Some Comments on "Planning Experience in Pakistan"

by

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Dr. Huda's conference address on "Planning Experience in Pakistan" is both useful and refreshing. He reviews, in the brief space of twenty pages, the principal economic problems and policy issues facing Pakistan at this crucial stage of its development. His approach is extensive rather than intensive, *i.e.*, he treats a wide variety of issues none of which is subjected to a deep conclusive analysis. This approach has merits particularly when the objective of the author is to pose problems in a thought-provoking manner, "without trying to find answers" [4, para 63]. And there can be no doubt that his address contributes no end of grist to the economist's mill. He has stimulated thought.

Because of the restriction of space, I have selected for discussion only three of the many issues raised in Dr. Huda's Address: *a*) the "overall" strategy of economic development in Pakistan, *b*) Pakistan's agricultural policy, and *c*) Pakistan's industrial policy.

1. ON THE 'OVERALL' STRATEGY OF ECONOMIC DEVELOPMENT

"Balanced" vs. "Unbalanced" Growth

Dr. Huda advocates a "balanced growth" as opposed to an "unbalanced growth" strategy [4, paras 24 to 26]. He deplores the fact that "imbalances have been a characteristic feature of our intersectoral and interregional growth, in spite of the plan postulate of "balanced growth" [4, para 25]. Dr. Huda quite rightly emphasises basic interdependence among the agricultural, industrial and foreign sectors of the economy. One could not push one of these sectors too far out of line with the rest, without penalising development effort, even in the "leading" sector. For economic development is not just an exercise in simple-minded "growthmanship" — or, more accurately, in economic "brinkmanship". The basic development problem is to maximize growth subject to such strategic constraints as foreign exchange, skilled labour and domestic

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saving[1]. All this is common knowledge now, but is sufficiently important to merit repetition.

While Dr. Huda's main point is well taken, his argument is deficient in several respects. First, his use of the much-abused terms "balanced" and "unbalanced" growth to illustrate his main point is somewhat confusing or perhaps misleading. Much of the confusion surrounding these two concepts has crept into Dr. Huda's exposition as well and much more so because of an unprecise use of these terms. Both these terms are normally used in an *ex-ante* sense in economics[2], but Dr. Huda uses them in an *ex-post* sense. Contrary to what Dr. Huda clearly implies, if an *ex-ante* unbalanced growth process leads to "distortions" in some strategic sectors of economy—*e.g.*, the foreign sector—then the correction of these imbalances *ex-post* does *not* make the growth process anymore balanced than it initially was.

Secondly, "unbalanced" growth does *not* mean that we neglect to make up for shortages that arise from emphasising one sector more than others. It only means that domestic demand for some products should be satisfied by domestic production, while that for the rest should be met from importers. Domestic production and imports are treated as *alternative* ways of satisfying domestic demand; and considerations of comparative advantage determine the basic choice in each case. "The optimal pattern of investment will then be one which concentrates first on one sector and then on another, with balance being approached only in the long run" [2]. It follows, and this has sometimes been overlooked even in the literature on development economics, that if the shortage of foreign exchange prevents the authorities from satisfying part of the domestic demand through imports, then either domestic demand must be curtailed or it must be supplied from domestic sources. Thus, an "unbalanced growth" strategy need not *necessarily* lead to any strain on the balance of payments. The entire strategy is based on the assumption that what cannot be produced at home can be imported from abroad. If, in Pakistan, the growth process in the past imposed strains on the balance of payments, the mistake was not in pursuing an "unbalanced growth" strategy, as Dr. Huda claims. Rather, the mistake lay in taking this process too far, without adequately providing for

[1]However, as common experience tells us, the foreign-exchange constraint turns out to be more binding than the domestic-savings constraint, the growth process normally encounters the "foreign-exchange barrier" first.

[2]By "balanced" growth is meant a simultaneous expansion of horizontally related sectors of production. Such a growth strategy is emphasised because it takes full advantage of the "dynamic external economies" generated by one sector in other related sectors of the economy. However, as Chenery has pointed out [2], this thesis crucially depends on the assumption that the supplies of the strategic inputs like capital and skilled labour are perfectly elastic. If instead we postulate an inelastic supply of these inputs then "unbalanced growth", involving an expansion of vertically related industries, presents itself as the only alternative course of action—*i.e.*, investment should be concentrated in a few sectors of the economy by the policy-maker. However, the entire debate over balanced vs. unbalanced growth has led to much fruitless controversy, reminiscent of the sterile saving-and-investment debate of the thirties.

imports to meet shortages in the 'neglected' sectors—that is, without satisfying the forcign-exchange constraint.

Thirdly, Dr. Huda's recommendation of pursuing a balanced-growth strategy suffers from an element of contradiction. For later on, in paragraph 48 [4], he calls for achieving a "breakthrough" in agriculture. At yet another place [4, para 32], he advocates a programme of "aggressive" industrialisation "because we have to build up industries as a viable, leading and dynamic sector of our economy"[3]. Now if he is asking policy-makers to implement both of his recommendations simultaneously — "balanced growth" — then he must assume that the supplies of skilled labour, capital and other strategic inputs are perfectly elastic, which assumption, as Dr. Huda will be the first to admit, is unrealistic in the context of Pakistan. However, if Dr. Huda's remarks are interpreted to mean that by promoting "unbalanced growth" in agriculture and industry *at different* points in time the economy will be moved to an ultimate intersectoral balance in the long run, then this is "unbalanced growth". Hence, Dr. Huda's conclusion that "our choice, therefore, falls again on balanced growth as the fundamental planning postulate" [4, para 26] is clearly a *non-sequitur*.

2. ON AGRICULTURAL POLICY

Dr. Huda has emphasised the need for achieving an "agricultural breakthrough" [4, para 48]. He also accepts the goal of achieving self-sufficiency by 1970 [4, para 59-a]. Without questioning these objectives, Dr. Huda's policy recommendation, to realise them, needs to be spelled out in greater detail. As it turns out, the issue that Dr. Huda has brought up for discussion is far more complicated than he makes it to appear.

2.1 Price Policy vs. Incomes Policy

Dr. Huda recommends that an agricultural price policy be formulated [4, paras 27 and 28] which will guarantee a "reasonable price" to the agriculturists to promote production in the agricultural sector[4]. But this is agricultural incomes policy and should *not* be confused with agricultural price policy as

[3]Dr. Huda really lets himself go on this point. "We must plan big and plan ahead. We must overcome the shortages of technical personnel, organizations and capital. In these days of super-tankers, pipelines . . . *the problem of raw material should not pose insurmountable*". This is brave and noble but, coming from Dr. Huda, it sounds strangely naive. Does he mean to suggest that the problem of ensuring an adequate supply of strategic raw-material inputs arises only from the cost and difficulties of transporting them from the country of provenance to the country of destination?

[4]Dr. Huda notes a basic asymmetry in the response of agricultural production to changes in the price of the agricultural products; "while high price does not guarantee high production, low price reduces the incentive to produce more" [4, para 28]. I do not know of any empirical evidence to support such a view. The real issue appears to me to be the empirical question: whether agricultural production is responsive to changes in the prices of agricultural products. Here the evidence is far from conclusive. This matter is discussed in the text.

such. This distinction is not a mere semantic quibble[5]. The objectives of these two types of policies are different. While the policy of maintaining the prices of agricultural products is designed to influence the incomes of the farmers and should, therefore, be more appropriately called an "Agricultural Incomes Policy", the objective of the price policy is to change the relative prices of agricultural products in order to influence the composition of agricultural output.

However, there is no denying the importance of an adequate agricultural incomes policy. As Falcon [3] notes, *uncertainty* regarding the prices at which the agriculturist can sell his produce is a big factor which tends to dull his susceptibilities to economic incentives. Hence a price guarantee, by dissipating much of the uncertainty that at present beclouds agriculture in Pakistan, should help create the necessary *preconditions* for agricultural growth — *i.e.*, it should help in creating an appropriate climate in which an agricultural price policy can work effectively.

2.2 Agricultural "Terms of Trade"

There is yet another possible source of confusion in Dr. Huda's argument. He has not distinguished an agricultural price policy from the policy of changing the *terms of trade* between agriculture and industry. This is misleading because, again, the objectives of these two policies are different. While the purpose of the former policy is to bring about an intra-agricultural adjustment in order, say, to increase "acreage" under a particular type of crop, the objective of the latter policy is to affect a transfer of real resources from industry to agriculture. Moreover, the two objectives are not interrelated. For instance, the government may want to change the composition of agricultural output without doing anything to alter the terms of trade between agriculture and industry.

However, this is not to deny the basic importance that attaches to keeping the agriculture-industry terms of trade at a 'proper' level. At the present stage of agricultural development in Pakistan, the government must see to it that the terms of trade do not move against agriculture. We should not imitate Japan and Russia where the agricultural 'cow' was milched, rather too much, to feed the industrial 'baby'. For, in contrast to Pakistan where we are faced with an agricultural deficit, these countries started out with a sizeable agricultural surplus (and they took steps to increase it). As a matter of fact, experience has shown, and Pakistan government have learnt their lesson only too well, that a shortfall in food output may upset the apple-cart of our industrial strategy since food imports drain away country's scarce foreign-exchange resources.

[5]The significance of such a distinction can be made clearer by an analogy. There is a basic difference between an exchange-control policy and an exchange-rate policy; while the latter policy implies that the government uses changes in the rate of exchange as a policy instrument, this policy instrument is "frozen" in the former case. Price fixation is not price policy.

A viable industrial superstructure can be raised only on the foundations of, at least, a self-sufficient agriculture.

2.3 The Agricultural Price Policy and Multiplicity of Supply Price Elasticities

The formulation of an agricultural price policy — *i.e.*, changing relative agricultural prices in order to change the *composition* of agricultural output — is a complicated affair. It must be noted, at the outset, that there is no such thing as the agricultural price policy for agriculture as a whole, as Dr. Huda clearly implies. For the most appropriate agricultural price policy will differ according to the price elasticity of the variable which the government may choose to influence. Problems arise because there are not one but several distinct variables that the government may like to influence. The more important of these variables are: *a*) aggregate agricultural output, *b*) output of a single agricultural commodity, *c*) the marketed agricultural surplus, *d*) the allocation of land and non-land resources, *e*) "acreage" under different crops (*e.g.*, cash crops vs. food crops), and *f*) "yield" of different crops. The significance of these distinctions is that the relevant price elasticities in each case may differ; and hence the price policy will differ in each case. For instance, it has been found that the price elasticity of the "acreage" under different types of crops is significant; while that of the "yield" is insignificant. It has been shown [3] that agricultural "yield" is dependent primarily on such factors as rainfall, irrigation, water facilities and other geographical factors.

Furthermore, the "acreage" response to price incentives differs for different crops. For instance, it has been estimated [3] that the price elasticity of supply of cash crops is 0.40, which is quite high (it is 0.35 in U.S.A.), while the price elasticity of the supply of food crops is insignificant. (However, the important thing is that it is positive—*i.e.*, 0.2 for wheat and 0.09 for *bajra* [5]). This, again, shows that changes in prices can and do exercise a considerable influence on the acreage under cash crops as opposed to that under food crops.

The upshot of this discussion is that the effectiveness, and the relevance, of the policy of changing relative agricultural prices varies with the price-responsiveness of the variable that the government desires to manipulate. For instance, while changes in relative prices of different agricultural products can be relied upon to produce the "desired" change in the *composition* of agricultural output (*e.g.*, more cash crops and less food crops or *vice versa*), such changes may not necessarily produce the "desired" effect on the level of agricultural output.

3. ON INDUSTRIAL POLICY

Dr. Huda has touched on several "issues" concerning the strategy of industrial development in Pakistan [4, paras 29 to 35]. He has pleaded for an "aggressive industrialization" policy [4, para 32]. In order to achieve this objective, he has emphasised developing industries where we have comparative advantage [4, paras 31 and 32] and doing some trust-busting exercises [4, para 30]. I will coment briefly on each of them.

3.1 Principle of Comparative Advantage as a Basis of Industrial Policy

Dr. Huda has emphasised the need for developing industries that use the country's relatively abundant raw materials as inputs—*i.e.*, where the country's "comparative advantage" (as he defines it) is the greatest. As an illustration, he cites the example of jute, cotton and leather-goods industries. He also recommends that greater attention be paid to the domestic production of cement and oil products. In each of these cases his sole criterion for the selection of a particular industry for special treatment is the domestic availability of raw materials that it uses as inputs — *i.e.*, "comparative advantage" in each case is determined by "natural" advantage in respect of raw-material inputs.

These recommendations have a strong intuitive appeal. However, Dr. Huda's line of argument is deficient in several respects. First, there is nothing new in these recommendations. After all, cotton-textile and jute-textile industries have dominated Pakistan's industrial landscape from the very outset; self-sufficiency in cement production has already been achieved, and leather industry has also made rapid strides. No doubt Dr. Huda knows all this. Then, why has he presented these "facts" in the garb of recommendations? The only possible interpretation of his position appears to be that he considers a greater expansion of these industries to be desirable since according to him Pakistan's "comparative advantage" is the greatest in these lines. But if this is what he means then he is clearly wrong. Even the pure theory of international trade tells us that when export industries operate under increasing costs it does not pay to specialise completely in such industries. For, in such cases, additional output will add more to costs than to net value added. As a matter of fact, it has been shown [10] that we may have overinvested in most of the consumer-goods industries, since the contribution of these industries to domestic net value added has now become negative. (This is particularly true of jute-textile and cotton-textile industries.) For this reason it is now the declared policy of the government definitely to discourage investment in these industries, as even a cursory study of first and second Private Investment Schedules will bear out. The industrialists are, instead, encouraged to invest in intermediate and capital-goods industries. This is in line with the broad industrial strategy laid down in the Third Five-Year Plan. These are steps in the right direction. One, therefore, wonders that Dr. Huda wants us to revert to an industrialization strategy which has outlived its utility!

However, Dr. Huda's argument is faulty in a more fundamental sense. His recommendation appears to be based on a misunderstanding of what is meant in economics by the terms "comparative advantage" and "natural advantage". Any country's comparative advantage, arising from its natural advantage, is not determined just by looking at that country's physical factor endowments alone. Rather it is determined by a comparison of factor endowments in at least two countries. For instance, in order to be able to say that country A is relatively capital-abundant, and that it should produce and export capital-intensive goods, it must be shown that it is endowed with a higher proportion of capital to labour than the other country with whom it trades — that is $\frac{\bar{C}_A}{\bar{L}_A} > \frac{\bar{C}_B}{\bar{L}_B}$, where $\bar{C}$ and $\bar{L}$ stand for physical endowments of capital and labour respectively in countries A and B (let B indicate the rest of the world).

The principle of comparative advantage, properly interpreted, tells us that it is not efficient for a country to undertake production of just any good without comparing the domestic rate of transformation with the foreign rate of transformation—*i.e.*, comparing the relative costs of producing a good at home or securing it from abroad. Thus, we produce jute and cotton textiles, rather than exporting them in raw form and importing them in manufactured form, not *only* because we happen to have lot of raw jute and cotton at home. It is because we can fabricate these goods more cheaply at home *than abroad.* Domestic availability of raw material, no doubt, is an important factor in lowering domestic costs, but the availability of other factors of production, like cheap labour, is also important[6]. In determining "comparative advantage" in any one country we must compare the relative costs of not only one input but of all the inputs—*i.e.*, the entire input function required to produce a given unit of output—in at least two countries. In other words, as Chenery has shown [2], what we must compare is the entire *production processes* in the two countries in order to establish comparative advantage.

3.2 Selective Import Substitution

Dr. Huda has rightly pointed out that the current cost-disability of the domestic producers *vis-a-vis* the foreign producers should not be taken as a sure argument against the domestic production of imported goods, if there is a reasonable expectation that, because of the economies of scale, the domestic production possibility curve will eventually shift outward. This is the standard infant industry argument and is widely accepted. As a matter of fact, this argument has had particular appeal for the policy-maker and the problem has been to dissuade him from carrying his protectionist enthusiasm too far. Pakistan has already gone through a period of intensive import substitution in a wide range

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[6]This point can be more readily understood if we remind ourselves of the finding that sugar production is not economical in Pakistan, despite a plentiful domestic supply of sugarcane. It has been suggested that it is more economical to import sugar from abroad and devote the resources used up in the production of sugar elsewhere.

of industries, particularly in consumer-goods industries. As a matter of fact, several studies have shown [6; 7; 8; 9] that industrial development in Pakistan has been a highly-protected bootstrap operation and that such a lop-sided pattern of industrialization (with its undue emphasis on consumer-goods industries) has promoted allocative inefficiency and has increased the strain on country's balance of payments.

Hence there is near-consensus that, both in order to promote a more rational allocation of domestic resources and also to solve the balance-of-payments problem, industrial policy should now shift *i*) to import substitution in intermediate and capital-goods industries and *ii*) to industries primarily producing for export. This line of thinking, first reported in the *Pakistan Development Review* [7; 9], has been faithfully reflected in Pakistan's Third Five-Year Plan. Seen in this context, Dr. Huda's recommendation that consumer-goods industries (cotton and jute-textile industries in particular) should be expanded is both anachronistic and wrong. Also, it is somewhat surprising that when everyone is talking of according *greater* emphasis to export expansion, Dr. Huda nowhere says a word about this important matter. As a matter of fact, he speaks little about the all-important question of allocative efficiency of industrial investment.

3.3 Monopolies and the Concentration of Income in the Industrial Sector

The broad strategy of industrial development in Pakistan has been to let the private-sector dog see the rabbit. It is increasingly felt that this strategy may have been taken to extremes. And in this respect Dr. Huda has given vent to a widespread concern about the social aspects of industrial development in Pakistan. Nowhere else in the world, except perhaps in Germany, have the industrial "robber barons" [8] been fed such large chunks of "meat" at the expense of public exchequer. The private sector is given very strong fiscal incentives to save and invest. Some of the incentives are: a differential tax in favour of paying dividends — 10 per cent of the corporate rate of 45 per cent; a rebate of personal income tax for investment in securities so that a man with Rs. 30,000 of income can get 40 per cent on such investment upto Rs. 12,000; dividend income is exempt from tax upto Rs. 5,000; and, on top of all, new industrial ventures get a six-year tax holiday. Such tax-exemptions, *etc.*, have seriously eroded the tax base.

However, this policy has been deliberate; and it has paid rich dividends. The annual growth rate of large-scale manufacturing has been about 15 per cent since 1960, three times faster than the growth in GNP. But there is no rose without a thorn. The overwhelming reliance on private sector has resulted in an undue concentration of income originating in the industrial sector in the hands of a few industrial tycoons. It has been estimated [8] that at present 24 industrial units control half of all industrial assets. The top industrialists also control banking and insurance. Dr. Huda has rightly drawn attention to these rather undesirable aspects of industrialization. Undue concentration of industrial power, backed by heavy protection, dulls the competitive spirit. It thus appears that some moderate exercise in trust-busting may now be in order in Pakistan in the interest of greater allocative efficiency in the industrial sector.

In this connection, Dr. Huda has deplored that "the example of Japan in this respect has not received the attention it deserves". However, contrary to what Dr. Huda recommends, Japanese experience with trust-busting in the post-War occupation period could hardly be the one that we would like to see repeated in Pakistan. As Allen points out [1], it was the conqueror's zeal to reform everything in a conquered territory, at whatever cost, that was the main motivating force behind the large-scale trust-busting in the occupation period. The occupation authorities also held the big *Zaibatsu* (*i.e.*, the big business) responsible for helping the Japanese war effort. It is significant that in the formulation of SCAP's (Supreme Commander for Allied Powers) policy Japanese preferences were not consulted. As Allen puts it, "they (the Occupation authorities) were intent upon dissolution (of Zaibatsu) ...... and if, in the process, economic efficiency were for a time diminished and the recovery delayed that was a price which Japan must pay........". As a matter of fact, there is solid evidence that Japan's post-War economic recovery was seriously retarded because the policy of destroying *Zaibatsu* (the big business) had disorganized the main centres of economic initiative. It is also significant, and more important from our point of view, that soon after the end of the Occupation, the *Zaibatsu* forces started gathering momentum once again; and by the early 60's *Zaibatsu* again loomed large on the Japanese industrial horizon. It may be noted that it was in the post-Occupation period that Japan was firmly set on the path of about the fastest economic growth achieved in the non-communist world.

We have cited the Japanese example at such length in order to show that, contrary to what Dr. Huda would have us do, our reformist's zeal can find little support from it. If anything the opposite is true: the periods of fastest economic growth both in the pre-Occupation and post-Occupation periods were associated with the dominating role of the *Zaibatsu* in Japanese economic life.

This is not to suggest that too much industrial concentration is good for country's industrial health. However, the fact remains that this is a consequence that we must accept once we have put the private sector in the 'centre-forward' position—a position that Dr. Huda also has not challenged. For, the emergence and growth of monopolies in the early period of industrialization has acquired the force of an historical truth. The reasons for this are not far to seek. In a country just starting on the growth path the supply of entrepreneurial ability is narrowly confined, while the capital needed for development can be rapidly accumulated only if incomes are unequally distributed, or if the state can enforce saving on a large scale. The relatively weak and inefficient fiscal machinery in developing countries has taught the policy-maker to accept the former course as a necessary evil. However, I agree with Dr. Huda that there is no reason why this process should be allowed to go on for ever. At least with respect to investment in new industries, the government could ensure that a more competitive industrial structure developed. As a matter of fact, the government has tried to do precisely this. The provision for private-sector investment was reduced from 78.8 per cent in the Second Plan to 68 per cent of total investment in the Third Plan; while the share of public-sector investment has been increased from 21 per cent to 32 per cent during the same period. The fourth-plan period is likely to witness a continuation of this policy. Government may also start thinking about withdrawing some of the rather over-strong tax incentives, like the tax holiday. However, the time for taking draconain measures in order to break up big industrial concern is not yet. Since maximizing economic growth must be the predominant sentiment of the policy-maker at the present crucial stage of Pakistan's economic development, our reformist's zeal had better be kept in check for quite some time to come.

GENERAL REMARKS

I have confined myself in the preceding pages to an examination of only a part of what Dr. Huda has to say in his address. But Dr. Huda says a lot about many things. He describes well the planning process in Pakistan. His observations on foreign aid and technical assistance are bold and well informed. He has also drawn attention to the very important problem posed by the servicing and repayment of foreign loans. His discussion of the problems is throughout unusually frank and there is no doubt that he has succeeded "in provoking you to think, deliberate and advise". Yet, thanks to such a narrowly-defined objective, his success could not be any greater.

However, I hasten to add that the seemingly critical tone of my comments should not blind the reader to the fact that this is an address of a very very busy man, who cares more for getting his main message across to his audience, rather than for logical rigour, orderliness in exposition and semantic niceties. Maybe I have looked rather too closely at the *way* he says things rather than on *what* he says. Maybe I have counted the trees instead of seeing the wood as a whole. If that be so, then let these comments of mine stand as an understatement.

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