Committee on Balance of Payments

DRAFT REPORT ON THE CONSULTATION UNDER ARTICLE XVIII:12(b) WITH PAKISTAN

1. In accordance with its terms of reference the Committee conducted the consultation with Pakistan under Article XVIII:12(b). The Committee had before it: (a) a basic document (MGT(60)74) including, as an annex, the Pakistan Government Gazette of 24 June 1960 setting out the licensing schedule for the second half of 1960; (b) a General Statement by the Government of Pakistan on the Policy regarding the use of import restrictions for balance-of-payments reasons (MGT(60)72); and (c) documents provided by the International Monetary Fund, as mentioned in paragraph 2 below. In conducting the consultation the Committee followed the "Plan" recommended by the CONTRACTING PARTIES. The consultation was completed on 28 October 1960. The present report summarizes the main points covered in the discussions.

Consultation with the International Monetary Fund

2. Pursuant to the provisions of Article XV of the General Agreement the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with Pakistan. In accordance with the agreed procedure the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Pakistan. The statement made was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision relating to the last consultation with Pakistan under Article XIV of the Fund Agreement and the background material prepared in connection with that consultation. The Fund has also provided a supplementary paper, dated September 21, 1960, to supply background information on recent developments.

"With respect to Part I of the Plan for Consultations, relating to balance of payments position and prospects, and with respect to Part III, relating to system and methods of the restrictions, since the conclusion of the last consultation under Article XIV of the Fund Agreement on November 4, 1959, Pakistan has made progress in reducing restrictions. The Fund will shortly consult with Pakistan, and expects to transmit to the CONTRACTING PARTIES the Executive Board decision relating to that consultation when it becomes available."
With respect to Part II of the Plan for Consultations, relating to alternative measures to restore equilibrium, pending the conclusion of its next consultation with Pakistan, the Fund has no comments on alternative measures.

Opening Statement by the Representative of Pakistan

3. The following is a brief résumé of the opening statement made by the representative of Pakistan, the complete text of which is attached as Annex I to this report. The economic situation in Pakistan had shown important gains in certain sectors in 1950/60. Agricultural production had increased. Industrial production had risen more rapidly than in the previous year, and this rise had enabled larger exports of manufactured goods, contributing quite significantly to the rise in foreign exchange receipts. The current accounts surplus increased from Rs.13.6 million in 1958/59 to Rs.127 million in 1959/60. The gold, dollar and sterling reserves had risen by Rs.126 million to Rs.1170 million, notwithstanding a certain degree of liberalization in imports. The year also witnessed a significant advance towards the freeing of the economy from price and distribution controls. On the other hand, money supply had increased substantially leading to a significant rise in prices and cost of living. The rise in money supply had occurred notwithstanding the absence of deficit spending by the Government which had this year avoided borrowing from the State Bank, and had been occasioned largely by the monetization of the balance-of-payments surplus. A rise in bank credit to the private sector resulted mainly from higher levels of imports. The rise in prices reflected an inadequacy of supplies in relation to effective demand.

4. Even in sectors of the economy showing improvement, there were certain underlying trends which counsels against complacency. The increase in food production was the result mainly of favourable weather conditions and crop substitution. Earnings from the basic exports of Pakistan, jute and cotton, actually declined by Rs. 80 million in 1959/60, and the improvement in exports of manufactured goods had been mainly due to the Export Bonus Scheme which could at best be considered as a temporary expedient. Furthermore, the improvement in the balance of payments in 1959/60 as a whole concealed a significant reversal of the trend in the second quarter of 1960.

5. The representative of Pakistan stated that his Government considered it to be of vital importance to concentrate on objectives which would bring about lasting improvements in the economy and in the balance of payments through consistent and integrated economic policies, and described in detail the principal factors and considerations relevant to these long-term objectives.
6. Members of the Committee thanked the representative of Pakistan for the comprehensive and informative statement. They noted with satisfaction the improvement in the economy of the country resulting in a more favourable balance-of-payments position. They expressed appreciation for liberalization measures and for the non-discriminatory policy followed in the application of the restrictions. They welcomed the courageous readiness which the Government of Pakistan had shown in instituting measures dealing with the balance-of-payments disequilibrium and the fundamental policy of increasing production and the long-term measures of economic development. Some members referred to the statement of the Pakistan representative that there had been a reversal in the trend in the second quarter of 1960, and enquired as to any forecast the Government might have made regarding future prospects for the balance of payments.

7. In reply to this and other questions, the representative of Pakistan advised the Committee that such forecasts were very difficult for a country like Pakistan whose economy was directly affected by fluctuations in prices of primary products on world markets and on the vagaries of nature. The fall in the prices of Pakistan's exports was not compensated by any fall in import prices. The set-back in the second quarter of 1960 was, however, partly attributable to seasonal factors. The general feeling of his Government, however, was one of cautious optimism; the situation would become clearer at the end of the first quarter of 1961, that is, at the end of the next jute and cotton season. If foreign exchange receipts remained stable and the reserves further increased in the first half of 1961 it would not be unlikely that his Government would consider undertaking a further liberalization since it was the declared policy of his Government to proceed with liberalization as quickly as possible, but he was not in a position to make any definite statements in this regard at this time. A member of the Committee observed in this connexion that if account was taken of Pakistan's transactions with the IMF there seemed to have been no significant change in the foreign exchange reserves in the first half of 1960.

8. A member referred to the recent rise in the price of jute. Asked to comment on this development the representative of Pakistan explained that it was the policy of his Government to maintain an adequate supply of raw jute for both domestic and foreign consumption at a price level which would at the same time encourage producers and sustain demand. He mentioned that the previous practice of fixing the amount of acreage under jute cultivation had been discontinued in January 1960. With respect to cotton, the policy was to keep prices at a level which would encourage the production of yarn and cloth. It was planned to increase cotton production by improving the yield per acre which at present was one of the lowest in the world. The prospects for jute and cotton were favourable for 1960.
Alternative measures to restore equilibrium

9. A member of the Committee noted from the opening statement of the Pakistan delegation that an increase in the money supply had occurred due in part to an increase in bank credit in the private sector. It was noted that there had been a sharp rise in money supply despite the fact that the Government had avoided borrowing from the State Bank. Despite the contractionary influence of the Government sector, money supply rose by Rps. 296 million compared to the rise of Rps. 198 million in the preceding year. In order to reduce inflationary pressure a tight monetary policy had been inaugurated by raising the bank rate from 3 to 4 per cent in the middle of January 1959. The higher bank rate had been followed by certain selective control measures in March 1960 with a view to checking excessive credit expansion in certain sectors. The member asked for details of these selective control measures and their results. The representative of Pakistan replied that, with a view to checking the hoarding of imported goods as a disinflationary measure and to directing credit to more essential programmes, credit restrictions had been imposed on bank advances requiring them to limit the granting of advances for imports of manufactured goods (excepting industrial machinery, iron and steel) and cotton yarn (except for export) to the extent of 60 per cent of the value of such goods under unsecured advances as well as advances secured by guarantee to a maximum of Rps. 50,000.

10. A member suggested that in the face of the inflationary pressures which had reflected themselves in high demand and shortages, it might be helpful if imports were further liberalized so that consumer goods in short supply could be imported in greater quantities. The representative of Pakistan noted with interest this suggestion which he said he would convey to the attention of his Government. Another member of the Committee noted, however, that while liberalization of imports should in general be welcome, in the present case the conservation of monetary reserves might well limit the freedom for this line of action. He suggested that monetary measures might be a more direct method for dealing with the present difficulties of Pakistan which related directly to the expansion of money supply.

11. Members of the Committee expressed an interest in the progress made to date by Pakistan under its two Five-Year Development Programmes, which had ended in June 1960, and in any effects they might have had on exports. The representative of Pakistan advised the Committee that the primary aim of the new Five-Year Plan was the attainment of self-sufficiency in certain essential products. The planning envisaged a total expenditure of Rps. 19,000 million. Some of its principal goals were to increase national income, to increase the production of food grains so as to attain self-sufficiency in these products by the end of the period, to increase industrial production of both small and large-scale industries and to accelerate the economic development of the less-developed areas of the country. While the statistics available thus far might reflect an insufficient progress in some sectors there had been substantial progress in others. The experience obtained in executing the Plan would contribute to the making of future progress in economic development. While the main target of the Plan was to achieve self-sufficiency in food production it was also the intention of the Government to promote, in so far as possible, the expansion of exports, although no significant progress had been made thus far in this regard.
12. One member of the Committee asked to what extent the Government felt the growing dependence on foreign aid provided an element of uncertainty. The representative of Pakistan replied that in most cases foreign aid appropriations were made on an annual basis while the commitments relating to the programme of economic development had to be planned over longer periods of time. He stated that dependence on foreign aid and grants would continue to be a major source of development financing and that the level of aid would be the principal determinant in the size of future development programmes.

System and methods of restriction

13. Members of the Committee expressed gratification for the import liberalization measure initiated on 1 July 1960. A member of the Committee expressed concern over the fact that under the present procedures the base period chosen for allocating licences was the year 1952, at which time his country had not entered the Pakistan market in regard to such goods as machinery. Considering the abnormal circumstances of the early post-war years, he suggested that a later period should perhaps be chosen for the purpose of issuing licences in future. Furthermore, the Registration (Importers and Exporters) Order of 1952 provided that all importers and exporters must register themselves with the Chief Controller of Imports and Exports before they were permitted to engage in trade. He pointed out that this practice constituted a certain limitation on imports from countries which had not established extensive trade channels in Pakistan. The representative of Pakistan undertook to report the concern over these two requirements to his Government.

14. The same member of the Committee noted that under the scheme for "new-comers" only persons or firms fulfilling prescribed conditions might apply for licences to import specified items and that this prevented those other than established importers from participating in the trade. He asked if there was any intention to expand the scope of imports permitted under this scheme. The representative of Pakistan explained that the purpose of this scheme was to enable those in the less-developed areas of the country who were not at present established importers to participate in the import trade. He explained that applications were considered individually on their merit by the Central Ceiling Committee and by the various boards which determined licensing policy. He stated that to his knowledge, no bona fide applications had ever been turned down and that there was no plan to modify the scheme.

15. Several members of the Committee expressed interest in the operation of the Export Bonus Scheme which provided the largest contribution to the rise in foreign exchange receipts by encouraging the export of manufactured goods. One member of the Committee noted that the Official Gazette of Pakistan circulated to the Committee published lists of goods that could be imported under the regular licensing schedule and wished to know to what extent these lists corresponded to the 227 items included under the Export Bonus Scheme. The representative of Pakistan explained that there was a certain amount of over-lapping between the lists under reference.
16. In reply to other questions, the representative of Pakistan stated that this scheme was considered to be only a temporary expedient and that the Government was aware of its inherent deficiencies. The experience gained in relation to cotton yarn, which had been placed under the scheme last year, might be noted. When exports of cotton yarn began to move the home market experienced shortages, consequently action had to be taken to reduce the bonus entitlement to 50 per cent of the original and at the same time to control and reduce the prices of both yarn and finished products. This experience had shown that the new measure made the internal market less attractive by strengthening the export incentive. Ultimately it had been necessary to request individual textile mills to supply a prescribed quantity of yarn to the domestic consumer. Similar developments had been experienced with respect to exports of tea.

17. A member of the Committee noted that under the Export Bonus Scheme exporters of the goods covered by it were given bonus vouchers for different percentages of the f.o.b. value earned which entitled them to import certain specified goods, including industrial raw materials. The documents before the Committee seemed to indicate that the exporters receiving the vouchers were entitled to sell them to importers. The member asked for confirmation of this information and asked how the prices for them were established. The representative of Pakistan affirmed that the vouchers could be transferred on the open market and that any price control was applied. The only element of control was the requirement that all importers in Pakistan were required by law to keep trading accounts open to official inspection whenever this was considered necessary.

Another member of the Committee called attention to the dangers inherent in such a system, especially where it was retained over a long period of time. He understood that in August 1959 the premium for these vouchers stood at about 160 per cent but that this rate might fluctuate between 130 and 200 per cent. He asked for details regarding the present rate of the premium. The representative of Pakistan regretted that more up-to-date information was not yet available. He confirmed that there had been instances in which complaints were raised against importers who were charging inordinately high prices for products imported under the scheme on the pretext of additional cost involved in the purchase of the entitlement vouchers. He pointed out that his Government had taken steps to remedy this situation.
18. One member of the Committee expressed concern over the fact that Pakistan maintained barter arrangements and several bilateral trade agreements. The representative of Pakistan noted in this connexion that although there could be no doubt about the desirability of conducting trade and payments on a multilateral basis, Pakistan was faced with special difficulties as a result of its reliance on a few export commodities. Members of the Committee commented that, although it was understandable that Pakistan in its present balance-of-payments position should try to avail itself of all possible trading opportunities, the reliance on bilateral agreements had inherent serious disadvantages. Imports from bilateral sources could be substantially more costly in terms of foreign exchange than similar imports from other countries. In the case of Pakistan, the number of bilateral commitments entered into by Pakistan had been declining and the Government had continued to practise some discrimination as a result of these arrangements. Attention was called to a statement made by the Pakistan Minister of Finance in January 1960 to the effect that it was the intention of the Government to conclude specific arrangements with individual countries in order to sell cotton, jute, tea and certain other commodities. Requested to comment on this statement the representative of Pakistan said that in his country all trade was conducted on commercial terms as all importers were free to decide from which source they would import, and that this freedom was not impeded by bilateral agreements except in one isolated case. Probably less than 2 per cent of Pakistan's total trade was conducted under bilateral arrangements which were in force with some fifteen countries. In most of these cases, the agreement provided for no quotas, but merely indicative commodity lists. Only in the case of the agreement with Japan was there a commitment to use single country licences; the agreement provided that Japan would permit Pakistan raw cotton to be imported on equal terms within the sterling quota for cotton, and that Pakistan would issue single country licences in favour of specified Japanese exports in the event that Japanese imports of Pakistan raw cotton reached an agreed quantity.

19. A member of the Committee considered that the inclusion of lists of goods with quantities shown, whether these be referred to as "targets" or "estimates" of trade, inevitably had a diversional effect on trade. These
"targets" or "estimates" could not fail to affect administrative decisions relating to the issue of licences or the allocation of quotas to importers. In this connexion the representative of Pakistan pointed out that all import licences issued in Pakistan, regardless of what general trade agreements were in force, were valid for imports from all countries; hence he did not feel that there could be any likelihood of indirect discrimination arising. The representative of Pakistan stated that his Government was fully aware of the desirability of conducting trade and payments on a multilateral basis. He assured the Committee that although his Government was constantly striving to reduce reliance on bilateralism, in the interim it was necessary to maintain certain arrangements in order to diversify or establish export markets.

20. A member of the Committee pointed out that although the amount of commodities entering Pakistan under barter arrangements were small, the few commodities involved could conceivably be of importance in the overall trade pattern of certain exporting countries. He suggested that where such arrangements existed consideration should be given to licensing similar items fairly freely from all sources in order that exporters in other countries might be provided with an opportunity to compete in the market. The representative of Pakistan assured the Committee that this point was kept constantly under review by his Government and that it would continue to be taken into account. He explained that barter arrangements were usually made to meet an urgent necessity to dispose of certain primary products during a season which would otherwise not be sold. A member of the Committee welcomed this encouraging clarification of Pakistan's purpose in the use of barter trade, and expressed the hope that this would continue to be the policy followed by the Government of Pakistan.

21. A member of the Committee observed that 20 to 30 per cent of Pakistan's total trade was under State trading. He asked if all countries had an equal opportunity to participate in providing imports under State-trading operations. The representative of Pakistan replied in the affirmative; State trading was conducted purely on the basis of commercial considerations, in accordance with Article XVII.

22. The question was put by a member whether Pakistan maintained a prohibited list. The Pakistan representative stated that there was a list of goods for which import licences were at present not issued. This list included such items as liquid gold, long-playing records, toilet articles and perfumery concentrates. A member of the Committee asked if Pakistan could permit token imports by establishing small quotas for these goods so that they would be permitted to enter Pakistan in minimum commercial quantities. The representative of Pakistan replied that this question would be considered in relation to the severity of the balance-of-payments difficulties.
Effects of the restrictions

23. Members of the Committee observed that the system of restrictions used by Pakistan might have an undesirable effect on the country's economic development in the long run because of the diversion of factors of production to less economic uses, consequently impeding Pakistan's ability to compete in export markets. They drew attention to the 1959 IMF decision urging the Government of Pakistan to revert to policies which would reduce the reliance on restrictions. The representative of Pakistan explained that his Government was aware of the possible adverse effects on economic development and efficiency of the continued use of restrictions over a long period. The restrictions were, however, indispensable in view of the need to protect the balance of payments. While the development programme envisaged self-sufficiency in certain sectors his Government fully recognized the benefits to be derived from international specialization in trade, and would constantly endeavour to minimize the incidental protective effects of the restrictions.

General

24. Members of the Committee thanked the representative of Pakistan for the information supplied to the Committee and the answers given to the various questions. Members of the Committee felicitated the Government of Pakistan for the improvement in the economic situation in Pakistan and for the internal monetary and fiscal measures taken with a view to restoring equilibrium. They welcomed the recent relaxation in import restrictions, and expressed the hope that Pakistan's balance-of-payments position would further improve so as to enable substantial relaxations of quantitative restrictions in the near future.

25. The representative of Pakistan stated that he had taken due note of the views expressed and suggestions made by members of the Committee and assured the Committee that these would be conveyed to his Government for careful and sympathetic consideration.