Notes and Comments

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

by

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The Pakistan Institute of Development Economics has initiated a number of useful studies on different aspects of the Third Five Year Plan. Many of these studies have already yielded thought-provoking articles, one of which is Dr. Bruce Glassburner's critique of the Third Plan's sixth chapter on the balance of payments and external resources [1].

2. The main conclusion reached by Dr. Glassburner as a result of his meticulous analysis of the balance of payments projections and policies is that the Plan's export targets are overambitious and may be difficult to achieve; that the import projections are conservative and will not sustain the projected investment or consumption levels, and as a consequence Pakistan may not be able to reduce reliance on foreign assistance to the extent visualized in the Plan.

3. Neat as these conclusions may appear at first sight, they are not fully supported by the analysis presented in the critique.

4. The *export* targets of the Plan (Annexure I) are questioned on three different grounds; first, that the Second-Plan performance in exports is an extremely shaky base from which to project an acceleration in exports; second, that rice export targets are optimistic; and third, the projected growth of manufactured exports at a rate faster than industrial output will not be easy since diversion of cotton yarn and jutegoods would hamper domestic industry.

5. The assumption that the Third-Plan export targets are only a statistical projection of the Second-Plan performance is incorrect. These targets are based on a detailed item by item study of all the exportable items analysing the existing and future planned production, expected domestic absorption, exportable surplus and likely price trends in each case. In commodities like jute and jute manufactures where Pakistan contributes a substantial proportion of the world trade,

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the demand side of the commodity or product has also been carefully analysed. As mentioned in para 25 of the balance of payments chapter of the Plan, these detailed projections have already been published in a separate study [3].

6. While judgements or opinions about the export prospects for particular items may differ, the overall increase implicit in the Plan's export targets is by no means unrealistic. In absolute terms the Third Plan does call for a faster rate of growth than that achieved during the Second Plan, 9.5 per cent per annum compared to 7 per cent, but the growth target for the Third Plan is also higher. The ratio of increase in exports to the increase in GNP is projected to increase from 1.3:1 during the Second Plan to 1.4:1 in the Third Plan. This modest acceleration, to quote the Plan, is based on two major policies. "Firstly, that the pattern of growth will be reoriented still further in favour of the export sector and the development programmes in the agricultural and industrial sectors will concentrate on exportable commodities and products. Secondly, even within the existing production pattern, a larger proportion of the increased agricultural and industrial production will be diverted to the export market through appropriate fiscal policies and other incentives to restrain domestic consumption and encourage exports".

7. Specific targets for manufactured exports visualized in the Plan are in fact lower than those suggested by the Export Promotion Council, and the projected increase in agricultural exports as a whole is even more conservative. It is almost certain that agriculture exports will be higher than the Plan projections of 2,050 million rupees in 1969/70 and will more than compensate for any possible shortfalls in manufactured exports. The export performance of the first year of the Third Plan fully supports the optimism latent in these expectations. Despite the temporary setback in exports during September 1965, foreign exchange earnings during 1965/66 are expected to increase by 15 per cent, agricultural exports by 7 per cent and industrial exports by 36 per cent. The corresponding Plan targets were an average of 9.5 per cent, 4.7 per cent and 18.1 per cent per annum respectively.

8. Dr. Glassburner considers the Plan's *import requirements projections* as unrealistic because in his view they forecast a reduction in the requirements of capital goods per unit of output and investment despite the predicted rise in capital-output ratios; and imply substantial import substitution in consumer goods and also in capital goods without any corresponding effect on the requirements of intermediate goods. The import substitution exercise is regarded as 'arbitrary' and extra model adjustments 'fairly drastic'. Consequently, the main results of the exercise are considered sufficiently 'surprising' to suggest strongly the need for further checks on the estimates.

9. Some of the points made in this analysis are pertinent and no one will doubt the need for continued work and further consistency checks in a field as complex as import substitution, but these points do not necessarily establish that the import projections in the Plan are conservative and will not sustain the investment and consumption levels implicit in the Plan.

10. As the Plan states (para 31—Chapter VI) the ratio of capital goods imports to total development expenditure will decrease from an estimated 36 per cent in the Second Plan to 29 per cent during the Third Plan partly due to the changing composition of the development programme (*viz.*, a larger proportion of allocation to less foreign exchange intensive sectors like agriculture, education, health and works programme) and partly the expansion of domestic capacity to produce more capital goods. Even if one accepts the premise that the capital goods required by the industrial sector will increase at a "rate at least paralleling the rate of industrial growth (ignoring in the process the problems of time lags and capacity utilization)" the validity of the assumption that capital goods imports as a whole will drop from 36 per cent to 29 per cent of the Plan expenditure is not affected, since industrial investment is only 28 per cent of the total. In other sectors, one has only to take note of programmes such as tubewells in West Pakistan or pump irrigation in East Pakistan to realize the immense growth possibilities with very favourable capital-output ratios that still exist.

11. Dr. Glassburner's assumption that import substitution possibilities were assumed as a lumpsum (around 15 per cent of the model's import requirements projections) and that this substitution *happened* to yield a global rate of growth of imports of 6.2 per cent —a rate which according to him coincided only coincidentally with a weighted average of the Plan's growth rate of total development plus non-development imports, is not correct. It is true that the import substitution procedure is not explained in detail in the Plan document (I wonder if any Plan document will); it is not clear however, why he should doubt what the Plan does state—*viz.*, that "the import requirements for the Third Plan have been estimated in relation to production targets on the basis of an input-output table for 1963/64 and estimates thus derived have been adjusted on the basis of targets of import substitution included in the industrial programme and by assuming that the demand for certain consumer goods would be restrained through appropriate fiscal and import policies". As this paragraph clearly states, the estimated import requirements as revealed by the model for each of the 30 sectors by broad commodity group were examined and reduced in relation to targets of industrial production included in the Plan. The possibility that in some cases the actual production may be less than the target was kept in view in carrying out this exercise.

12. Dr. Glassburner is not happy about the drastic extra model adjustments for the requirements of capital goods and consumer goods. Without going into the more difficult question of defining the precise role that econometric models should play in planning and policy-making, it is obvious that models assume a production function with technological coefficients reflecting past trends and any changes in these coefficients will undoubtedly affect the requirements for capital goods. Since the publication of the Plan document, a lot of additional work has been done on import substitution possibilities during the Third Plan and there is by now ample evidence to suggest that the import substitution estimates visualized by the Plan are not unrealistic [7]. The Plan assumes that as a proportion of Plan investment, the requirements of capital goods will decrease from 61.7 per cent in 1964/65 to 60 per cent in 1969/70, and domestic production of capital goods will increase fiom 1270 million rupees in 1964/65 to 3480 million rupees in 1969/70, *i.e.*, at an annual compound rate of 18.7 per cent compared to a rate of 28.3 per cent during the Second-Plan period. These calculations are shown in the following tables:

TABLE I

ESTIMATED VALUE OF DOMESTIC PRODUCTION OF CAPITAL GOODS IN 1964/65

	Gross product metallurgical and metal product industries 195/960 (FGP*) *million rupees*	Industrial production index 1964/65 (1959/60 =100)	Estimated product 1964/65 FGP* *million rupees*	Proportion of investment goods in total gross product (%)	Gross value domestic production investment goods (FGP*) *million rupees*	
					1959/60	1964/65
					(in 1959/60 prices)	
	(1)	(2)	(3)	(4)	(5)	(6)
Base metals	133	311	414	20	25	85
Metal products	147	304	447	70	105	315
Machinery	70	244	171	100	70	170
Electric products	72	500	360	70	50	250
Transport equipment	144	389	560	80	115	450
Total:	566	345	1,952	340	356	1,270

* FGP = Factory gate prices

Source: [7].

TABLE II

ESTIMATED REQUIREMENTS OF INVESTMENT GOODS IN 1969/70

	1964/65		1969/70	Per cent of investment	
	Projected in Third Plan	Actual		1964/65 (actual)	1969/70 (Projected)
Plan investment	6,776	6,730	11,400	100.0	100.0
Investment goods imports	2,707	2,520	3,350	39.9	29.4
Domestic production of investment goods*	1,473	1,473	3,480	21.8	30.6
Total investment goods:	4,180	3,993	6,830	59.3	60.0
Share of investment goods in Plan investment:	61.7%	59.3%	60.0%		

*The figures of this table are in 1964/65 prices while the corresponding figures in Table 1 are in 1959/60 prices.

TABLE III

ESTIMATED INCREASE IN THE DOMESTIC PRODUCTION OF CAPITAL GOODS (IN 1964/65 PRICES)

	1959/60	1964/65	1969/70
Production of capital goods (gross value—factory gate price)	425	1,473	3,480
Cumulative increase over preceding five years in production index)	100	347	236
Annual rate of growth in preceding five years (per cent)		28.4%	18.8%

13. The anticipated demand for consumer goods over the Third-Plan period according to the model is based on income elasticities of demand and other factors which assume constant prices and no changes in consumption taxes in future. If the Plan assumes as a matter of deliberate strategy that the demand for certain consumer goods will be restrained through appropriate fiscal and import policies, I see no reason why one should quarrel with this assumption on the plea that the elasticities implicit in the model will require larger imports of consumer goods.

14. In his discussion of *commercial policies*, Dr. Glassburner has raised some interesting issues, but the discussion does not quite lead to his main conclusion that "it is doubtful that such mild policy measures (*viz.* more import

liberalization, more export bonus and more protection for Pakistan's industrialists) can bring about the marked shifts in the relative growth rates of imports and exports which the Plan calls for". In assessing the impact of these policies the author refers to some pertinent conclusions revealed by certain other research studies carried out in the Pakistan Institute of Development Economics. One of these argues that the liberalization of imports under the free list system has not led to a general reduction of prices of these goods and therefore there is no movement towards an "equilibrium exchange rate"[4]; and other suggests that export policies encourage industries with a larger import component [5]; while a third one concludes that industries enjoying tariff protection are more inefficient than others and that increased protection of capital goods industries as proposed in the Plan may be a mistake since these are more capital intensive [6].

15. The general assumption that the ultimate objective of all commercial policies must be to achieve foreign exchange equilibrium is not correct. At least in the short run the demand for capital goods and other development imports is exogenously determined by development plans and policies and not entirely by the price of foreign exchange. Marginal changes in demand for these goods can of course be secured gradually by tariff changes which may influence the level of investment and will encourage or discourage import substitution, but then some economists may start raising questions about the efficiency of protected industries!

16. Very few policies can secure multiple objectives and often unforeseen difficulties may arise, necessitating further corrective measures. The assumption, for example, that the main objective of the 'import liberalization programme' initiated in January 1964, was to increase the supplies of imported goods at a rate more rapid than the growth in demand for them, is incorrect. It is also argued that "since according to available price data, there has been no discernable effect on the scarcity value of imported goods and the price of bonus voucher has not come down either, the liberalization seems to have done little by way of bringing Pakistan closer to a neighbourhood of foreign exchange equilibrium".

17. The import liberalization programme in essence manifests only a shift from direct to indirect controls of imports which means that instead of restricting imports within available resources through a system of licences, imports are regulated through graduated adjustments in tariff and credit policy. To the extent this shift occurs only in respect of comparatively more essential development imports (as was done in this case), there may be a second legitimate objective to increase supplies of these imported materials to stimulate investment and production. The impact of this shift from direct to indirect control on the utilization of industrial capacity and in accelerating investment has been very encouraging so

far. The Third Plan takes note of the favourable impact of this shift and recommends that future reforms of the import policy must aim at securing a further shift from quantitative controls of imports to more indirect controls.

18. Perhaps the most interesting part of Dr. Glassburner's article is his advice that Pakistan should seek additional foreign assistance beyond that anticipated for the Plan, in view of the "shaky" export targets and conservative import projections, despite his awareness that "the foreign aid picture is seriously clouded by a 'diplomatic crisis' over the postponement of this year's meeting of the Aid to Pakistan Consortium".

19. Mr. Keith B. Griffin, a former Research Adviser at the Pakistan Institute of Development Economics, seems on the other hand somewhat unhappy about Pakistan's heavy dependence on foreign aid. In his critique "Financing Development Plans in Pakistan" [2] he says: "This entire social and economic system, and the planning exercise which is the manifestation is supported and sustained by foreign assistance . . ." and that "continued reliance on foreign loans and private foreign investment is quite likely to tend to a situation in which debt repayment obligations and repatriation of private capital persistently grow at a faster rate than exports". He concludes by repeating the familiar hypothesis that increased dependence on foreign aid tends to "inhibit change and retard development".

20. During the Second-Plan period, Pakistan increased imports at a rate faster than exports (16 per cent versus 7 per cent) and as a result the inflow of foreign assistance increased by 28 per cent per annum. The balance of payments strategy for the Third Plan is based on the expectation that from 1965 onwards exports will increase faster (9.5 per cent) than GNP (6.5 per cent) and imports (7.3 per cent) and the rate of increase in flow of external resources will consequently slow down to 6.5 per cent per annum. This strategy flows from a synthesis of the political and economic objectives of the country, as embodied in the Perspective Plan. While there is no doubt that the realization of these goals would demand a lot of effort and fully stretch the resources and ingenuity of the country's industrialists, exporters and policy makers, but they cannot be regarded as overly ambitious.

21. It is gratifying that Dr. Glassburner has pointed out some of the difficulties involved in the achievement of the goals set for balance of payments in the Third Plan. These difficulties are recognized and have been stated explicitly in some cases. But the conclusion that the effort is beyond the feasible range is too drastic and in any case does not follow from Dr. Glassburner's own analysis.

ANNEXURE I.

EXPORT TARGET FOR THE THIRD FIVE YEAR PLAN

(million rupees)

	1964/65 (Estimates)	1969/70 (Projections)
A. Primary Commodities		
1. Raw jute	820	750
2. Raw cotton	320	550
3. Hides and skins	70	80
4. Raw wool	90	90
5. Rice	145	250
6. Fish (fresh and dried) ..	45	100
7. Other primary commodities ..	140	230
	1,630	**2,050**
B. Manufactured Products		
8. Jute manufactures	350	800
9. Cotton manufactures.. ..	180	350
10. Fish (processed)	50	150
11. Paper and newsprint ..	20	50
12. Other manufactures	270	650
	870	2,000
C. Invisible Earnings	550	750
Total (A+B+C)	**3,050**	**4,800**

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