above), but the rate of growth of import payments must be drastically curtailed. From a Second Plan growth rate of payments (for imports plus debt service) of virtually 16 per cent per annum¹⁰, the rate must drop to less than half that amount—if the Plan target is to be met. The amounts of imports and their annual growth rates are summarized in Table III.

As Table III shows, "development imports", *i.e.*, imports of commodities which contribute to output growth, are to experience a drop in growth rate of nearly two-thirds of the Second Plan average, the largest part of this reduction coming in the import of capital goods. Development imports are to drop to a growth rate which is virtually the same as that of overall output growth, but the capital goods component is to fall well below the overall output growth rate. At first blush this seems quite plausible—*i.e.*, to step down development imports to the overall rate of growth of output. But, in fact, this is heroic. A very large proportion of development imports are channelled into large scale manufacturing, a sector which grew at a very high rate over the Second Plan period (13 per cent per annum [10, p.2]), and which is counted on to achieve a higher rate (15 per cent per annum or more) over the Third Plan period¹¹.

⁸ Keith Griffin [2] argues that the present strategy raises urban consumption standards at the expense of rural standards, and that this "redistribution" has had little, if any, favorable effect upon the private savings rate.

⁹ The long-term phasing is planned. By having exports grow at twice the rate of growth of imports for fifteen years, the absolute deficit narrows rapidly after 1975 (*see* 10, Table 6, p. 24). Again, this calls for a sharp change; whereas exports grew at about 6 to 7 per cent in the Second Plan period, total imports (including PL 480 and Indus Basin imports) grew at a rate of nearly 16 per cent per annum (calculated from [10, Annexure I, p. 97]).

¹⁰ Despite an unplanned shortfall. *See*, discussion of foreign aid, below.

¹¹ All manufacturing grew at a rate of 8.6 per cent per annum over the Second Plan period, and is projected at 10.0 per cent per annum for the Third Plan. The growth rate for large scale manufacturing is explicit in the Plan for the Second Plan period (as cited above), but no breakdown of Third Plan rates by large and small scale sectors is given. The 15 per cent rate suggested above was computed by the author assuming that (minimally) the large scale sector's rate of acceleration would equal that for all manufacturing.

TABLE III
IMPORTS AND PAYMENTS IN THE SECOND AND THIRD FIVE YEAR PLANS

Category of Imports (1)	Total expenditure for Plan Period (in million rupees)		Annual percentage increase over Plan Period ^a		Interplan percent- age reduction in annual growth rates
	II	III	II	III	Col (4) — Col (5)
	(2)	(3)	(4)	(5)	Col (4) × 100 (6)
I. Development Imports					
Capital goods	8,735	13,920	20.5	4.5	78
Raw materials for investment	2,945	6,120	12.2	12.7	(— 4)
Freight charges and insurance	1,174	1,960	28.5	4.2	85
Technical assistance	432	500	12.3	—	—
Total development imports	13,286	22,500	18.7	6.5	65
II. Non-Development Imports					
Consumer goods	2,923	3,590	4.4	3.3	25
Raw materials for consumer goods industries	1,881	3,760	16.5	9.0	45
Freight charges and insurance	481	730	19.0	4.3	77
Invisible payments	1,738	2,110	3.3	4.8	(—45)
Total non-development imports	7,023	10,190	8.0	5.8	28
III. Debt Servicing:	951	2,816	15.8	20.0	(—27)
Total Imports and Payments	21,260	35,500	15.8	7.3	54

a) computed between end-years.

Source: [10, pp. 96-98]

These comparisons clearly imply a sharp drop in the imported-capital to output ratio—although capital-output ratios generally are expected to rise. Whereas the overall capital-output ratio was 2.3 at the end of the Second Plan, it is expected to rise to 2.6 by the end of the Third, because “relatively more emphasis is going to be placed on heavy industry and on creating infrastructure in East Pakistan...” [10, p. 32]¹². Thus, implicitly, total capital requirements are expected to increase roughly 13 per cent more than output.

The Plan document states that “The import requirements for the Third Plan...[have] been done on the basis of input-output analysis which relates imports to production in various sectors of the economy for the year 1963/64. The estimates thus derived have been adjusted on the basis of targets of import substitution included in the industrial programme...”. In view of what we have seen (above) of the marked changes in projected import growth rates, this statement is arresting. Input-output tables are useful for prediction only insofar as their assumptions concerning the linearity of input-output relations hold. Differentials in the growth rates of aggregated sectors can take place, of course, insofar as the growth rates of the basic sectors change in response to alterations in the composition of final demand. Input-output relationships, being linear and homogenous, “predict” changes in input demand in the specific sectors which are proportional to the related output. Thus changes in individual rates of growth of a given aggregated category of inputs can take place only if the outputs to which they are related are experiencing changing growth rates.

Most of Pakistan's capital goods are still imported¹³. A linear planning model would thus be expected to generate a rate of growth of capital imports which at least roughly parallels industrial growth. Such, as we have seen, is not the case in Pakistan's Third Plan. The answer to this apparent puzzle is that the planning model has a type of non-linearity built into it. It was accomplished, not by changing basic input-output coefficients, but rather by computing rates of change for “macro-coefficients”, and projecting these changes from the Second Plan years to the Third Plan years¹⁴.

¹² These ratios, given on page 32 of the Plan, differ from the end-of-plan gross capital output ratios given on page 19, which (in the context of perspective planning) are given as 2.6 and 2.9, respectively. The former rates assume “a time-lag of 1½ years between the investment and output”, whereas the latter rates are computed “assuming no time lag between investment and output”. The relative difference in the changes in the ratios is not great enough to be of significance for the present argument.

¹³ Lewis and Soligo show that, in 1963/64, imports (at market prices) supplied two-thirds of domestic demand for “investment and related good” [5, Table A-4, pp. 126-127].

¹⁴ Thirty sectors were “condensed” into seven macro-sectors, and comparisons were change for the coefficients were assumed to be constants in the Third Plan projections for the seven sectors [17, pp. 2-6].

The import requirements projections of the input-output mode reflect this 'non-linearity'. The overall growth of demand for goods now imported is projected to a level in 1969/70 which is 59 per cent above that estimated for 1964/65, implying an annual growth rate in requirements of slightly less than 10 per cent. The model's annual rates for sub-categories of such goods are as follows:

intermediate goods	11 per cent
capital goods	7.5 per cent
consumer goods	8.4 per cent ¹⁵

Thus, although the model's reductions of growth rates (comparing with Table III) are substantially less than those of the Plan, they remain *very* sizeable reductions. These rates, it should be emphasized, do not take into account estimated import substitution. Import substitution was handled as essentially a separate (though related) exercise. The procedure used is not explained in published sources. From Tim's projections [17, Table 16-1], it would appear that import substitution possibilities were assessed as a lump sum (a round 15 per cent of the model's import requirements projections)¹⁶. This subtraction happens to yield a global rate of growth of imports of 6.2 per cent—a rate which coincides (perhaps only coincidentally) with a weighted average of the Plan's growth rate of total development plus non-development imports.

The problem of distributing the required import substitution among the producing sectors was initially approached within the Planning Commission with the assistance of an especially constructed 23×7 subtable. The capital goods sector was left out of consideration entirely because it was felt that the production target in that sector had already been pushed to the maximum, and that no further production for import substitution was possible. The load then fell on consumption goods (for which a fairly arbitrary import substitution goal was fixed), and upon intermediate goods. This programming exercise involves an iterative procedure which takes account of induced additional import requirements, thus ultimately providing a consistent set of import requirements and import substitution figures¹⁷.

¹⁵ Calculated from [17, Table 6-1].

¹⁶ I have not been able to determine how this sum (or proportion) was decided upon. It has been said that "total substitution requirements are known", presumably at least roughly determined by foreign exchange constraints, given growth goals.

¹⁷ A similar procedure is described in detail by Tims in [18].

Had this exercise been followed in detail in preparing the published Plan figures, then, the final set of import growth rates should have shown essentially no change for capital goods (as compared with that of the model), and substantial decreases in those of both intermediate goods and consumer goods. Instead, the capital goods import growth rate was substantially reduced (*cf.* Table III and model rates, above), as was that for consumer goods, while the intermediate goods category was left to grow at roughly the model rate. In short, the input-output tables were used only as a general guide. The extra-model adjustments (*cf.* quotation, p. 506 above) appear to have been fairly drastic.

The upshot of this exercise is that *i*) large reductions in requirements of capital goods now imported, per unit of output (and investment), are anticipated, despite the predicted rise in capital-output ratios; *ii*) the model's reduced overall imported capital goods growth requirement is further reduced (by estimated import substitution) in the Plan (by approximately 40 per cent)¹⁸; *iii*) the growth rate of imported intermediate goods is to be little affected for capital goods industries, but stepped down drastically for consumer goods industries; and *iv*) imports of consumer goods, although projected at a much higher-than-Second-Plan rate by the model, are to be heavily substituted for, so as to reduce the Third Plan rate well (25 per cent) below that of the Second Plan.

It is beyond the scope of this study to examine the interstices of the input-output table and the investment program's details in order to determine whether or not the "non-linearity" in requirements for capital goods now imported is realistic, or whether the estimate of import substitution which is coupled with it squares well with the inter-industry relations themselves. The results, however, are sufficiently surprising to suggest strongly that such checks should be made (if they have not already been made by the Planning Commission) before important policy decisions, based on their assumed empirical validity, are made.

Whatever the reliability of the method of import projections it appears from the data which emerge from them, and from the little evidence available on recent performance, that such an upturn in import substitution would be a discontinuous one, rather than simply an acceleration. A recent study by Lewis and Soligo at the Pakistan Institute of Development Economics [5] revealed that import substitution in intermediate and capital goods industries since the inception of economic planning has taken place at a surprisingly high rate—virtually paralleling that in consumer goods industries. However, despite these encouraging findings for the entire period, their data indicate that there was a sharp drop in import substitution in the capital goods industry in the first

¹⁸ That is, the Plan's capital goods import growth rate is approximately 60 per cent of that of the model's "capital goods imports" growth rate, uncorrected for import substitution.

four years of the Second Plan period¹⁹. Thus, the Third Plan strategy demands a reversal of recent tendencies. To accomplish this will surely require drastic policy changes. As the discussion of commercial policy below suggests, such a *volte face* does not seem to be in the offing.

Referring again to Figure 2, it can be seen that manufacturing is expected to shoulder a double burden, each part of which is onerous. A sharp turnabout in growth rates in *both* exports and import substitution is to become necessary. This will not only require the marked policy shift indicated above, but if the goals are reached, they are very likely to be accomplished only at a very high economic cost. Manufacturing industry in Pakistan is not yet efficient. Indeed, many industries appear to be (or at least to have been) so extremely inefficient as to be unable to make a genuine *net* contribution to import substitution. Soligo and Stern have come to the startling finding that half of the manufacturing industries (mainly consumer goods) which they examined contribute *negative* value added [13, pp. 13ff.]. If these findings are to be trusted, accelerated reliance on manufacturing industry will be self-defeating—at worst costing more in terms of scarce domestic capital and foreign exchange resources than they are able to contribute as output; and at best producing output at an alternative cost which must be extremely high²⁰.

Commercial Policy

In recent years, several innovations in commercial policy have been introduced as means to alter the pattern of flow of imports and exports. The Plan suggests that these instruments of policy will continue to be used, and that little else that is new will be introduced. During the Second Plan period, restrictions on many imports were reduced²¹ as a means of increasing their rate of flow in

¹⁹ See [5, Table III, p. 106]. Although import substitution accounted for 27 per cent of output growth in Lewis and Soligo's twenty-six industries from 1954/55 to 1959/60 (the First Plan period) these same industries showed *negative* import substitution from 1959/60 to 1963/64. Domestic output, though rapidly growing (76 per cent over four years), provided for less than the total increment in domestic absorption plus exports.

²⁰ Many, if not most, economists would agree that a high short-run sacrifice to development of domestic manufacturing can be justified if long-run high returns can be foreseen as scale expands and skills develop. A smaller number (including the author) would concede that certain non-economic benefits accrue to what Milton Friedman has called "monument building", i.e., building clearly uneconomic industrial plants for reasons of national prestige. But there are limits to the social sacrifice which is warranted. The Soligo-Stern data indicate that the high protection rates with which Pakistan has subsidized domestic industry have been excessive—though, of course, nothing careful in the way of analysis of either the infant industries effect or the non-economic benefit has been attempted in Pakistan.

²¹ But not on all imports, by any means. More than two-fifths of all imports have been and remain under direct control, either as government imports or as capital imports controlled by the Central Permission Committee, the Provincial Directorates, and the development banks [16].

order to improve the rate of utilization of productive capital in place, to encourage further investment, and to induce better allocation decisions through greater exposure of import goods users to the market mechanism. At the same time the wherewithal to make their "liberalization" possible was provided through substantial increases in foreign aid, particularly commodity aid. The impact of this effort to make imports more liberal has not yet been carefully assessed²². Summarizing this aspect of commercial policy, briefly, there are three facets to the policy *per se*; "automatic" re-licensing under the Open General Licensing (OGL) system: free access to import privileges through the bonus voucher²³ market; and the "free listing" of 55 items (mainly raw materials and spare parts). Automatic licensing has had the effect of reducing the need for administrative decision making, substituting rules for discretion. It has also led to an accelerated inflow of imported goods. Access to foreign exchange (for limited purposes) through the bonus voucher market has also reduced the relative burden on the administrative organization, and has forced on voucher users a foreign exchange price which reflects scarcity values. The "free list" has had the dual effect of increasing supplies of imported commodities, and of offering easier entry for new competitors into the import trade.

The Plan expresses satisfaction with these policies [10, p. 89] and suggests (while refraining from blunt affirmation) that they will be extended and intensified. What are the implications of this policy orientation for balance-of-payments problems over the next five years? Insofar as something approaching an equilibrium exchange rate, reflecting the true scarcity margin of foreign exchange is to be approached by elimination of the "horizontal gap" between supply and demand, the implication is that imports (or their substitutes) must be made increasingly available—at a rate *more rapid* than the growth in demand for them. There is at least a suggestion in available price data that this sort of effort is only slightly less difficult of achievement than the problem of Alice and the White Queen²⁴.

²² At least not in published form. An unpublished memorandum [16] prepared in late 1964 by Philip Thomas of the Pakistan Institute of Development Economics for the Central Commissioner for Imports and Exports has as yet not been revised for general public use. A forth-coming paper by Mati Lal Pal [12], also of this Institute, attempts a quantitative analysis; and, of course, internal documents of the Pakistan Government and the governments of the aid-giving nations have dealt with the matter.

²³ Bonus vouchers are issued to exporters as a subsidy. They may be sold freely. The current (July 1965) prices run slightly over 150—*i.e.*, importers pay a 50 per cent premium to exporters for this foreign exchange. Inasmuch as holders of bonus vouchers have only *permits* to purchase foreign exchange, the cost of foreign exchange to them is 2.5 times the official rate of exchange (about Rs. 11.9 per US dollar).

²⁴ With apologies to Dr. Mahbubul Haq. See his chapter heading quotations to chapters 6 and 7 of [3].

The work of Mati Lal Pal [11; 12,] though by no means conclusive, indicate that the scarcity value of imported goods has been little affected recently. Unfortunately, the Pal data are partial, and have been collected at points in time too close for the purpose of testing the hypothesis that the rupee's market over-valuation has been reduced. On the other hand, Pal's data offer nothing which would lead us to reject the obverse of that hypothesis. Pal has also attempted to check prices of several important "free listed" goods landed in Pakistan since "free listing" began. The results are essentially that the net impact of liberalization plus rising demand has been in the neighbourhood of zero, though careful weighting in favor of the major items might yield a stronger suggestion of general price reduction of free-listed goods than his unweighted indices²⁵.

Another crude gauge of the general strength of the rupee is the "premium" on export bonus vouchers. Their stability for the past one and one-half years has been remarkable. The standard deviation of bi-weekly observations from March 1964 through July 1965 was only 6 per cent of the mean price, with no suggestion of a downward trend.

It must, of course, be conceded that although import liberalization appears to have done little by way of bringing Pakistan closer to a neighbourhood of foreign exchange equilibrium, there has been no deterioration in the rupee's position, either. Keeping even may be as much as can be hoped for under the circumstances.

There appears to be a built-in circularity in Pakistan's commercial policy: exports are being induced by making ever larger quantities of imports available. The export bonus scheme is double-edged in this respect: it automatically places import privileges in the hands of the subsidized exporters, in the form of bonus vouchers; and, as Soligo and Stern have argued, it "... provides incentives for the expansion of precisely those industries which have a large import component [14, p. 16]²⁶. Similarly, "performance licensing" is used to give import preference to export industries.

Tariff protection also has come under criticism, and the Third Plan effort to change the pattern of protection (partly in response to this criticism) may make matters worse in one area (general productive efficiency) while attempting to make them better in another (import substitution):

²⁵ Pal's work is in the process of revision at the time of this writing.

²⁶ Soligo and Stern further attack the bonus scheme for giving the largest subsidies to manufacturers of goods that have low yields of foreign exchange per unit of value received by exporters [14, pp. 6-9]. Perhaps it should be added, however, that discussion of a broadening of the list of items which may be exported "on bonus" has been going on in Pakistan for some time. Raw cotton may be included, and perhaps other primary goods.

"In the past, tariff concessions have generally been given on an ad hoc basis and primarily to protect consumer goods industry. With the rapidly changing composition of the industrial programme, it is necessary to review the tariff structure to provide increasing protection to domestic capital goods industry" [10, p. 89].

Two recent articles in this *Review* agreed with this policy shift, one [5] arguing that excess demand had induced considerable import substitution in the capital and intermediate goods industries, but that liberalization, by eliminating the excess demand, would eliminate the incentive; the incentive, then, would have to be replaced by an increase in tariff protection. Soligo and Stern [13, p. 24] argue that, inasmuch as consumer goods are over-protected, a shift in the protection pattern is called for—in the direction which the Plan calls for.

The Lewis and Soligo argument rests upon the assumption that import substitution in capital and intermediate goods is economically desirable and that liberalization is pushing us toward a neighbourhood of equilibrium. The latter assumption has already been questioned on empirical grounds (above), and the former assumption also seems dubious in light of more recent work.

Soligo and Stern, in [13] seem to be arguing that over-protection in one area should be matched by over-protection in another. Their data, as we have seen (above, p. 509), show startling inefficiency in protected industries, and unless one can assume that Pakistan's capital goods industries are more efficient than her better-established consumer goods industries, their (Soligo and Stern's) policy recommendation would seem to be a *non sequitur*.

More recent work by the same authors [14] reinforces the notion that increased protection of capital goods manufacturing in order to induce import substitution may be a mistake:

"The principle emphasis in import substitution is to be placed on the establishment of capital goods and related industries. These same industries are also cited as containing export possibilities. Yet it is these very industries which have the highest import components. Investment in these industries would be consistent with the criterion of maximizing foreign exchange earnings per unit of capital only if these industries are relatively less capital intensive than other industries which have lower import components. This is not likely to be the case" [14, p. 14]²⁷.

²⁷ The authors of this quotation are aware that "maximization of foreign exchange earnings per unit of capital" is not a sufficient criterion for optimality.

Foreign Economic Assistance²⁸

A large and consistent flow of foreign economic assistance is central to the planning strategy. The Plan estimates that external resource requirements will be Rs. 16,500 million, or 32 per cent of the "total resources" expected to be utilized during the Plan period³⁰. This figure matches exactly the estimate of resources for development which are to be generated in the domestic public sector, during the Plan period [10, p. 66, Table 4]. Development resources to be generated in the domestic private sector are only 13 per cent greater than foreign resources (from all sources, subject to the qualification of footnote 30 below). Thus, external resources, in essence, constitute one of three pillars of equal strength. Substantial weakening of any of the three would require a basic revision of the Plan's structure.

Foreign economic assistance, which is planned to constitute more than 80 per cent of all external resources for development, is categorized as (1) project aid, (2) commodity aid, (3) Public Law 480 funds, and (4) Indus Basin funds. The planned breakdown of the first three of these categories is shown in Table IV.

28 The Third Five Year Plan concerns itself not only with foreign aid, but also with all sources of external resources. Private foreign investment is important, but not the only one, all in the total picture, and is therefore, not discussed in detail here. Griffin [2] suggests that the total outflows may match or exceed capital inflows—in which case net foreign capital would be zero or negative.

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²⁹ The Consortium consists of Belgium, Canada, France, W the Netherlands, the United Kingdom, and the United States of A Bank and the International Development Association.

30 Total resources here mean, of course, only those to be The total, 52,000 million rupees, is roughly equivalent to the product for the period. The total of Rs. 16,500 million excludes PL 480 aid except for Rs. 1,000 of counterpart "development expenditure" also excludes Indus Basin e Works Programme—which requires PL 480 funds in the

total investment (and output). The project aid component is to grow at a 4.5 per cent rate³¹. Project aid involves substantial lags in utilization, particularly in heavy investment areas. As a consequence, a very large build-up of commitments has been accumulated over the Second Plan period. However, planning during the Third Plan period calls for a reduction of the project aid "in the pipeline" by Rs. 1,000 million. This will call for a marked increase in rates of aid utilization in water and power, and transport and communication, where recently commitments have outstripped disbursements by very large amounts. For example, in 1963/64, water and power in the public sector utilized through disbursements less than one-fifth of the funds committed in that year, transportation and communication in the public sector, in the same year, utilized less than one-third of the total commitments to its projects [9, Table 4.8, p. 123].

TABLE IV

FOREIGN ECONOMIC ASSISTANCE PROJECTIONS FOR THE THIRD FIVE YEAR PLAN PERIOD

(in million rupees)

	Disbursements ^a	Commitments ^a
Project aid	8,800	7,800
Commodity aid	5,500	5,500
PL 480 funds	1,000	1,000
Total:	15,300	14,300

a) five-year totals.

Sources : [10, pp. 92-93, Tables 5 and 6].

This piling up of aid commitments in the pipeline would appear to be primarily the fault of the aid-requesting and aid-committing machinery—rather than of absorption capacity. Total public sector project aid commitments jumped from US \$59.9 million in 1961/62 to \$193.2 million in 1962/63 and to \$402.1 million in the following year: nearly a seven-fold increase. Disbursements, which were running ahead of commitments in 1961/62, rose by almost half over the same two years (1961/62 to 1963/64)³². From these indications, therefore, one might surmise that although bunching of aid plus some limits to absorption capacity led to a low aid utilization during the Second Plan period, the opposite will be the Third Plan³³.

[9, Table 5, p. 92].

important aid-utilization bottleneck does appear in water and power sector, however [idem]. Disbursements of public sector water and power rose from \$0.6 million to \$21.7 million (1961/62 to 1963/64), while commitments rose from \$112.7 million [idem].

During the Second Plan period were very close to being equal to the exchange gap to be filled (Rs. 10,950 million). The short-fall was not a serious problem. Fortunately, the unexpected rise in exports more

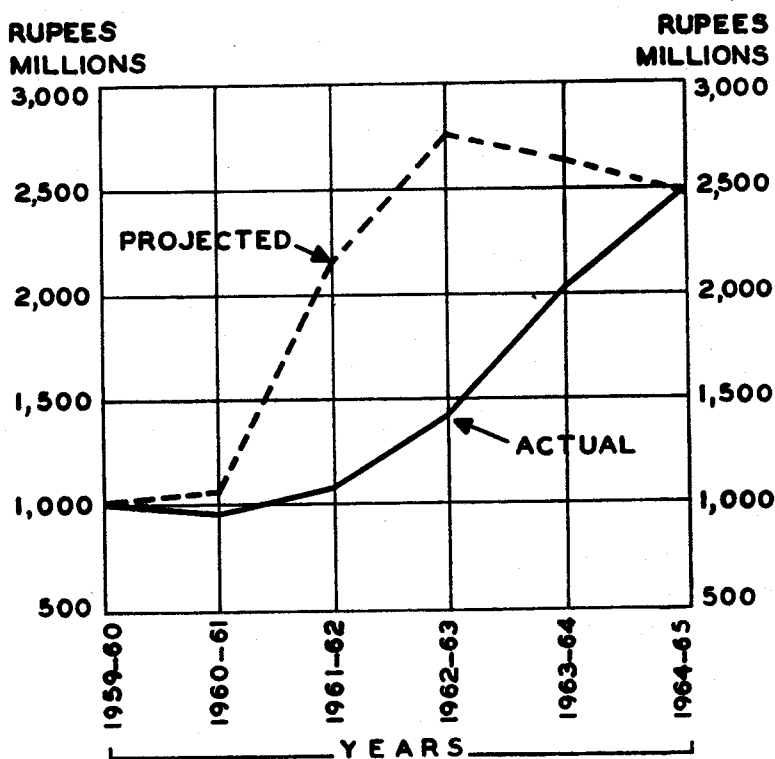


Figure 3. External Resources in the Second Plan Period

The Plan states [10, p. 73] that estimates of disbursements for the Third Plan period "assume that the average period over which the project aid will be fully disbursed will become slightly longer because of the changing composition of the development programme and that almost 10 per cent of committed funds will be disbursed in the first year, 25 per cent in the second year, 35 per cent and 20 per cent in the third and fourth years respectively, and the remaining 10 per cent in the fifth year". The implication seems to be that this phasing pattern represents a stepping down of utilization rates—a rather surprising prediction in view of the Second Plan experience.

As a partial check the above percentages were applied to the project aid commitments for the five years of the Second Plan. That phasing pattern "predicts" disbursements of Rs. 1,549 million for the year 1964/65, whereas the actual (preliminary estimate) disbursements for the year were Rs. 1,349 million, 13 per cent less than the prediction of the phasing pattern. In other words, the Plan's projections, which are based on the 10-25-35-20-10 phasing pattern, constitute a more rapid rate of utilization, rather than a slowdown—at least with reference to the terminal year of the Second Plan period.

Doubts about the phasing of aid are reinforced by examination of the Second Plan's projections and utilizations. As Figure 3 (a reproduction from [8]) shows, actual utilization fell behind projections in 1960/61, and despite sharp increases in utilization in the last three years, convergence was accomplished in the final year only by reducing the projection for 1964/65 below that of 1963/64. The rapid acceleration in the later years indicates that any significant slowdown in the Third Plan years would call for a marked change of practise.

The above remarks with reference to the growing build-up of aid in the pipeline apply to project aid, but not at all to commodity aid. As Table V shows, disbursements outran commitments through the first three years of the Second Plan period, and were expected by the planners to be equal to commitments in 1964/65 [9, Table 4.7, p. 122]. That was true in spite of the fact that annual commodity aid commitments were 2.2 times as large in the final year as compared with the initial year of the Plan period. In short, demand for commodities made available through the aid program more than maintained the pace of increased supply. The Third Plan phasing of commodity aid calls for a marked slow-down in the rate of increase of both disbursements and commitments (see Table VI). In view of the fact that total imports of raw materials and intermediate goods are expected to maintain a rate of increase comparable to that of the Second Plan period, this slowdown in the commodity aid component clearly means that the bulk of the anticipated gains in Pakistan's own foreign exchange earnings are to be spent to maintain a supply and demand balance for these

TABLE V
COMMODITY AID DURING THE SECOND
FIVE-YEAR PLAN
(in million rupees)

Year	Commitments	Disbursements	Pipeline
Opening pipeline			513
1960/61	428	480	423
1961/62	408	446	423
1962/63	618	636	405
1963/64	[879	784	500
1964/65 (est)	950	950	500
Totals	3283	3296	

Source: [9, Table 4.7 p. 122]. Dollar figures were converted to rupees at a ratio of 1: 4.75.

TABLE VI
COMMODITY AID DURING THE THIRD
FIVE-YEAR PLAN
(in million rupees)

Year	Commitments	Disbursements	Pipeline
Opening pipeline			500
1965/66	1000	1000	500
1966/67	1100	1050	550
1967/68	1100	1100	550
1968/69	1150	1150	550
1969/70	1150	1200	500

Source: [10, Table 6, p. 93].

types of imports. This would seem to imply that little further ground, if any, will be gained in pushing commodity imports toward a neighbourhood of market equilibrium³⁴.

Assistance under the United States Public Law 480 will also be decelerated. Total commodity imports from the United States under this special aid category came to Rs. 3,089 million over the Second Plan period, and are to total Rs. 4,000 million for the Third. Whereas the annual value of these imports grew by 40 per cent between 1960/61 and 1964/65, the average annual value for the Third Plan period will be only 8 per cent above that of the terminal year of the Second Plan period³⁵. The addition to demand generated by growing population and rising consumption standards will thus have to be met out of growth in domestic output—which, if the Plan's production growth goals are met, appears plausible³⁶. It is hoped that population will grow by no more than 3 per cent per annum (the Plan assumes a rate of 2.7 per cent), which, with an anticipated agricultural production growth rate of 5 per cent annually, would yield a 2 per cent per capita increase in agricultural output per year. If consumption standards are sufficiently restrained, the requirements of both expanded exports of agricultural commodities and import substitution for them, can probably be met³⁷.

PL 480 aid is largely excluded from the Plan's calculation of external resources. As Table IV shows, only Rs. 1,000 million are considered as development expenditure. Yet the remaining Rs. 3,000 million of expected accruals represent acquisition of foreign resources as well. Therefore any complete accounting must take this large sum into consideration. Some part of it is offset by U. S. uses—for expenditures that would presumably otherwise be paid for in foreign exchange. But this amount is small, relatively. The Plan [10, p. 95] assumes it to be 10 per cent, or Rs. 400 million for the Plan period. The *Economic Survey* [7, p. 202] states that the proportion is 6 per cent, by agreement. Taking the higher figure, then, Rs. 2,600 million remain available in one form or another as resources for use by Pakistan or for Pakistan.

³⁴ This is, of course, a speculative inference. No careful extrapolations of demand and supply exist that might allow for an estimate of the time-trend of excess demand. The impression that increased growth will sustain or increase pressures on imports emerges strongly from comparative growth rates, however.

³⁵ And 4 per cent *less* than that of 1963/64.

³⁶ Still, this entails a drop in PL 480 food supplies as a proportion of total food supplies from 15 per cent at the outset of the Plan to 5 per cent at the end [10, p. 121]. Perhaps, as domestic production reduces the need for PL 480 foodstuffs, consideration should be given to alternative uses of US surpluses—to feedgrains, in particular.

³⁷ It will surely require policy constraints, however. Consumption propensities in the agricultural sector are very high and could easily eliminate any prospective increase in marketable surpluses of food crops.

no less for the Third Plan period than for the Second. Accordingly, a rounded *minimal* estimate of the external resources cost would be Rs. 1,300 million.

Table VII offers an estimation of the limits of the range within which disbursements of external assistance will have to fall if the Plan is implemented. This may be compared with the Plan's own figures, as given in Table IV. Obviously the range of difference (from Rs. 3,500 million to Rs. 5,400 million) is primarily due to the placing of the Indus Basin program into a separate, extra-Plan, category. Nevertheless, using the lower estimate of the total, annual assistance requirements will average Rs. 3,760 million (US \$792 million).

TABLE VII

ESTIMATES OF TOTAL FOREIGN ASSISTANCE UTILIZATION FOR THE
THIRD FIVE YEAR PLAN, INCLUDING PL 480 AND INDUS BASIN
WORKS

(in million rupees)

	Low estimate	High estimate
Project and commodity aid		
PL 480	14,300	14,300
Planned development expenditure		
Indus Basin	1,000	1,000
Other	2,200	2,200
Indus Basin foreign exchange expenditures	—	400
	1,300	2,800
Total:	18,800	20,700

Source: See text.

Because of the international nature of the Indus Basin program, a very large proportion (72 per cent) of the foreign exchange cost is to be met by grants, thus keeping servicing costs to Pakistan very low. Only \$260 million in loans from the United States Government and from the World Bank must be repaid [19]. Other aid, by contrast, has become predominantly loan aid³⁹. As a consequence, debt servicing costs are expected to rise by 20 per cent per annum over the Third Plan period; these costs will consume as much foreign exchange as the entire Indus Basin Project—and 16 per cent of total aid resources. This alarmingly rapid rate of increase of servicing obligations is one of the main reasons why the Plan seeks to reduce relative dependence on aid as rapidly as possible. But this is the other horn of a serious dilemma which is common to many underdeveloped countries: difficulties in marshalling internal resources make foreign economic assistance tremendously attractive; but, although it is (compared to commercial capital resources) very cheap, its continued increase inevitably entails the drain of a rising proportion of foreign exchange resources

³⁹ Roughly 80 per cent of commitments over the Second Plan period were loan commitments [7, p. 196, Table 95].

into debt servicing. If the pace of development is to be maintained, then, more and more must be borrowed for the purpose of meeting these costs, at least for a time.

Economists disagree on the matter of the significance of the problem of rising debt service obligations, tending to polarize toward extreme positions: a) aid is a trap leading to economic serfdom in which the poorer nations eventually find themselves having to undertake rigorous measures to stimulate earnings, not for development, but to repay their debtors; and, on the other extreme: b) aid is really costless, or at any rate, service charges are a readily bearable burden for a country that is growing well, and which can count on generous multilateral aid. The latter thinking is encouraged by the notion that debtor nations, being largely capitalist nations living with persistent fear of Keynesian unemployment, will become increasingly willing to meet the financing of their debtors' debts as a means of offsetting the deflationary effects of capital repatriation.

Both of these views seem essentially mistaken to me, although both contain some truth. As things now stand for Pakistan, she is probably receiving about as much foreign assistance as she can hope to get. The fact that she must surrender nearly one-sixth of this over the next five years for repayments and interest certainly has to be regarded as regrettable. Considerations of absorption capacity notwithstanding, there *is* an alternative cost involved. As for the neo-Marxian argument that the capitalist lenders will happily lend the additional funds to cover servicing costs in order to avoid deflation, one need only observe the world's present monetary muddle (and to remember J.M. Keynes's frantic protests in the 1920's) to realize that fear of deflation cannot be relied upon to orient Western policy-makers.

One further note of importance: all that has preceded has accepted the implicit premise of Chapter VI of the Plan that the country has one balance-of-payments problem⁴⁰. Indeed, Pakistan, a dual economy geographically, has a problem which is a complex of the problems of the two wings, one of which (the East) is capable of earning virtually all of the foreign exchange resources which she can absorb. The other has proven capable of absorbing vastly more than she can earn. This aspect of the interwing disparity problem may prove most intractable over the Third Plan period. Oddly enough, its solution calls for elimination of East Pakistan's favorable external balance by increasing her share of foreign resources. If there are blueprints for such a policy, they do not emerge in this context of the Plan.

⁴⁰ This naivete on my part was pointed out to me by Wouter Tims in his comments on an earlier draft.

Conclusion

This paper has attempted to make explicit much of what is implicit in the Third Plan's treatment of the international sector of the economy. The analysis is not complicated and therefore does not seem to call for summarization. I think it can be said without fear of contradiction (from other members of the economics profession in Pakistan at least) that the Plan's treatment of this vital area is weak and urgently needs further work.

The analysis has suggested that the Third Plan goals in the international sector will be very difficult to achieve by the policy measures contemplated in the Plan document. Doubt is cast on Pakistan's ability to expand exports and curb imports to the extent necessary to reduce reliance on foreign economic assistance as much as is planned. If this analysis is correct, then Pakistan has these choices: *i*) to reduce the GNP growth goal to a level consistent with more modest import requirements; *ii*) to revise strategy to favor output with much lower import requirements (presumably agriculture); or *iii*) to seek additional foreign assistance beyond that anticipated for the Plan⁴¹. Unfortunately, none of these looks politically attractive by itself at this point in Pakistan's history. Perhaps a combination of *ii*) and *iii*) would be, or could become, acceptable in time. Nevertheless, the nation's policy makers should seriously contemplate the possibility that such a choice will eventually have to be made.

⁴¹ A fourth has been suggested by Wouter Tims: that priority be given to projects with short gestation periods, high export potential, and high capacity to substitute for imports. In Tims' opinion, much can still be done in this area. But (although Tims would not agree) I would argue that the best candidate for all three is the agricultural sector. Also, I must admit that alternative *iii*) seems likely to yield little in time to help the Third Plan; but it is interesting to speculate on the likely reaction of the aid-givers to an exchange crisis brought on by an over-utilization of aid funds in the early years of the Plan period.

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