

# GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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## Committee on Balance-of-Payments Restrictions

### DRAFT REPORT ON THE 1977 CONSULTATION WITH PAKISTAN

1. In accordance with its terms of reference, the Committee has conducted a consultation with Pakistan under Article XVIII:12(b). The Committee noted that the previous consultations under the simplified procedures for Article XVIII:12(b) had been held in 1973 and 1975 (BOP/R/72 and BOP/R/83). The last full consultation with Pakistan had been held in 1969 (BOP/R/39). In conducting the present consultation the Committee had before it a basic document transmitted by the Government of Pakistan (BOP/180), a supplementary background material supplied by the International Monetary Fund dated 6 October 1977.
2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (see BISD, 18th Supplement, pages 52 to 53). The consultation was held on 19 January 1978. This report summarizes the main points of the discussion.

### Consultation with the International Monetary Fund

3. 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 the consultation with Pakistan. Upon the invitation of the Committee, the representative of the Fund made a statement as follows:

"Pakistan has experienced a slow rate of real economic growth and substantial budgetary and balance of payments deficits during the period 1974/75-1976/77. The economy's growth rate has averaged only 2 per cent and has not kept pace with the rate of population increase. In the agricultural sector, cotton production in particular has suffered recurrent setbacks occasioned by drought, floods, and pest infestation and has increasingly fallen below output targets; the shortfalls in cotton production have had seriously adverse consequences for domestic manufacturing activity and for Pakistan's export performance. Elsewhere in the agricultural sector, the production of the major grain crops has expanded. However, in the aggregate, real growth within the farm sector has averaged only 1.5 per cent. The growth performance of other major sectors in the economy has also evidenced substantial weakness. In the industrial sector, real value added in manufacturing has declined in absolute terms during the period under discussion due essentially to a continued sluggishness in textile production attributable to weak external demand and the shortage of raw cotton. In addition, during 1976/77, the performance of the major nonagricultural sectors, including construction and transportation, suffered from dislocations resulting from political developments.

"Despite the slow growth of total real income, the Pakistan authorities have tried not to curtail the country's development effort. Consequently, development expenditures have been increased sharply, and over the three-year period the ratio of fixed capital formation to GDP has risen from 12 per cent to 18 per cent although the domestic savings ratio increased only from 7 per cent to 8 per cent.

"Under these circumstances, the Central Government budget has incurred large overall deficits, as the rapid rise in development and other outlays has exceeded by a wide margin the increase in revenues; the latter has been constrained by the slow growth of the economy and the stagnation in the export sector which led to the suspension or reduction of major export taxes. The emergence of sharply higher budget deficits has necessitated substantial recourse to foreign financing in the form of both assistance on concessional terms and medium-term borrowing. However, these sources of financing have not been sufficient to prevent in addition a heavy reliance on borrowing from the domestic banking system.

"The sizable increases in net claims on the public sector, which have taken place over the past three years, have been an important factor contributing to excessive rates of monetary expansion, which have ranged between 19 per cent and 25 per cent. Despite this, however, the rate of

inflation has declined and averaged only 10 per cent over the past two years. This trend has been attributable for the most part to an abatement in the rise in import prices, to a more favorable supply situation for basic commodities, and to the economy's need to reconstitute real money balances following the high rates of inflation in earlier years.

"Pakistan's external sector position has weakened considerably since 1973/74 as a result of both domestic and external factors which have contributed to a deterioration in the merchandise trade account. On the import side, payments have risen sharply due to expanded input requirements for the development program and substantial increases in the international prices of many of Pakistan's major import commodities. On the other hand, export receipts have stagnated reflecting the precipitous decline in exports of raw cotton as well as a weak demand internationally for Pakistan's manufactured products. As a result, the trade deficit increased from \$473 million in 1973/74 to an estimated \$1.5 billion in 1976/77. Although the impact of these factors within the current account has been partially offset by rising labor remittances, the current account deficit has over the period on the average exceeded US\$1 billion, rising from \$548 million in 1973/74 to an estimated \$1.3 billion in 1976/77. These deficits have been financed for the most part by large long-term capital inflows made available by aid donors on concessional terms. However, despite these inflows, the total three-year deficit requiring official financing has exceeded US\$1 billion and has necessitated heavy medium-term official borrowing at terms approximating those for commercial loans. In addition, in 1976/77, a reduction in such borrowing in conjunction with an expanded current account deficit led to a sharp decline of about US\$280 million in net foreign assets.

"Pakistan's recent heavy foreign borrowing for development and balance of payments purposes has generated a substantial increase in the public sector external debt. Over the three years ended June 30, 1977, total disbursed foreign loans repayable in foreign currency rose by about US\$2 billion and now amount to US\$6.5 billion. Concomitantly, debt service payments have risen to US\$310 million, and the debt service ratio (debt service as a percentage of current account receipts) rose to over 15 per cent. Pakistan's gross international reserves at the end of June 1977 stood at \$438 million, or the equivalent of two months' 1976/77 imports.

"Pakistan's net external position is not expected to improve markedly during 1977/78. The most recent balance of payments forecast made available to the Fund assumes largely offsetting increases on the trade account despite expectations for a domestic economic rebound and an enhanced export performance attributable to a projected recovery in cotton production and in the demand for textile exports. Some increase in private remittances and long-term capital inflows is expected. However, the deficit requiring official financing, at US\$360 million, is forecast to remain near last year's level. In view of the substantial reserve losses incurred in 1976/77, this deficit is to be financed primarily by medium-term borrowing, while the decrease in net foreign assets is to be limited to about US\$50 million. With regard to external debt, service payments are projected to increase to US\$464 million and yield a debt service ratio of 18.5 per cent. The strong upward movement in these payments reflects, for the most part, the winding up this year of the four-year debt relief arrangement with the Consortium and the commencement of payments on a balance of payments loan from Iran.

"In the area of exchange and trade policies, the Pakistan authorities have been concerned in recent years about protecting their export competitiveness and have taken measures to forestall a possible sharp decline in export receipts. These measures have comprised largely the reduction or abolition of export taxes, including the taxes applied to rice and staple cotton exports. With respect to changes in import duties over the period under discussion, an import surcharge of 10 percentage points was imposed on a large number of commodities for revenue purposes in the 1976/77 budget, and in the 1977/78 budget, most import duties were increased by an additional 20 per cent also for revenue purposes.

"Since 1972, in the context of a major rationalization of trade policy, there has been a substantial easing of import restrictions. In 1976/77, the Import Policy Order permitted the importation of a significant number of consumer goods, and later in the year measures were introduced which placed some industrial and additional consumer goods on the free list, including the import of staple cotton on an emergency basis. The import program for this year continues the liberalization trend, and the five minor liberalizations undertaken more than outweigh the one instance of tightening.

"The Pakistan authorities have completed the compilation of an exhaustive list of import items currently banned implicitly in order to provide the basis for an anticipated major simplification and

rationalization of the import regime. The Fund welcomes the recent liberalizing trend in Pakistan's trade relations and the intention of the authorities to pursue a further reordering and rationalization of the import system. The pursuit of these policies, as well as other fundamental external and domestic measures, would allow a reduced reliance on trade restrictions."

Opening Statement by the Representative of Pakistan

4. In his opening statement, the full text of which is contained in the Annex, the representative of Pakistan recalled that there had been sharp and progressive increases in the adverse trade balance of Pakistan in recent years; from a deficit of \$473 million in 1973/74 the trade balance had deteriorated to a deficit of \$1,447 million in 1976/77. The trade deficit last year was now larger than total export receipts. No significant improvement could be expected in the situation during the current financial year. He drew attention to the problem of reduced export earnings and increased import costs with the consequential increase in the external debt and depletion of Pakistan's foreign exchange reserves. He drew particular attention to the persistent and increasing trade deficits with the industrialized trading partners - the United States, the European Communities and Japan; and to the adverse effects of tariff and non-tariff barriers in some of these markets faced by Pakistan's exports. This had particularly affected Pakistan's cotton textiles exports, which accounted for one third of total export earnings. He also drew attention to the magnitude of Pakistan's external debt and to the severe problems of debt service payments.

5. Commenting on the nature of Pakistan's trade régime described in the basic document, the representative of Pakistan stressed that one outstanding fact of the situation was that ever since 1972, when Pakistan had carried out a complete overhaul of its trade régime through the realignment of the exchange rate of the rupee and the introduction of a simplified and liberal import policy, Pakistan had consistently maintained the trend towards further rationalization and liberalization of its import policy, despite mounting trade deficits, and increasing balance-of-payments difficulties.

6. He concluded by expressing the hope that the full consultation being undertaken would lead to a better understanding by Pakistan's trading partners of the difficulties faced by Pakistan, in particular of the adverse effects of the bilateral restraints and different non-tariff barriers faced by its exports in some of its traditional markets and that the Committee would find it possible to recommend that developed countries maintaining tariff and non-tariff barriers against Pakistan's exports eliminate these barriers so as to help Pakistan achieve a better balance in its foreign trade and overcome its balance-of-payments problems.

Parts I and II balance-of-payments position and prospects - alternative measures to restore equilibrium

7. Members of the Committee welcomed this opportunity to examine the changes that had occurred in the import régime of Pakistan since the last full consultation in 1969. It was noted that a number of recommendations

made by the Balance-of-Payments Committee in 1969 had since been adopted, in particular the simplification and liberalization of Pakistan's import policy and exchange rate system. It was noted that in 1972 an extensive overhaul of the system had resulted in simplified import licensing procedures and that the import list had since become progressively more liberal. The documentation before the Committee revealed quite clearly that Pakistan continued to experience serious balance of payments difficulties and that there was a clear need for the use of measures to safeguard Pakistan's financial position within the meaning of Article XVIII, paragraph 9. Despite these difficulties Pakistan had pursued its efforts towards liberalization and it was noted with satisfaction that the Government of Pakistan intended to continue its efforts towards further rationalization and liberalization of the import system.

8. Turning to the different components of the balance of payments of Pakistan, it was noted that Pakistan's export performance had been weakened in the past two years by setbacks in the cotton and cotton goods sector due partly to supply problems and weakened foreign demand. As cotton-related exports accounted for approximately one third of Pakistan's export earnings it was asked what prospects or plans the government had in this area. The representative for Pakistan was also asked to comment on the effects of the reduced cotton crops, of government policies with respect to this sector, and on the shortages of fertilizer experienced in 1975 and



1976. The representative of Pakistan confirmed that the serious setbacks in two successive cotton crops had been reflected in the balance of trade. The sharp decline in export earnings from raw cotton was indeed owing to these crop failures. The decline in the level of export earnings from cotton yarn and cotton fabrics could not however be attributed to this factor. Enough cotton had been available to meet the needs of the textile industry. The government had also liberalized the import of long-staple cotton and synthetic fibre and yarn to ensure that there was no shortage of raw materials for the textiles industry. The decline in the export earnings from textile products was mainly attributable to conditions of recession in the international market and to increasing restraints on textile products faced in Pakistan's important traditional markets. Concerning plans for the future, he stated that his Government had adopted necessary measures to ensure sufficient and timely availability of fertilizers and pesticides for the cotton crop. The Pakistan authorities were confident that the production of cotton would not only come back to its normal level but would increase in the future.

9. Noting that remittances from Pakistan's workers abroad had increased considerably over the past years, it was asked whether this item had made an appreciable difference on the balance of payments. The representative of Pakistan said that the increases in the level of remittances had been most welcome, and had acted as a cushion in a situation which would otherwise have been much worse. The remittances had not, and were not expected to alter the overall balance, as they had been more than offset by increases in expenditure on invisibles.



10. Questions were asked on the estimates of increased export earnings projected for 1977-78 and whether these would need revision. The representative for Pakistan said that the projected growth of exports for 1977-78 was based on the expectations of an improvement in the production of cotton as well as an improvement in the international economic situation, leading to improved demand for Pakistan's products and better access to traditional export markets.

11. Several questions were asked on the subject of plans for diversification of Pakistan's exports. The representative of Pakistan stated that the policy of the Government of Pakistan was geared both to diversification of products and of export markets. In regard to the diversification of products, he pointed out that the share of rice, leather and leather goods, hand-knotted carpets and other smaller items in the total export earnings of Pakistan had been increasing appreciably. Plans for the future aimed at further enlarging the volume and value of these exports. Pakistan could even be in a position to enter the export market for some new products, such as sugar. Pakistan had succeeded to an appreciable degree in diversifying into new and non-traditional export markets. Obviously, however, the developed countries, constituting the largest trading entities and markets in the world would continue to be of critical importance to Pakistan's exports.

12. Turning to the import side it was noted from the basic document (BOP/180, paragraph 8) that the composition of imports was undergoing changes; the share of consumer goods was gradually yielding to imports of capital goods

and raw materials. In this context it was asked in what way the objectives of the development plan of Pakistan would influence the future pattern of imports. For instance, it was asked whether Pakistan aimed at self-sufficiency in the field of consumer goods production. The representative of Pakistan explained that the policies of the Government did not aim at self-sufficiency in the production of all requirements of the economy or of all consumer goods. They did, however, aim at self-sufficiency in terms of resources so as to be able to minimize dependence upon external assistance and to establish the base for self-sustaining future economic growth. Development plans accordingly emphasized the development of social and economic infrastructure, increase in the production of staple agricultural commodities such as wheat, rice, cotton and oil-seeds; development of basic sectors such as iron and steel, cement, agricultural and industrial chemicals, heavy electrical equipment and capital goods industries so as to provide the basis for future growth.

13. It was noted by the members of the Committee that the rate of inflation in Pakistan had decreased substantially over the past few years. This had been achieved despite substantial monetary expansion under what might be considered fortuitous circumstances and it was asked whether this success was temporary, and what plans the government had for controlling future monetary expansion, and what were the prospects of controlling inflation. For instance, it was asked whether the government believed that further liberalization of the import régime would help restrain inflation. It was

also noted that Pakistan had a large budgetary deficit attributable largely to expenditure for development needs. Public sector expenditure had risen sharply with recent wage scale increases. The representative of Pakistan said that his authorities were greatly concerned with keeping the rate of inflation under control. To that end policy measures had been adopted to limit monetary and credit expansion, to mop up excess liquidity in the economy and to reduce budgetary deficit. It was also intended to ensure that adequate supplies of essential consumer requirements such as wheat, edible oil, tea, etc. were available. It was hoped that the situation which had already stabilized would remain under control. In response to a question the representative of the International Monetary Fund said that the future rate of inflation was difficult to forecast and would depend on several factors including: the reconstitution of cash balances, the rate of monetary expansion and developments in the budgetary situation, the supply situation for basic foodstuffs and finally the level and prices of imports.

14. Turning to the question of exchange rate policy, it was noted that the rupee was pegged to the dollar at a fixed rate and that no changes had occurred in this rate. It was asked whether exchange rate action would help Pakistan control the balance-of-payments deficit. It was also asked whether the recent decline in the dollar had had a beneficial effect on Pakistan's balance of payments and whether there would be an advantage to Pakistan in realigning its exchange rate as an alternative to import restrictions. The representative of Pakistan said that it was too early at this stage to say

whether the decline in the value of the dollar would have effects on Pakistan's trade balance. He pointed out that there seemed to be no evidence that the use of flexible exchange rates had led to the dismantlement of trade barriers between developed countries. The representative of the International Monetary Fund said that it was relevant to look at the direction of Pakistan's trade to see whether the drop in the value of the dollar had had an effect. Noting that the decline of the dollar had been mainly vis-à-vis the Japanese yen and some of the currencies of the European Communities, he recalled that one third of Pakistan's exports were directed towards these countries and that some 40 per cent of Pakistan's imports came from these countries. While this would seem to point towards an effective partial depreciation of the rupee, he cautioned that the effects of exchange rate changes were a function of time, supply and demand elasticities, exports and imports and the economic situation in third markets. He went on to point out that whereas an exchange rate change would affect all imports and exports, import restrictions were a more selective tool in that they normally applied to only a part of imports.

15. Members of the Committee noted the high degree of dependence of Pakistan on energy imports, and asked whether the government had any programme to minimize this dependence. The representative of Pakistan stressed his government's concern with the problem and stated that apart from developing hydro-electricity and thermal power based upon natural gas (of which Pakistan had large reserves), the Government of Pakistan had launched an extensive programme of search for oil, in which the National Oil and Gas Corporation as well as some multinational companies from abroad were involved. Technical

assistance had also been received, in this particular field, for instance from Canada, which was greatly appreciated. Only limited success has been achieved in this endeavour so far. Pakistan was already operating a nuclear power plant in Karachi, and had an ambitious long-term programme to set up a string of nuclear power plants in various parts of the country to meet the very rapidly growing energy requirements of the economy.

16. Members of the Committee asked whether Pakistan had adopted any measures to encourage private capital inflows. The representative of Pakistan recalled that even at the time when his government had nationalized banking services and insurance, as well as steel and chemicals, it had been a part of the policy not to interfere with foreign investments in Pakistan. This policy was being fully maintained and further strengthened so as to encourage the inflow of foreign private capital. These policies were already showing favourable results.

17. In reply to a question concerning the growing burden of foreign debt servicing, the representative for Pakistan stressed that this constituted a major problem. He said that Pakistan was actively seeking adjustment or relief from long-term debts from donor countries. He expressed the hope that developed countries would understand the critical importance of debt relief to the development of countries such as his.

18. In reply to a question concerning the tariff increases of 1976-77 and 1977-78 and whether they had had an ameliorating effect on Pakistan's balance of payments, the representative of Pakistan explained that these increases in import duties had been motivated mainly by the need to reduce the budgetary deficit and mobilize domestic resources so as to meet essential needs. These increases were not intended as trade measures and there was no evidence that they had any ameliorating effect on the balance of trade.

Parts III and IV system, method and effects of the restrictions

19. In reply to questions concerning the surcharges of 10 and 20 per cent imposed in 1975 and 1976/77 the representative of Pakistan explained that these increases no longer existed. A consolidated tariff structure had been adopted by Pakistan under Finance Act 1977 and had been notified to the GATT for the purpose of a waiver for the renegotiation of Pakistan's Schedule (see document L/4567).

20. In reply to a question concerning the purpose of margin requirements asked by banks on letters of credit, and whether this amounted to a form of prior import deposits, the representative of Pakistan explained that the minimum margin requirements were not a "prior import deposit" in the classic sense. They were part of the broad policy to limit credit expansion.

21. Several questions were posed concerning the import licence fee of 2 per cent of the value of imports imposed by Pakistan; it was questioned whether the fee was consistent with the provisions of Article VIII of the GATT in that it was not commensurate with the cost of the services rendered. Clarifications were also asked with regard to the availability of import licences if foreign currency were available to the importer. The representative of Pakistan replied that the import licence fee of 2 per cent was primarily meant to finance the administration of import controls and should be seen in the context of the need and desire to maximize domestic resources and minimize budgetary deficits. The fee also, of course, served to introduce some discipline in the import trade.

22. A question was asked whether import licences could be obtained freely by parties holding their own foreign exchange. He also explained that under the law, Pakistani nationals residing in Pakistan could not hold any foreign exchange abroad. However, import licences were issued freely and without limit in the case of items on the free-list from the resources of the Government of Pakistan itself. Import licences in regard to items on the tied-list were issued on the basis of rationing of funds available for particular items from particular sources. The representative of Pakistan further explained that there were some special regulations to provide for imports without involving the resources of the Government of Pakistan. Personal Baggage Rules were one instance of this nature. The representative of Pakistan also described a regulation known as Pay As You Earn Scheme under which industrial plant and machinery could be imported from abroad on credit and the price paid from the proceeds of the exports of the plant over a period of time.

23. Members of the Committee expressed appreciation for the efforts made by the Pakistan authorities to pursue its trend towards trade liberalization since 1972, despite the difficulties encountered in its balance-of-payments situation in its monetary expansion and budgetary deficits. It was noted that further simplification and rationalization of the import régime was being considered and that in this context the authorities had made the compilation of an exhaustive list of import items currently banned implicit.



They expressed great interest in obtaining this list and expressed hopes that Pakistan would find it possible to continue this trend towards import liberalization. In reply to questions asked as to the possibilities of future elimination of tied-lists of imports the representative of Pakistan said that it should be possible to reduce tied-lists substantially if donor countries agreed to untie their credits. In reply to another question concerning the reduction of barter trade the representative of Pakistan said that his authorities attached considerable value and importance to its trade relations with the socialist countries. This trade had provided a valuable cushion to Pakistan's industry in the difficult situation created by the international recession and increasing protectionist policies in traditional markets; to the extent it would not be possible to eliminate the tied-list. With regard to future liberalization of import controls, he emphasized that this process was linked to the question of available resources to finance Pakistan development. He did confirm that it was his government's policy to move towards liberalization within the existing possibilities.

#### Conclusions

1. The Committee expressed understanding for the continuous balance-of-payments difficulties experienced by Pakistan and recognized that there was need for trade measures as provided under Article XVIII:9 to 12.
2. The Committee acknowledged that some of the elements affecting Pakistan's balance of payments - the large need for development finance, the level of monetary expansion, the rate of inflation, the budgetary deficit, the size and servicing of the foreign debt - posed difficult and often conflicting choices of policy. The Committee noted that the rate of inflation was relatively low despite excessive monetary expansion.

3. The Committee recognized that a number of external factors, beyond the control of the Pakistan authorities - economic recession in third countries, difficult access to markets and import restraints on certain goods - affected Pakistan's export performance and therefore its balance of payments. Despite these added difficulties Pakistan had pursued its efforts toward trade liberalization started in 1972. The Committee welcomed the intention of the Pakistan authorities to pursue simplification and rationalization of its trade régime with a view to achieving in the long-run fully liberalized trade. In this context the Committee expressed the hope that the adoption of the fundamental external and domestic measures referred to by the International Monetary Fund would enable Pakistan to further reduce its reliance on trade restrictions.