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Problems in Pakistan's Prosperity

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### Problems in Pakistan's Prosperity

Pakistan's economy has made striking progress since the inception of the Ayub regime in October 1958, but indications that trouble may lie ahead have recently appeared. In the last fiscal year before the new regime (July 1957-June 1958), the balance of payments on current account had shown the sizable deficit of Rs. 335.7 million, representing 20 per cent of total receipts for goods and services. In fiscal 1958/59, there was a modest surplus of Rs. 35.0 million which increased to Rs. 118.1 million in fiscal 1959/60. However, in the past fiscal year 1960/61, the trend was reversed and a deficit of Rs. 90.8 million appeared.

Concurrently with the balance of payments movements, the amount of international reserves declined from \$390 million in mid-1956 to \$232 million in September 1958, their lowest level in the history of Pakistan. From October they began to increase and reached the high-point of \$443 million in February 1961. Since then, however, they have fallen steadily, and were \$356 million at the end of October 1961--a decline of 20 per cent in eight months.

### Governmental Policies

The original economic improvement resulted partly from governmental policies, and partly from fortuitous circumstances.

After coming into power, the Ayub regime instituted an economic program designed both to prevent the further falling of the country's very low level of international reserves and to reduce domestic inflationary pressures. To achieve the former aim, the Government granted an amnesty to those nationals who surrendered illegally held foreign exchange, expanded its controls over the country's imports, and instituted an incentive scheme for exporters. This scheme, called the Export Bonus Scheme, is designed primarily to stimulate the exportation of manufactured goods and new agricultural products. Pakistan's traditional exports--raw jute, raw cotton, hides and skins, and wool are excluded, for the most part. Under the scheme, exporters of the favored goods are granted bonus vouchers based upon a fixed percentage of their f.o.b. value. During 1959, there were two percentage levels; 20 per cent, for the export of primary commodities and jute and cotton manufactures; and 40 per cent, for the export of all manufactured goods except jute and cotton. In 1959 and the first half of 1960, about 37 per cent of all exports received bonus vouchers.

These vouchers are negotiable, being traded on the Karachi stock exchange, and permit their owner to obtain a license and foreign exchange (at the official rate) for the import of those goods included in a list of about 200 items. As the goods obtain high prices in the local market, there is a strong demand for the vouchers. Between January 1959 and June 1960, about 12 per cent of Pakistan's private imports were effected by vouchers. The price of a 100 rupee voucher has fluctuated considerably, reaching a high of Rs. 178 in February 1960, and a low of Rs. 87.5 in August 1961. In September 1961, the price had risen sharply to Rs. 118.5 as the result of the inclusion of rayon yarn in the list of goods imported only with bonus vouchers. At the mid-July 1959 price of Rs. 165, the exporters of primary commodities and jute

and cotton products received an effective rate of Rs. 6.33 per dollar, and exporters of all other manufactured goods obtained the effective rate of Rs. 7.90 per dollar, as compared with the official rate of Rs. 4.76 per dollar. The importer who purchased imports by means of the bonus voucher, paid for them at the effective exchange rate of Rs. 12.62 per dollar.

Partly as a result of these governmental measures, the balance of trade improved considerably in 1959. Imports declined by 11 per cent and exports expanded by 8 per cent, so that the deficit was sharply reduced from Rs. 470.8 million in 1958 to Rs. 153.7 million--a decline of 67 per cent. (See Table 6.)

The Government attacked domestic inflation by reducing its budgetary deficit through improving the methods of tax collection and effecting some changes in the tax structure, and by less recourse to the banking system to finance the reduced deficit. The efforts of the Government to reduce its contribution to the expansion of the money supply are indicated in Table 1.

Table 1

Factors Affecting the Money Supply <sup>1/</sup>  
(millions of rupees)

<u>Change in</u>	<u>1957/58</u> <sup>2/</sup>	<u>1958/59</u> <sup>2/</sup>	<u>1959/60</u> <sup>2/</sup>	<u>1960/61</u> <sup>2/</sup>
Net claims on public sector	767	252	107	156
Counterpart funds	- 35	- 27	-158	- 92
Claims on private sector	40	- 4	358	250
Quasi-money	-177	- 49	-200	-285
Other domestic assets and liabilities	38	- 96	- 31	14
<u>Net foreign assets</u>	<u>-282</u>	<u>122</u>	<u>220</u>	<u>- 30</u>
Money supply	+351	+198	+296	+ 13
Percentage change in money supply	+7.0	+3.7	+5.3	+0.2

<sup>1/</sup> Minus sign indicates factors decreasing money supply

<sup>2/</sup> July/June

Source: International Financial Statistics

In 1957/58, the last fiscal year before the establishment of the new Government, the money supply had expanded by 7.0 per cent. The predominant factor behind this expansion was the large governmental borrowings from the banking system. The expansion would have been even greater were it not for a sizable reduction in the country's net foreign assets.

In fiscal 1958/59, the new Government sharply reduced its borrowings from the banking system, thereby lessening the rate of increase in the money supply. In fiscal 1959/60, the increase in governmental borrowing was reduced still further and was outweighed by the accumulation of counterpart funds so that the governmental sector exerted a net contractionary effect on the money supply. The expansion in the money supply was caused primarily by an accumulation of foreign assets and by an increased extension of credit to the private sector. This latter factor reflected, to a large extent, the expansion in agricultural, industrial, and commercial activities which was being stimulated by the Government's policies.

In the past fiscal year 1959/60, there was but a slight increase in the money supply. Increased credit to the public and private sectors was counterbalanced by a further accumulation of counterpart funds, by a large increase in time and savings deposits and by a slight decline in foreign assets.

The Government's reduction of the inflationary financing of its expenditures was made possible by two factors: increased foreign assistance, and increased revenues. In fiscal 1957/58, Pakistan received Rs. 674.0 million in official loans and grants, excluding commodity aid. They increased to Rs. 775.0 million in fiscal 1958/59 and Rs. 1,008.0 million in 1959/60. Higher revenues resulted from improvement in the system of tax collections, changes in the tax structure, and expanding economic activity. The increasing level of economic activity, as indicated by the index of industrial production, is shown in the following table.

Table 2

	<u>Index of Industrial Production</u>				
	(1954 = 100)				
	<u>1958</u>	<u>1959</u>	<u>Percentage</u>	<u>1960</u>	<u>Percentage</u>
	(1)	(2)	increase	(3)	increase
			(2-1)		(3-2)
January - March	160.7	180.4	12.3	202.6	12.3
April - June	155.4	172.4	10.9	193.5	12.2
July - September	162.2	180.8	11.5	196.7	8.8
October - December	170.0	186.8	9.9	217.2	16.3

Source: Pakistan Central Statistical Office, Statistical Bulletin, September 1961, p. 1087.

In every quarter-year period, the index has exceeded its level in the corresponding period of the preceding year and, in almost every period, by more than 10 per cent.

While governmental policy was conducive to this improved economic climate, it might not have succeeded had not circumstances combined to expand considerably the country's foreign exchange earnings from exports.

External Trade

In 1960, jute prices rose considerably because of a severe drought during the planting and early growing season which reduced the production of raw jute, and thereby limited the amount of raw jute available for exportation. The volume index on jute exports fell by 7.2 per cent, from 83 (1953=100) in 1959 to 77, the lowest level since the establishment of the State. The decline was concentrated in the last part of the year, when the reduced crop was brought to market. Since Pakistan is the world's largest supplier of jute, changes in her crop have a direct bearing upon world market prices. From the spring of 1960, when it first became apparent that the new jute crop would be in short supply, the price of jute rose sharply, as is indicated in the following table.

Table 3

Raw Jute: Average Export Value  
(Rs. per bale)

	<u>1959</u> (1)	<u>1960</u> (2)	<u>Percentage increase</u> (2-1)	<u>1961</u> (3)	<u>Percentage increase</u> (3-2)
January - March	163.5	142.2	-13.0	357.0	151.1
April - June	147.5	168.6	14.3		
July - September	140.1	207.5	48.1		
October - December	154.4	263.8	70.9		

Source: Pakistan Central Statistical Office, Statistical Bulletin, September 1961, p. 1051.

This price increase continued in 1961 with an average export value during the first quarter of Rs. 357.0--an increase of 151.1 per cent over 1960, and of 118.3 per cent over 1959.

Jute prices increased to such an extent that they more than compensated Pakistan for the reduced volume of her jute exports. As Table 4 indicates, total earnings of jute exports increased in 1960 by 18.5 per cent. In the first quarter of 1961, export earnings reached Rs. 300 million--an increase of 59.6 per cent over 1960, and of 65.7 per cent over 1959.

Table 4

Raw Jute: Total Export Value  
(Rs. million)

	<u>1959</u> (1)	<u>1960</u> (2)	<u>Percentage increase</u> (2-1)	<u>1961</u> (3)	<u>Percentage increase</u> (3-2)
January - March	181	188	3.9	300	59.6
April - June	127	169	33.1		
July - September	125	142	13.6		
October - December	247	307	24.3		
January - December	680	806	18.5		

Source: International Financial Statistics.

Cotton is Pakistan's second most important agricultural export, but unlike jute, her main foreign exchange earner, Pakistan cannot influence world market prices to any appreciable extent. In 1959-60 (August-July), Pakistan exported only 334 thousand bales of cotton, as compared with total world export of 15,342 thousands--a share of 2.2 per cent.

In 1960, Pakistan was faced with the propitious combination of enlarged export supplies of raw cotton and relatively favorable international prices. The volume index of raw cotton exports increased to 31 (1953 = 100) in 1960 from 19 in 1959--an increase of 63.2 per cent. Most of this increased volume was due to the sudden appearance of Communist China as a purchaser in June, and by expanded sales to Hong Kong. Total sales increased by 33,786 tons--from 53,298 tons in 1959 to 87,084 tons in 1960. Communist China's purchases totaled 20,477 tons, while Hong Kong doubled its purchases from 5,401 tons to 10,880 tons. Thus these two areas accounted for 76.8 per cent of Pakistan's enlarged exports of raw cotton.

The levels of export prices and total export earnings are indicated in Table 5.

Table 5

Raw Cotton

	<u>Average Export Value</u> (Rs. per Bale)			<u>Total Export Value</u> (Rs. million)		
	1959 (1)	1960 (2)	Percentage increase (2-1)	1959 (3)	1960 (4)	Percentage increase (4-3)
January - March	406.1	425.4	4.8	39	59	51.3
April - June	403.8	436.8	8.2	39	90	130.8
July - September	413.5	435.8	5.4	26	47	80.8
October - December	393.8	454.3	15.4	11	15	7.1
January - December				118	211	78.8

Source: Pakistan Central Statistical Office, Statistical Bulletin, September 1961, p. 1051; and International Financial Statistics.

Export prices, strengthened by strong foreign demands, were higher throughout 1960, and in the first quarter of 1961 they reached Rs. 484.3--a 13.8 per cent increase over the corresponding period in 1960. Enlarged volume and higher prices caused Pakistan's earnings from raw cotton exports to soar. During 1960 as a whole, the value of these exports increased by 78.8 per cent. Increased earnings from raw jute and raw cotton exports totaled Rs. 219 million and accounted for 63.3 per cent of the total increase in the value of exports. The rest of the increase, mainly consisting of cotton and jute manufactures, was due partly to strong foreign demand and partly to the Export Bonus Scheme.

Present Difficulties

Concomitant with this expansion in foreign exchange earnings was a large expansion in foreign exchange expenditures, which was partly due to the expanding economic activity which necessitated added imports of raw materials, spare parts, and capital equipment; and partly due to the new liberalization policy of the Government. Foreign exchange allocations for imports of raw materials and spare parts were granted more freely, and an increasing number of imports were placed under open general license. However, Pakistan's imports are still far from being completely liberalized, as is indicated by the very existence of the Export Bonus Scheme.

The extent of the increased exports and imports is indicated in Table 6.

Table 6

	<u>Balance of Trade</u>				
	<u>(Rs. million)</u>				
	<u>1958</u>	<u>1959</u>	<u>Percentage</u>	<u>1960</u>	<u>Percentage</u>
	<u>(1)</u>	<u>(2)</u>	<u>increase</u>	<u>(3)</u>	<u>increase</u>
			<u>(2-1)</u>		<u>(3-2)</u>
Exports	1,416.9	1,527.3	7.8	1,873.2	22.6
Imports	1,887.7	1,681.0	-10.9	3,112.1	85.1
Trade balance	- 470.8	- 153.7	---	-1,238.9	---

Source: Pakistan Central Statistical Office, Statistical Bulletin, various issues.

The improved balance of trade in 1959 was not continued in 1960. While exports rose to their highest level since the Korean conflict, imports increased at a much faster rate, thereby enlarging the trade deficit to Rs. 1,238.9 million--the largest deficit in Pakistan's history. The Finance Minister, Mr. M. Shoaib, reported that nondevelopmental imports rose from Rs. 734.3 million in 1958 to Rs. 1,179.5 million in 1960--a 60 per cent increase--and he expected them to rise even further in 1961.

During 1960, increased imports were more than covered by enlarged export earnings and by higher levels of foreign aid, so that the country's supply of foreign currency was increasing. However, in 1961 the situation has deteriorated. Imports are expanding at a rate faster than foreign currency receipts, and the supply of international reserves is being depleted.

The Pakistani Government is faced with a range of alternatives. At one extreme, it can continue its present policy of encouraging the import of raw materials and capital equipment in order to enable production to expand, and permitting the import of consumer goods in order to give added incentive for expanding production and for improving the attitude towards exerting

extra effort by increasing its rewards. This alternative, however, assumes a supply of foreign exchange adequate to pay for the increased imports, i.e., expanded export earnings and/or larger foreign aid. As already mentioned, foreign assistance to Pakistan has been increasing. The Pakistan Planning Commission has estimated that the public sector will require during the Second Five Year Plan (1960-65) Rs. 8,450 million--\$1,775 million--in foreign assistance, excluding United States commodity aid and the Indus Valley Project requirements. The yearly contributions of foreign assistance would have to increase to about 70 per cent above their present levels if this figure were to be reached. It remains to be seen whether the Aid-Pakistan-Consortium, meeting early in 1962, will provide all the aid which Pakistan desires. Pakistan has been assured of continued commodity aid by the recent agreement with the United States whereby the United States committed itself to provide Pakistan with agricultural commodities valued at \$621 million over the next four years.

If foreign aid is not forthcoming in the desired amounts, Pakistan will have to redouble her efforts to expand her foreign exchange earnings. This may necessitate strong action to guard against the growth of demand in excess of available resources and the emergence of serious disparities between internal and external prices. This might require the modification of present development plans.

The other alternative is to revert to more stringent economic controls in order to guard foreign exchange reserves. This alternative involves the likelihood that incentives will be reduced and the processes of production will be hampered by the controls themselves.

Towards which alternative the Pakistan economy will veer will depend in large measure upon how optimistic-or pessimistic-the Government is both on the potentialities for expanding domestic production and on the supply of its future international reserves.