

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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Committee on Balance-of-Payments Restrictions

REPORT ON THE 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 consultation under the same provisions had been held in July 1967 (cf. BOP/R/12 and BOP/70). In conducting the present consultation the Committee had before it a basic document transmitted by the Government of Pakistan (BOP/97), a decision of the Executive Board of the International Monetary Fund dated 23 July 1969 (Annex I) and two papers dated 20 June and 15 July 1969 respectively containing background material supplied by the Fund.
2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation took place on 17 November 1969. The present report summarizes the main points of discussion.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the International Monetary Fund had been invited to consult with the CONTRACTING PARTIES in connexion with this consultation with Pakistan. In accordance with the agreed procedures 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 Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of July 23, 1969 taken at the conclusion of its most recent Article XIV consultation with Pakistan and particularly to paragraph 4 which reads as follows:

4. Progress has been made in rationalizing the exchange system through expansion of the scope of the cash-cum-bonus scheme. The Fund notes the intention of the Pakistan authorities to make further moves in that direction. The Fund believes that in order to facilitate the elimination of internal price distortions and to strengthen the balance-of-payments position, high priority should be given to measures to simplify the exchange system with a view to its unification. In the meantime, the Fund does not object to the present arrangements on a temporary basis. The Fund urges that Pakistan terminate its bilateral payments arrangements with Fund members and keep under review its arrangements with other partners.'

"At the present time, the general level of restrictions of Pakistan which are under reference does not go beyond the extent necessary to stop a serious decline in its monetary reserves."

Opening statement by the representative of Pakistan

4. In opening the discussion the Pakistan representative recalled the principal points contained in the "basic document" supplied by his Government to serve as a basis for the consultation (BOP/97). It was noted that Pakistan's balance of payments remained under considerable strain during the first half of the current Third Five-Year Plan. The shortfall in its disbursements of foreign assistance placed serious limitations on imports, and development imports were subject to the added pressure of urgent needs for larger imports of food and other non-development goods. A severe shortage of raw materials had reduced industrial production below capacity. The Export Bonus System had been considerably simplified in November 1967 with the number of export bonus rates reduced from six to two and a cash-cum-bonus import scheme had been introduced in the second half of 1967, which had helped to strengthen the price structure and had been progressively expanded. In general import restrictions were resorted to as a purely temporary measure to ensure the most judicious use of the insufficient foreign exchange resources. Imports of raw materials for capital goods production had greatly increased. Raw material imports had been increased in order to ensure fuller utilization of existing industrial capacity, on which much of the country's success in expanding exports would depend. Increases in export earnings had made possible a progressive liberalization of imports, the continuation of which would, however, depend on international financial support. In the view of the Pakistan authorities the import restrictions maintained by Pakistan were necessary in order to implement programmes and policies of economic development and to safeguard the external financial position, as provided for in Article XVIII of the General Agreement. The full text of the opening statement by the representative of Pakistan is reproduced in Annex II to the present report.

I. Balance-of-payments position and prospects

5. Members of the Committee noted with pleasure the improvements in the economy and the balance of payments in 1967-69. They expressed sympathy with Pakistan's efforts to promote economic development and recognized the pressure that this created for the balance of payments. As a result of the fairly rapid rise in export receipts, the country had been able to rely to an increasing extent on its own foreign exchange resources for the financing of its development programme. It was gratifying to see that the Pakistan Government had taken successive steps to provide freer access to its markets as the improvements in the balance of payments permitted. On the other hand, it was noted that, partly owing to the liberalization measures already taken and partly owing to the need to replenish stocks which had been drawn down in the second half of 1968/1969, a substantially higher level of imports was expected to result in a sizable deficit on the overall balance of payments in 1969/1970, contrary to the forecast made earlier this year. This development clearly would put the economy under considerable pressure and might rule out any new departure in liberalizing imports in the immediate future.

Members of the Committee expressed the hope that current policy and measures taken by the Government to restore equilibrium could soon bear fruit so as to enable Pakistan to continue and intensify the rationalization of the exchange and trade system and the liberalization of imports. A member of the Committee commented in this context that, while substantial growth would seem to have been achieved in Pakistan during the past decade, enormous efforts remained to be made. The Committee indicated its understanding of the new efforts the Government of Pakistan was making in the equalization of personal income and in the improvement of education, housing and other social services, and in contending with the serious development problems of East Pakistan, but urged that a close watch be kept on undesirable inflationary effects. It was, therefore, not merely a question of attaining an acceptable rate of growth in gross national product. For a country such as Pakistan particular attention should be paid to the achievement of the most efficient allocation of resources and the avoidance of their dissipation through inflation.

6. In response, the representative of Pakistan stated that his Government was fully aware of these fundamental structural problems which were being tackled on a continuing basis. As regards the short-term problem of inflation, a determined effort was being made to utilize existing industrial capacity to meet domestic demand as well as to increase exports which, by enabling larger imports, would also help to mitigate the upward pressures on prices.

7. Recalling that for several years, Pakistan's balance of payments had been under considerable strain, some members of the Committee invited the representative of Pakistan to comment on the future prospects of the country's balance of payments. The representative of Pakistan observed that the two principal sources of the country's foreign exchange supply being export earnings and foreign aid, the prospects would depend to a large extent on the market conditions for the country's exports and the aid policies of the developed countries. Given a favourable climate in these two areas, the Government of Pakistan was determined to play a positive rôle in expanding production in order fully to take advantage of export opportunities and in making good use of aid funds.

8. In discussing the prospects of expanding Pakistan's exports, some members of the Committee noted that the most dynamic element in the country's export growth had been in manufactures, there being virtually no increase in primary commodity exports in recent years. In 1968-69 exports of manufactured goods had, for the first time, exceeded those of primary commodities. On the other hand, it might be noted that nearly two thirds of the manufactures exported comprised jute and cotton goods. The representative of Pakistan was invited to comment on whether any policies or programmes were being developed to sustain and improve this impressive performance in the manufactures sector and to diversify this sector of the exports while at the same time reducing reliance on special export incentives. The Pakistan representative described the various measures that had been taken for the promotion of exports, including the establishing of export promotion bureaux and trade offices in various countries, the undertaking of market studies, etc. The volume of exports on the other hand, depended on the markets available for their absorption. In the case of agricultural products, be it rice, jute, cotton or wheat, climatic conditions were a factor. Manufactures production in Pakistan was dependent on imported raw materials and consequently on the availability of foreign exchange resources for import payment.

9. A member of the Committee noted that one of the remarkable developments in Pakistan had been the attainment of self-sufficiency in food grains and that this seemed to be attributable to deliberate efforts to make use of modern cultivation methods and new agricultural inputs such as fertilizers, pesticides and high-yielding and hardy varieties of seed grains, apart from increased irrigation facilities. What measures were being taken to maintain progress in raising production in general, and in particular in regions more susceptible to the vagaries of nature, such as East Pakistan, and whether the achievement of self-sufficiency would lead to the development of new crops in the interest of augmenting exports or providing a more varied diet, would seem all to be interesting questions worthy of the Committee's attention in discussing long-term economic prospects of the country. The representative of Pakistan agreed that the improvement in agricultural production had been made possible by the application of modern science and technology and described the contribution that had been made by various research institutions in this regard. He expressed appreciation for the generous technical assistance that had been provided by a number of developed countries in this domain and considered that the progress made would certainly be consolidated to the permanent benefit of the country. Yet, in spite of the improvements brought about by scientific research and modern technology, nature would continue to be a factor in agricultural production in an insufficiently developed country such as Pakistan. The representative of Pakistan also described the current programme of agricultural development and diversification.

II. Alternative measures to restore equilibrium

10. The Committee briefly discussed the internal financial and fiscal problems of Pakistan in relation to the country's overall balance of payments. In the light of the important events of the past year, members of the Committee asked whether there would be any significant changes in the Government's economic policy, especially with respect to efforts to contain inflation. In this context it was noted by a member of the Committee that while the restrictive credit measures adopted by the State Bank in 1965/66, following a period of rapid monetary expansion, would seem to be desirable in the circumstances of that time, the continued and intensified limitation on credit expansion might, in present circumstances, cause permanent damage to, or at least slow down, the country's economic development. In reply to a question on whether the Pakistan monetary authorities would contemplate measures to ease the credit supply to the private sector to facilitate economic expansion, the representative of Pakistan stated that his Government was alive to the implications of a tight money and credit policy for the economic development programme and would certainly keep a close watch on the trend; the aim would be to avoid, as much as possible, any slowing down of economic growth while keeping inflation under control.

11. Another member pointed out that the current tight credit situation might at least be partially remedied by increasing domestic savings, and asked what measures the Pakistan Government might wish to adopt to stimulate or to accelerate domestic capital formation. The representative of Pakistan mentioned, in this regard, a number of steps that had been taken, e.g. the granting of income tax

concessions for reinvested revenue, higher rates of interest for fixed deposits, special concessions for investment in the less-developed regions of the country. The situation was kept constantly under review and a flexible policy was followed.

12. It was noted by a member of the Committee that along with the rapid increase in outstanding external debt, debt servicing payments had risen sharply in recent years. Asked to what extent the Government of Pakistan had been successful in keeping this charge on its balance of payments within bounds, particularly regarding short-term suppliers' credit, the representative of Pakistan replied that the problem of mounting debt servicing obligations, which was one faced by many developing countries, was indeed a serious one for Pakistan. The policy being followed by Pakistan was aimed at limiting the annual servicing burden to no more than 20 per cent of export earnings. Whether it would prove possible for Pakistan to abide by this prudent rule would, however, depend on the policies of the capital exporting countries.

13. A member of the Committee commented on Pakistan's present exchange system which involved, in effect, a set of multiple exchange rates. In his view, the system was not only burdensomely complex but distorted the price structure of imports. It had resulted, for instance, in underpricing capital equipment, while overpricing spare parts for the same equipment. The Fund had considered that simplification of the system and its unification would facilitate the elimination of internal price distortions and strengthen the balance-of-payments position. Pakistan was urged to continue to simplify its exchange rate system so as to permit the price mechanism to play a larger rôle in the allocation of resources. It was suggested that in considering the balance-of-payments problems of Pakistan, it would be interesting for the Committee to learn what are the Government's policies with regard to the continued reliance on this system; whether it envisaged the abandonment of its use in favour of a unitary exchange rate in the foreseeable future, and whether there were plans to add other products to the list of products imported at the depreciated rates.

14. The representative of Pakistan recalled his earlier statement about the substantial reduction - from six to two - in the number of bonus rates in 1967 which had greatly simplified the exchange system. Since then, the coverage of the "cash-cum-bonus" system of imports had been progressively enlarged, the number of products covered by this method being increased from eleven in the second half of 1967 to seventy-five, ninety-four, ninety-five and 111 in the four successive licensing periods. This demonstrated the Pakistan Government's determination to make progress in this direction whenever the circumstances permitted.

III. System and method of the restrictions

15. It was suggested by a member of the Committee that, in order to achieve the most efficient allocation possible of the country's limited resources, the utmost reliance should be placed on the operation of market forces. Local industry, in particular, should be exposed to increased foreign competition rather than

shielded from it by import prohibitions, controls and regulations. In his view, the very extensive import control and regulations applied by Pakistan, which covered virtually all imports, were detrimental to the long-term interest of the economy. In this connexion, questions were asked regarding whether Pakistan planned to expose domestic producers to greater foreign competition in the interest of efficiency by relaxing those controls and regulations. In reply, the Pakistan representative recalled the successive measures of liberalization that, as shown in Section 6 of the "basic document" BOP/97, had been taken by his Government in the past few years. The restrictions and controls that now remained were far less extensive and incomparably more liberal than they had been in the earlier 1960's. The restrictions had been maintained for the purposes stated in paragraph 2 of Article XVIII of GATT, namely to provide the necessary leeway for the protection of the balance of payments as well as new industries in a developing country. Pakistan had demonstrated its readiness to remove its import restraints as the balance-of-payments situation improved, and appreciated the IMF's understanding as reflected in its judgment regarding the general level of the restrictions under reference quoted in paragraph 3 above.

16. Members of the Committee discussed in some detail the functioning purposes and methods of operation of the Trading Corporation of Pakistan, and asked how successful it had been in accomplishing the objectives for which the Corporation had been founded and other questions regarding its activities. In reply, the Pakistan representative stated that the purposes of the Corporation were:

1. to act as counterpart of the State-trading agencies of the Socialist countries;
2. to handle bulk imports of selected items so as to secure economies in expenditure and to combat certain malpractices;
3. to take for public revenue the excess profits arising from domestic shortages; and
4. to act on behalf of small manufacturers and exporters unable to engage in direct exportation (cf. BOP/97, page 3).

The TCP, therefore, aimed at providing better and more effective facilities for trading and its operation constituted neither quantitative nor cost restrictions on imports.

17. Members of the Committee sought assurance from the Pakistan representative that the TCP's operations would not involve discrimination against certain supplying countries in favour of any other particular countries, that the traditional contracts between foreign exporters and Pakistan's end-users of industrial materials would not be interrupted and that the activities of the TCP would be confined to commodity groups where bulk buy would lead to demonstrated efficiency and economy. In reply, the Pakistan representative stated that the TCP's operations were invariably guided by such commercial considerations as price, quality, delivery terms. It was free to select the sources of supply in the light of these considerations. The TCP enjoyed no exclusive right in trade and the system remained one of private enterprise. There was no present indication that the product coverage of the Corporation might be extended.

18. A member of the Committee remarked that, having regard to the first main purpose of the TCF - to facilitate trade with Socialist countries relying on State-trading agencies - the scope of the activities of the Corporation would obviously be affected by the number and coverage of Pakistan's bilateral agreements. The IMF had urged that Pakistan keep under review its payments arrangements with countries not members of the Fund and the number of Pakistan's bilateral agreements had remained unchanged in number in the past three years. The member enquired whether Pakistan intended indeed to reduce reliance on bilateral trading arrangements. The representative of Pakistan stated in reply that it was the intention of his Government as from now on to keep the level of its bilateral trade within 10-15 per cent of its total external trade and that it was in deference to the wish of the IMF that Pakistan had refrained from concluding a new bilateral payments agreement with Yugoslavia at governmental level. Nor had the last payments agreement with Ceylon been extended when it expired last February. Other members of the Committee expressed concern over Pakistan's continued reliance on bilateral arrangements in its trade with certain countries, pointing out that their operation entailed a measure of discrimination against other suppliers. They recalled the views of the IMF on this question and expressed the hope that the share of Pakistan's trade covered by bilateral arrangements would at any rate not be increased beyond the 10-15 per cent mentioned above. They expressed the hope that any discriminatory effects of Pakistan's bilateral trading arrangements would be reduced by allowing its trading partners to compete in those items covered by bilateral agreements and that discriminatory measures would not be applied in order to safeguard the operation of the TCF in bilateral trading.

19. In reply to questions the Pakistan representative explained the nature and purposes of the various "goodwill" trade agreements, treaties of friendship and commerce, and transit trade agreements that Pakistan had entered into with a large number of countries, as well as the special Regional Co-operation for Development arrangements entered into among Pakistan, Iran and Turkey. In the view of the Pakistan authorities these agreements in no way involved a deviation from the principle of non-discrimination.

20. Members of the Committee, commenting on Pakistan's present practice of announcing its import control policy on a six-monthly basis, recalled that a change-over to a twelve-month licensing period in 1967 had been heralded at that time as another move towards liberalization, inasmuch as this afforded foreign exporters certainty of the import opportunities over a longer period, and asked the reasons for which the shorter period had been reverted to. The representative of Pakistan, in reply, referred to the various difficulties which had been met in the attempt to adopt the longer licensing period in 1965. The failure of the Consortium on Aid to Pakistan to meet and agree on the level of assistance, the crop failures and the resulting acute shortage of essential commodities in the country were among the factors demonstrating the impracticability of taking commitments over any considerable period. The further attempt made with respect to the 1966-67 licensing period was again thwarted by the lack of adequate foreign exchange reserves. In fact the shorter period had been found to afford more frequent opportunities for the introduction of liberalization measures, as might

be witnessed from the changes introduced with the announcement of each six-month licensing policy since 1967, notably in the successive extension of the coverage of the cash-cum-bonus régime.

21. A member of the Committee stated that according to information available to exporters in his country Pakistan levied a sales tax at the general rate of 15 per cent ad valorem on most products. In the case of imported goods, the tax is calculated on the c.i.f. duty-paid value. Contrary to the rules of GATT a large number of categories of products (including hand tools, insecticides, pesticides, farm implements, photographic films, edible oils, etc.) were reported to be subject to this tax if imported, but exempt if domestically produced. Since 1965 a Defence Surcharge of 25 per cent of the tax had also been collected on the taxable goods. The question was put as to whether Pakistan had any plans to eliminate the unequal treatment accorded to imported and local products in the levying of this tax. Commenting on this information, the Pakistan representative stated that the Defence Surcharge had been discontinued. Under the Sales Tax Act all goods, both imported and locally produced, were liable to this tax but the Central Government was empowered to grant exemptions for specific items. In fact a large number of essential goods were so exempted whether imported or locally produced, including betel nuts, fertilizer, diesel oil, etc. Some goods were, however, exempt from the tax only if locally produced, including cement, bicycles, cutlery, insecticides, pesticides. The tax was intended to be levied on a single stage of production; raw materials intended for the manufacture of a final product which itself was subject to the tax would not be taxed.

22. In the course of discussion questions were put and representations made concerning various aspects of the administrative control system. It was noted, inter alia:

- that the system was complex and the procedures cumbersome;
- that excessively long delays were often involved in the release of foreign exchange for import payment;
- that the regulations governing the import of motor vehicles, including automobiles, lorries and tractors, required that they conformed to a prescribed norm and that each model be submitted for testing and certification by the competent authorities, but that the import of sample units for this purpose was sometimes impeded by the controls;
- that the customs procedures did not provide for the return to the consignor of products which were for one reason or another refused admission into Pakistan, and the loss incurred by the exporter might be substantial.

23. With regard to motor vehicles the representative of Pakistan stated that imports of cars were subject to value limit of Prs 11,000 (c.&f.) per car. This limit had been imposed as the smaller cars were considered more suited to the conditions in Pakistan. In fact, this limit allowed as large a car as the Mercedes 200 to be imported.

Conclusions

24. Members of the Committee expressed appreciation for the progress that had been made by the Pakistan Government in liberalizing imports and in simplifying the exchange system in the direction of unification and greater reliance on the market forces for the allocation of the resources. The hope was expressed that further improvement in the balance of payments would soon enable further steps in that direction.

25. The representative of Pakistan expressed appreciation for the sympathetic attitude and understanding shown by members of the Committee, and stated that he had taken due note of the views expressed by them including the representations and comments concerning the administrative procedures, which he would certainly convey to the attention of the competent authorities in Pakistan.

ANNEX I

International Monetary Fund Executive Board Decision
Taken at the Conclusion of the Fund's Consultation
with Pakistan on 23 July 1969

1. This decision is taken by the Executive Directors in concluding the 1968 consultation with Pakistan pursuant to Article XIV, Section 4 of the Articles of Agreement.
2. Pakistan has continued to achieve a satisfactory rate of growth of GNP, accompanied by a substantial increase in exports. However, the problem of unused capacity in manufacturing has remained serious. The Pakistan authorities are dealing with this problem by measures designed to encourage a fuller use of existing capacity while limiting additions to capacity. The Fund believes that these efforts would be facilitated by a greater reliance on the price mechanism.
3. In the first nine months of fiscal year 1968/69 there was a substantial monetary expansion resulting partly from bank financing of large government expenditures for food stockpiling and from an increase in net foreign assets. However, following recent political and social disturbances, there was a reduction in economic activity and credit to the private sector declined more than seasonally. Credit demands of the public and private sectors may rise sharply in 1969/70, indicating the need for caution as economic recovery gets underway. Therefore, the Fund notes with satisfaction the efforts being made by the Pakistan authorities to increase government revenues and limit the rise in government nondevelopment expenditures. In order to curtail the increase in expansionary forces without affecting development expenditures, the Fund also suggests that agricultural policies be examined with a view to reducing the need for the government to finance stocks of agricultural products.
4. Progress has been made in rationalizing the exchange system through expansion of the scope of the cash-cum-bonus scheme. The Fund notes the intention of the Pakistan authorities to make further moves in that direction. The Fund believes that in order to facilitate the elimination of internal price distortions and to strengthen the balance of payments position, high priority should be given to measures to simplify the exchange system with a view to its unification. In the meantime, the Fund does not object to the present arrangements on a temporary basis. The Fund urges that Pakistan terminate its bilateral payments arrangements with Fund members and keep under review its arrangements with other partners.

ANNEX II

Opening Statement by the Representative of Pakistan

1. I have the privilege to present to this Committee the background document in BOP/97, which contains material supplied by the Government of Pakistan for the purpose of consultation under paragraph 12(b) of Article XVIII of the GATT. In accordance with the plan of consultation, the document provides information on the legal and administrative basis of the restrictions, methods used in restricting imports, treatment of imports from different sources including information on the use of bilateral agreements, commodities or groups of commodities affected by the restrictions, import under State trading, measures taken since the last consultation to relax or otherwise modify the restrictions, and effect of restrictions on trade and general policy in the use of restrictions for balance-of-payments reasons.
2. The Committee will have seen in the document that Pakistan's balance of payments unfortunately remained under considerable strain during the first half of the current Third Five-Year Plan period. The disbursements of foreign assistance were 22 per cent below the Plan expectations for this period which imposed serious limitations on the level of imports. The pressure on development imports was more intense since non-development imports increased by 21 per cent over Plan projections because of larger food and other non-development imports as well as rising debt service burden. A severe shortage of raw materials resulted in considerable under-utilized capacity.
3. Consequently, the balance-of-payments policies were thoroughly reviewed by the Government of Pakistan and various changes in them were brought about. In this connexion, I might mention that number of export bonus rates which over the years had risen to six, was reduced from 22 November 1967 to two - 40 per cent for fully manufactured goods and 30 per cent for all other goods, with the minor exception of raw wool on which the bonus rate is 20 per cent. This has helped to simplify the operation of the Export Bonus Scheme. A cash-cum-bonus import scheme was introduced for the first time in the import policy for the period July-December 1967. This scheme has helped us in adjusting the price of imported raw material to more realistic level as well as reducing direct control on imports. The scope of the scheme has since been expanded and the list now covers the necessary imports of the private industrial sector.
4. Mr. Chairman, we would like to reassure the Committee that the Government of Pakistan intends to use import restrictions as a purely temporary measure in order to meet short-term needs of the economy. Adjustments are made in the import policy so as to make a most judicious use of the available resources, which are obviously insufficient, in order to conserve a major portion for more important sectors. Priority is given to development imports, essential raw materials and consumer goods.

5. The share of raw materials for capital goods has steadily increased from PRs 550 million in 1965-66 to PRs 990 million in 1968-69 of the total import bill during the first four years of the current Third Five-Year Plan mainly due to Government's policy of liberalizing import of essential raw materials. There is a considerable under-utilized production capacity in the country. An increase in the quantum of raw materials to more adequate levels is absolutely necessary in order to utilize the existing capacity. Pakistan's export and saving efforts are largely dependent on the increase in production which it can get out of the existing capacity. With increase in export earnings, the Government is gradually liberalizing imports. The Government is anxious to carry forward this liberal policy. Sir, I would be less than candid if I did not add here that the realization of this objective of my Government would depend to a very large extent on the continued support and understanding by the international institutions like GATT, International Monetary Fund and the World Bank. Without the adequate financial assistance on a continuing basis, the steady pursuit of liberal commercial policies by Pakistan will remain vulnerable to serious strains and stresses.

6. In the background document, we have attempted to provide full information and necessary clarifications to the Committee. I hope that at the end of our discussions today, the Committee will be satisfied that the import restrictions maintained by Pakistan are necessitated in order to implement programmes and policies of economic development designed to raise the general standard of living of its people as well as to safeguard its external financial position and to ensure an adequate level of foreign exchange reserves, as provided for in Article XVIII of the General Agreement.