Balance of Payments Problems of Pakistan

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Introduction

This study seeks to analyse developments in Pakistan's balance of payments during the period 1948-60. The first section attempts to give a definition of the payments problem and briefly discusses the various causes of balance of payments disequilibrium in the light of the accepted theory. Against the theoretical background thus provided, Sections II to VII review the major phases in Pakistan's balance of payments and highlight developments. The final section summarises the main conclusion emerging from the study.

I

Nature and Causes of Payments Difficulties

The nature and causes of balance of payments difficulties show enormous diversity. There are first the problems caused by wide fluctuations of export prices and earnings particularly in countries like Pakistan which are heavily dependent on the export of a few primary products, markets for which show a great deal of instability. In the same group are difficulties resulting from major harvest failures. Then there are balance of payments difficulties which stem from more permanent causes and denote, in terms of the terminology used by the International Monetary Fund, a "fundamental disequilibrium" in the payments position. Finally, developing economies appear to be faced with problems which arise essentially from need for finding sufficient foreign exchange resources for their development programmes.

In discussing the balance of payments problems of Pakistan in this paper, we would focus mainly on the payments problems which arise from a basic disequilibrium in receipts and payments. The difficulties posed by fluctuating earnings and harvest failures are largely self-correcting and

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can be overcome if adequate foreign exchange reserves are available. Similarly, the shortage of foreign exchange in relation to the development needs of under-developed areas can be more effectively discussed as a part of the general problem of the scarcity of resources. Thus, even though the generally high import-coefficient in the investment programmes renders foreign exchange availabilities, a key factor in the development process, the task of accelerating capital imports into under-developed countries through foreign aid, loans and investment does not constitute, properly speaking, a payments problem.

The absence of basic disequilibrium, as we have defined it, requires that a country is able, over an average of good years and bad, to meet its payments (including ordinary capital outflow) out of its receipts from current transactions and ordinary capital inflow, without being compelled to keep economic activity below a desirable level or to restrict imports merely for the purpose of avoiding a deficit in its balance of payments[1]. The above definition is widely accepted and has been found to be generally useful. But it is noteworthy that even if we follow what appears to be a precise definition, an element of qualitative judgement necessarily enters into balance of payments analysis. For instance, it is evident that the reliance on exchange control and trade restrictions for non-balance of payments purposes *i.e.*, their use as tools for influencing the allocation of resources between consumption and investment is, according to the above definition, consistent with an equilibrium in the overall balance of payments. But there always remains the practical problem of distinguishing between exchange control and trade restrictions as instruments for controlling total imports and as tools for allocating resources between development and non-development uses. Furthermore, in so far as the level and degree of import restrictions, which are in all circumstances difficult to measure, vary from period to period, the recorded balance of payments does not give altogether a true indication of the real changes in the payments position over time.

Before we set out to examine the major trends in Pakistan's balance of payments, a brief mention of the causes[2] of balance of payments disequilibrium, in the sense we are using the term, would also be helpful. One of the most frequent causes of the payments problem faced by developing economies is current monetary imbalance caused by an excessive rate of

1. E.M. Bernstein "Strategic Factors in Balance of Payments Adjustment" IMF *Staff Papers*, Vol. V (August 1956), p. 151. As Bernstein points out this definition can be further refined to provide that a proper balance of payments should enable a country to add to its monetary reserves as proportionate share stock of monetary gold or its equivalent in foreign exchange.

2. For a useful discussion, *see* E.M. Bernstein, *op. cit.*

credit creation. The development of inflationary pressures, defined as the excess of money demand over the supply of goods and services at a given price level, almost invariably leads to a balance of payments problem. Indeed economists who view the balance of payments essentially as a monetary phenomenon regard excessive credit expansion as the cause of payments difficulties[3]. Inflationary pressures if they persist often give rise to a price-cost disparity which inevitably tends to impair a country's competitive position. If the domestic price level has got out of line with the international price level, then, given the exchange rate, foreign demand for exports would decline while the country's demand for imports would be unduly stimulated. In dynamic world certain structural changes are also taking place which have direct influence on the balance of payments. The capacity to earn foreign exchange may not always keep in step with the requirements of foreign exchange even though internal monetary balance exists and the domestic price level is competitive. Among structural changes which adversely affect the payments situation, the loss of major export markets and the secular deterioration in the terms of trade deserve special mention.

The actual balance of payments problem of an individual country cannot, as a rule, be attributed solely to any one of the above causes. In most cases, there is a complex payments problem to which each of the main causes contribute in varying degree. Indeed, the causes themselves shade into one another. Current inflation cannot easily be separated from price-cost disparity which is also in the nature of a structural change. While it may be difficult to identify precisely the causes of balance of payments disequilibrium, it is, nevertheless, helpful to attempt a broad classification of determining factors. Our analysis of Pakistan's payments problems would make this clear.

II

Pakistan's Balance of Payments: Major Periods

Five main phases of Pakistan's balance of payments may be distinguished:

(1) The period immediately following non-devaluation decision of September 1949 which involved a serious test of the country's balance of payments.

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3. "In a real sense the credit expansion is the cause of payments problem". J.J. Polak, "Monetary Analysis of Income Formation and Payments Problems" I.M.F. *Staff Papers*, November, 1957 (Vol. VII). "A continuing balance of payments deficit ultimately requires credit creation to keep it going." H.G. Johnson "Towards a General Theory of the Balance of Payments," in *International Trade and Economic Growth*, London, 1958, pp. 153, 168.

(2) The period from the Korean boom in mid-1950 to mid-1952 during which foreign exchange earnings increased very sharply and made possible very substantial liberalisation of imports. (3) The period from about middle of 1952 to August 1955 during which time the recession in the world commodity market emerged and terms of trade turned greatly adverse necessitating the almost complete reversal of the earlier liberalisation measures. (4) The three-year period following the devaluation of the rupee in August 1955 in which the internal monetary situation deteriorated greatly and large food deficits emerged leading to a very tight foreign exchange position. (5) The attempts at strengthening the balance of payments since the end of 1958 by stabilising the economy and curbing excessive monetary expansion.

III

Non-Devaluation Decision and Trade Deadlock with India

Before we turn to analysing the impact of non-devaluation decision of September 1949 on Pakistan's balance of payments, it will be helpful to summarise briefly the payments situation during 1948-49. (The Pakistan trade year is July-June).

The year 1948-49 is of special interest. Not only was it the first complete trade year after the Partition but also it was characterised by relative stability in the conditions of demand for Pakistan's raw materials even though the 1949 U.S. recession had some dampening effect on the level of commodity prices in the later half. Analysis of trends in this period is, however, rendered somewhat difficult by the fact that the official balance of payments statements do not include transactions with India upto February 1951. There was no exchange control with India until that period. It is, therefore, necessary to adjust the official figures to take account of the position with India. This can be done to some extent by using the trade figures available from customs records and the reports of the working of the Indo-Pakistan Payments Agreements.

The recorded balance of payments showed a large deficit of Rs. 455.4 million during 1948-49. This was offset to a substantial extent by surplus in transactions with India of Rs. 247 million under the Payments Arrangements[4] with that country. It is evident that the overall position neverthe-

4. Trade surplus with India was estimated to be as large as Rs. 459 million for 1948-49. This was presumably offset to some extent by other current transactions and capital transfers.

less showed a deficit[5]. It must be stressed that this deficit was the result to some extent of a deliberate policy decision. Imports were liberalised substantially in August 1948 to meet the shortages of essential goods which had resulted partly from the dislocation of normal trade channels brought about by the migration of traders, administrative and technical difficulties, in the wake of Partition and the cautious import policies followed until the middle of 1948. The improvement in the supply of imports was utilised to build up stocks as well as to meet the back-log of demand from the war and the early post-war years. The running down of the foreign exchange reserves was made possible by the releases from the large accumulated sterling balances accruing to India and Pakistan as a result of the financing operations connected with the Second World War.

An important feature of the payments position in this period was the very heavy dependence on the export of a single commodity to a single country. Export receipts (f.o.b.) to overseas countries, as recorded by the Exchange Control Statistics stood at Rs. 804.6 million. In contrast, exports to India alone amounted to Rs. 1043.8 million[6]. Thus out of the total estimated export earnings of Rs. 1848 million, nearly 56 per cent were derived from India. The largest export by far was that of raw jute, earnings from which were placed at over Rs. 1190 million. Jute exports to India alone were valued at Rs. 800 million. The quantum of raw jute exports during 1948-49 stood at 6 million bales, of which India accounted for over 4 million bales. This crucial significance of Indian market for the Pakistan jute trade was to play a major role in the payments developments in the ensuing period.

On September 17, 1949 India decided to devalue her rupee to the same extent (30.5 %) as the devaluation of the Pound Sterling. Pakistan did not follow suit and so maintained the par value of her rupee *vis-a-vis* the United States dollar and other non-devalued currencies. Pakistan was the only sterling area country to do so and her decision came as a considerable surprise. The analysis of this decision which had lasting repercussions on her economy is necessary for understanding subsequent developments in Pakistan's balance of payments. Such an analysis should, however, be made in the light of the circumstances and expectations as they existed in September, 1949 and not in the light of subsequent developments which were unexpected and could not be foreseen.

Three distinct but interrelated arguments were at the back of Pakistan's

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5. There was, however, the problem that a part of the surplus with India was settled in the form of bilateral rupee balances which were not readily convertible into international currencies. These balances have indeed remained blocked to this date due to dispute which developed between the two countries following September 1949.

6. *Source:* Central Statistical Office.

decision not to devalue her currency. Firstly, it was felt that in view of the inelastic supply of exports and relatively inelastic demand for imports, the balance of payments was not likely to improve as a result of the devaluation. Secondly, that the basic balance of payments position did not give any cause for concern and further that if payments pressure did emerge it could be met to a reasonable extent by the drawing down of the foreign exchange reserves which in September 1949 were quite large. Thirdly, it was expected that the non-devaluation decision would have a favourable impact on the internal price level and the lower import costs in domestic currency of machinery and other capital goods would provide an incentive for the much desired industrial growth. Some improvement in the terms of trade through switching off purchases from 'hard' to 'soft' currency area was also probably expected. All these aspects bearing on the exchange rate decision will be examined here.

The basic presumption of the non-devaluation decision was that the balance of payments would not have materially benefited from the devaluation of rupee. It needs to be emphasised that the non-devaluation of rupee implied in effect its revaluation upwards *vis-a-vis* a large number of world currencies. This latter group included Pakistan's most important trading partners such as the United Kingdom, India, Japan and Continental O.E.E.C. countries. The case for the non-devaluatoin decision therefore rested not so much on the argument that the devaluation was unlikely to improve the balance of payments, but rather that an appreciation *vis-a-vis* the most important trading partners was not likely to lead to a significant deterioration in the payments position. This seemingly fine distinction is necessary to make because there exists no *a priori* reason for assuming a symmetry in the elasticities of import demand and export supply in the upward and the downward direction. The basic assumptions underlying the non-devaluation decision may therefore be restated as follows:

1. Due to inelastic import demand the imports would not increase much or at all as a result of the cheapening of currencies of major suppliers or alternatively the increased pressure if it arises at all could be kept in check through the use of exchange and import restrictions. The assumption of inelasticity of import demand was based on the low substitution of home produced goods for imports in Pakistan due to the predominantly agricultural nature of the production structure. It may have also been felt that to some extent, the current level of imports would tend to decline later without devaluation. As noted earlier, the working off of the backlog of earlier import demand was not an insignificant factor in sustaining imports during 1948-49.

2. On the exports side, it was assumed that exports would not suffer as a result of the higher value of the rupee *vis-a-vis* the devalued currencies

because the nature of agricultural operations in Pakistan ensures maximum utilisation of productive capacity irrespective of cost conditions. It was also felt that the devaluation will induce little, if any, additional diversion from home consumption to exports because industrial structure of Pakistan did not permit such substitution. Practically all of Pakistan's raw jute and over 80 per cent of raw cotton were exported since the country had little large-scale industry. With an unchanged supply of exports, earnings from exports could generally be expected to remain unchanged, with the prices of exports in the home currency adjusting[7] to some extent to the changed exchange rates. The above statements need one qualification. In the case of raw jute there was a presumption that the international demand for it was highly inelastic[8] so that a possible reduction in exports and production would actually increase earnings.

The foregoing analysis indicates that even on the basis of balance of payments consideration alone, a strong case existed for the non-devaluation decision. It is, however, basic to the understanding of 1949 developments that the exchange rate decision was based on wider considerations; though the fact that payments imbalance during 1948-49 was not serious and reserves were ample, was an important prerequisite. Thus the desire to alleviate inflationary pressures in the economy played a considerable part. Provided the local currency prices in devaluing countries did not rise, Pakistan's total import costs were expected to decline by about 20 per cent. This combined with some expected decline in domestic prices of export products was expected to bring about a decline in the internal price level. The accompanying reduction in costs of living and excessive profit margins of exporters who had benefited from abnormally high post-war raw material prices were considered desirable. The possibility of the improvement in the terms of trade to the extent that demand conditions for some of Pakistan's exports were inelastic and the source of imports could be shifted from dollar area to devalued countries were also probably given some weight.

The immediate and unexpected result of Pakistan's non-devaluation decision was the trade deadlock with India due to latter's flat refusal to accept

7. Perhaps, it was anticipated that such adjustments would probably need not to be substantial. Supplies of tea, raw wool, raw jute, hides and skins in countries, which were devaluing were still short. Pakistan's principal competitors of raw cotton (the United States and Brazil) were not devaluing. Egypt produced longer staple varieties mainly for different markets and large price premium existed over the Pakistan varieties.

8. However this argument is not very sophisticated. The inelasticity of international demand for a commodity does not necessarily mean that export demand for that commodity *facing a single country* is also inelastic. The other relevant factor is the elasticity of the supply of the commodity in the rest of the world. Thus the assumption about the inelasticity of world demand for Pakistan jute involves not only an inelastic international demand for jute but also an inelastic supply of jute in the outside world—India. *See* Shorter, F.C., Jute Production Policies of India and Pakistan, the *Indian Economic Journal*, Vol. 3. (1955).

the new parity between the India and the Pakistan rupee[9]. It is quite apparent that India's action was largely political and represented an effort to exploit the very great dependence of Pakistan on her as a market for raw materials and as a source of supplies. The stalemate which resulted in a virtual elimination of trade between the two countries continued until February 1951 when India finally agreed to the new exchange ratio. Meanwhile the Pakistan economy was put to a serious strain which was relieved only by the fortitious circumstance of the beginning of the commodity boom in mid-1950.

We shall now consider the extent to which Pakistan was able to divert her export trade and thus maintain her foreign exchange earnings in 1949-50.

Export Earnings (Excluding India)

		Million Rs.
July-Dec. 1948	...	288.2
Jan.-June 1949	...	516.4
Total 1948-49	...	804.6
July-Dec. 1949	...	323.9
Jan.-June 1950	...	545.7
Total 1949-50	...	869.6

As can be seen from the above figures Pakistan's overseas export earnings showed an improvement in rupee terms of about 8 per cent between 1948-49 and 1949-50. In terms of their real purchasing power, however, there was a much greater increase as the appreciation of the exchange rate implied *vis-a-vis* devalued currencies a sharp decline in import prices in local currency. The improvement in real export position with overseas countries was, however, due entirely to higher raw cotton earnings which in turn reflected the operation of autonomous factors *viz.* larger crop and improve-

9. The dispute centred around jute. In order to forestall the rise in prices of raw jute, in India as a result of Pakistan's non-devaluation decision, the Indian Government issued an ordinance fixing maximum domestic currency prices for raw jute. Since jute prices in Pakistan were, at the new rate, above this maximum the Indian purchasers refused to enter the Pakistan market. This led to cessation of jute exports from Pakistan to India. Thus Pakistan was forced to support raw jute prices in order to protect the grower. It is significant that minimum prices fixed in Pakistan were 25% below the pre-devaluation level. (F.A.O. Survey on Jute: 1950).

ment in international prices. By and large the conclusion is justified that the sudden decline in exports to India during 1949-50 was not compensated to any appreciable extent by higher exports to other countries. Analysis of the raw jute exports makes this point abundantly clear. Raw jute exports to India which at 4.13 million bales during 1948-49 (July-June) were responsible for 40 per cent of total foreign exchange earnings were reduced to 1.65 million bales in 1949-50. The bulk of these exports took place in the period before the exchange rate changes in September. Raw jute exports to countries other than India at 1.92 million bales during 1949-50 also denoted a small decline of 0.2 million bales over the previous year, related in part to reduced purchases by the United States under the impact of the recession. Thus by the very nature of heavy dependence on India for jute sales, the jute export market was seriously disrupted and the Government had to step in to maintain prices. Fortunately 1949-50 jute production[10] turned out to be unusually small (3.3 million bales) so that Government price support operations proved reasonably successful. Nevertheless the newly established Jute Board had acquired nearly one million bales of raw jute by the end of 1949-50 season.

The impact of the loss of jute exports to India on Pakistan's balance of payments was obscured in the boom years 1950-51 and 1951-52. But the following table shows that the reduction has proved to be permanent.

Volume of Raw Jute Exports to India
(000 *bales*)

1948-49	4133	1954-55	1231
1949-50	1654	1955-56	1354
1950-51	2559	1956-57	614
1951-52	1678	1957-58	641
1952-53	1491	1958-59	172
1953-54	1360	1959-60	619

The steady fall in raw jute exports to India and the accompanying increase in the latter's production has resulted in a steep decline in Pakistan's share in the total world jute production. However, the attainment of near self-sufficiency in raw jute by India cannot easily be attributed to the non-devaluation decision of Pakistan because India would have made all-out effort to increase her raw jute production in any case. Whatever its causes the fact remains that the sharp reduction in Pakistan jute exports must be regarded as one of the structural factors responsible for the balance of payments disequilibrium.

10. Jute crop is harvested beginning with July. The smaller crop thus was quite unrelated to developments in the exchange rate field.

IV

Korean War Boom and Import Liberalisation

Pakistan's balance of payments showed unusual strength, from mid-1950 to mid-1952, the period dominated by the commodity boom induced by the outbreak of the Korean War. The scramble for raw materials raised export prices to an unprecedented level and resulted in a notable improvement in the terms of trade. Pakistan's export earnings recovering from the aftermath of the deadlock in jute nearly doubled between 1949-50 and 1950-51[11]. Exports during 1951-52, though somewhat lower than in the previous year, were well maintained. Taking the two years together, however, the current account position showed only a relatively small surplus of Rs. 138.0 million and the gold, dollar and sterling reserves showed net increase of only Rs. 87 million over the period. The quick absorption of the high level of earnings by expansion in both private and government imports was perhaps the most interesting feature of balance of payments developments during this period.

The recorded current account surplus attained an all time peak of Rs. 578.0 million in 1950-51 and compared very favourably with the deficit of Rs. 348.6 million in 1949-50. The improvement of Rs. 926.6 million was due entirely to higher receipts as total payments actually rose by Rs. 564.6 million. The most notable increase was in private account imports which jumped up by 50 per cent over 1949-50. The expansion in imports was, however, not so much the result of expansion in income as a reflection of the impact of substantial liberalisation of import policy in mid-1950. The free import list (Open General Licence) established in June 1950 marked a substantial improvement over the somewhat cautious policy introduced in October, 1949 after the non-devaluation decision. With the signing of the trade agreement with India at the end of February, 1951 another O.G.L. brought in additional items from India. The influence of higher export incomes on private imports during 1950-51 was limited for two reasons. Firstly, a substantial portion of the increase in export incomes was mobilised by the government in the form of higher export duties. A notable example of the use of stabilisation devices was the raising of the export duty on staple cotton to Rs. 300 per bale by November, 1950 from Rs. 60 per bale, the level prevailing during 1949-50. Due largely to the higher duty on cotton, collections of export duties increased manifold to Rs. 427.7 million in 1950-51. The resulting government surpluses on revenue account were funded. It is estimated that the net monetary impact of the government's fiscal opera-

11. The comparison is made after adjusting 1949-50 figures for exports to India.

tions during 1950-51 was contractionary to the extent of roughly Rs. 160 million. It was largely as a result of this surplus in government transaction that the money supply during the period rose by only Rs. 384 million notwithstanding the powerful expansionary influence of Rs. 560 million exerted by the foreign sector. The private sector (including change in time deposits) experienced, broadly speaking, a neutral effect on the money supply. The expansion in money supply of 13.8 per cent was nevertheless sizeable. This suggests that the delay in the full impact on the economy of the expansion in exports was due in part to the usual time lags. Private import payments rose steadily from July-September 1950 onwards reaching their peak in January-March 1952. For the year 1951-52 as a whole private import payments at Rs. 1758.7 million were 50.4 per cent higher than in 1950-51. With foreign exchange earnings only slightly lower, higher payments during 1951-52 were the chief causes of the sudden deterioration in the balance of payments which culminated in the deficit of Rs. 440 million for the year. The question arises as to what extent the sharp and the continuous rise in payments was the result of the operation of automatic adjustment mechanism and to what extent it was due to autonomous factors.

Even a cursory examination suggests several factors combined with the continued high export incomes to bring about an exceptionally steep rise in payments. Firstly, the import policy was liberalised further in July 1951. Most notable addition to the free import list (O.G.L.) were cotton textiles of the value of less than Rs. 1.50 per yard. Secondly, the government fiscal operations which exercised a significant contractionary influence in 1950-51 were a powerful expansionary factor in 1951-52. The net creation of credit in Government sector amounted to Rs. 377 million[12]. The large deficit was related mainly to a sharp increase in public development expenditure, through Government efforts following recessionist tendencies, to maintain the internal prices of jute and cotton through support schemes was also a contributory factor[13]. Finally, an element of speculative imports towards the end of 1951-52 was also probably not insignificant. The foreign exchange reserves had begun to drop after mid-1951 and the decline was accelerated in the first quarter of 1952. The general business expectation was developing that the liberal import policy could not be sustained in view of the sudden weakening of the export markets in early 1952. Probably not an insignificant portion of the enlarged imports during 1951-52 was utilised

12. M. Haq, *Deficit Financing in Pakistan:* 1951-60, Monographs in the Economics of Development, No. 3, Institute of Development Economics, Karachi.

13. From May to Sept., 1952, for instance, the Cotton Board purchased 400,000 bales (total crop 1.8 million bales) and the Jute Board took 1.35 million bales (total crop 6.3 million bales) off the market from March to July, 1951. These stocks were later liquidated at a considerable loss.

for the building up of stocks. Private sector credit expanded by Rs. 229.8 million or 42 per cent during the year. That the level of imports was being artificially maintained, through the creation of bank credit, was realised by the Government which introduced selective credit controls in June, 1952. Restrictions laid down that no letter of credit should be opened unless a margin of 50 per cent in the case of licensable goods and 75 per cent in the case of goods under import O.G.L. was deposited with the authorised dealers. Authorised dealers were directed not to release foreign exchange for imports into Pakistan unless drafts forming part of documents of such imports had been negotiated in the country of export under letters of credit- These restrictions did not apply to machinery, chemicals and medicines. Banks were instructed that advances against stocks of imported goods should not be allowed in excess of 50 per cent of their value and unsecured advances or advances secured only by a guarantee were prohibited. The drain on reserves had, however, become so severe by July, that the O.G.L. was sharply curtailed in August, 1952 and completely abolished in November, 1952.

The above analysis strongly suggests that the balance of payments deficit which emerged in 1951-52 notwithstanding the high level of receipts was to some extent the result of the deliberate policies. The higher development expenditure and net outlay on price support schemes for jute and cotton was financed through net creation of money in the government sector. In the private sector import policy encouraged the building up of stocks. The imbalance which thus appeared was not merely the result of over-adjustment to the expansionary influences emanating from the export boom. The automatic adjustment mechanism would have, as it did, met only part of the gap. The fact remains that the government was not successful in maintaining internal balance. From the long run point of view also the degree of import liberalisation achieved during 1951-52 was probably not sustainable.

Quite apart from the broad issue whether the policy of import liberalisation was pushed too far in view of the temporary nature of the higher earnings the question may be posed, whether the pattern of import policy with its implicit emphasis on consumer goods imports was in the long-term interests of the country. No doubt the large inflow of imports exercised a healthy influence on the prices of basic consumer goods like cloth[14]. It appears likely, however, that declining prices of consumer goods and the generally low profit margins in nascent industry acted as a disincentive on industrial investment. The share of capital goods in total private imports was quite

14. Prices of mill-made cloth for selected urban centres showed all round decline between 1949-50 and 1951-52 (Pakistan Statistical Year Book, 1954).

low in 1951-52, averaging less than 10 per cent. A more careful allocation of foreign exchange might have facilitated early industrial growth by restraining consumption expenditures on the one hand and by maintaining profits on the other. As it was the transition to tight import restrictions came too suddenly and caused unnecessary dislocation and shortages.

V

Import Restrictions and Industrial Growth

The quarterly balance of payments deficit which had grown steadily from Rs. 45.7 million in July-September, 1951 to Rs. 273.3 million in April-June, 1952 rose to the peak level of Rs. 408.5 million in July-September, 1952. These deficits which had by September 30, 1952 reduced gold, dollar and sterling reserves to Rs. 662.3 million, the lowest level since Partition. At this level foreign exchange reserves were sufficient to cover less than three months' payments (at 1951-52 rate). Their further running down, in view of the highly volatile nature of Pakistan's foreign exchange earnings, was considered extremely undesirable. The Government's policy, therefore, aimed, for the next several years, at maintaining a strict balance between foreign exchange expenditures and estimated earnings. Thus in the period of nearly three years from end-September, 1952 to end-June, 1955, the balance of payments on current account showed only a relatively small deficit of around Rs. 90 million.

The recorded deficit is a particularly poor guide to the real balance of payments position for this period. The degree of restrictiveness of imports varied greatly within this period and can be said on the whole, to have increased considerably between end-1952 and middle 1955. However, the very restrictiveness of imports and high prices of consumer goods encouraged industrial expansion. The development of cotton textile industry which had been underway for a few years received great stimulus during 1953 and 1954 due to the almost complete stoppage of cloth exports. The successful import substitution greatly strengthened the long-term balance of payments off-setting to a very appreciable extent the effect of deterioration in the terms of trade.

The most disconcerting feature of balance of payments developments during 1952-55 was the sharp drop in export receipts from Rs. 2,137.2 million in 1951-52 to Rs. 1,297.5 million in 1952-53 and further to Rs. 1,180.3 million in 1954-55.

Exports Earnings

		Million Rs.
1951-52	...	2,137.2
1952-53	...	1,297.5
1953-54	...	1,268.1
1954-55	...	1,180.3

The reduction in earnings between 1951-52 and 1954-55 was not the result so much of the loss of volume as of a reduction in export prices. The export price index which had risen to 111.5 (1948-49 = 100) during 1951-52 touched a low of 64.0 in 1953-54 and rose only slightly to 67.1 in 1954-55[15]. This denoted a fall of 23 per cent as compared to the pre-Korean boom year 1949-50. With 1949-50 prices, export earnings during 1954-55 would have been 30 per cent higher than they actually were. This would have been meant additional foreign exchange resources of Rs. 354 million during the year. The comparison with 1949-50 makes it abundantly clear that the fall in export prices was much more than could be attributed to the recession following the Korean boom.

The extent of the sharp decline in import availabilities can be judged from the following figures of private import payment.

		Million Rs.
1950-51	...	1,169.3
1951-52	...	1,758.7
1952-53	...	1,110.7
1953-54	...	676.2
1954-55	...	676.7

It may be mentioned that the reduction in allocation for private imports was related not only to the fall in foreign exchange earnings but also to the harvest failures in 1952 and 1953 which caused a serious wheat shortage in the West wing. Even though substantial wheat imports (over Rs. 200 million) became available under foreign aid and loans the country had to incur a substantial expenditure (totalling Rs. 258 million) out of its resources on foodgrain imports during 1952-53 and 1953-54, (Table VIII).

There can be little doubt that the curtailment of imports involved a very considerable tightening of quantitative restrictions on imports. However,

15. It may be noted in passing that import prices increased by 2 per cent between 1949-50 and 1954-55. The deterioration in the terms of trade over this period amounted to over 25 per cent.

the very fact that a drastic reduction, of the order that took place, was possible, must be considered remarkable. The ability of the economy to take a sharp cut in imports was related in no small measure to the vigorous industrial expansion which made possible a sizeable addition to consumer goods supplies during 1953-54 and 1954-55. As mentioned above, cotton textile industry came to be firmly established in these years. The imports of cotton piece goods and yarn which had averaged over Rs. 510.6 million during the three years 1949-50 to 1951-52 came down to an average of only Rs. 66.4 million during 1953-54 and 1954-55. The country had become self-sufficient at least in the coarse and medium varieties of cloth. It is also significant that textile prices of domestically produced textiles which had risen to a high level in 1953 actually showed large declines in 1954 and 1955 (Central Statistical Office, Pakistan Statistical Year Book, 1955).

The development of the cotton textile industry, which typified the early stages of industrial growth in Pakistan, has implied net import substitution even in the short run because the industry is based entirely on domestic raw material and has relatively speaking a low capital-output ratio. The importance of this factor in sustaining the balance of payments position of Pakistan particularly in the period under consideration cannot be over-emphasized.

In order to complete the discussion of relevant factors we may add that on the whole, the monetary situation did not present a serious imbalance during 1952-55. Large credit creation took place in the Government sector but the fact that private sector credit increased very little and foreign exchange reserves declined sharply in the second half of 1952 greatly cushioned the over-all rate of monetary expansion. The increase in money supply of 17 per cent for the three year period took place against the background of rather satisfactory trends in output. The domestic price level declined, but this change could be attributed to the exogenous factors of decline in export prices and incomes and bumper food crops. Some increase in liquidity for the period is nevertheless indicated by changes in the money national income ratio. It rose from 0.17 in 1952-53 to 0.23 in 1954-55[16]. This suggests that to some extent consumption and investment outlays were postponed and money balances were built up in anticipation of improved availabilities. In so far as this happened, inflation was suppressed and pressure on balance of payments postponed.

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16. R.C. Porter, Income Velocity and Pakistan's Second Plan, *The Pakistan Development Review*, Vol. I. Number I. Page 51.

VI

Devaluation and Internal Inflation

By the middle of 1955 Pakistan's balance of payments presented a mixed picture. The domestic availabilities particularly of consumer goods were improving with the continued rapid expansion in industrial output and impact of the arrival of first shipments under the United States Commodity Aid Programme of 1954-55. The terms of trade during 1954-55 had improved by nearly 10 per cent. However, some of the basic problems remained. The import policy continued to be restrictive and the availability of foreign exchange resources was emerging as a major bottleneck in the way of development effort. Export earnings had come down to a low level and needed urgently to be stepped up. These were the circumstances in which Pakistan decided to devalue her rupee effective from August 1, 1955. The devaluation (30.5 per cent) restored the value of the Rupee *vis-a-vis* Pound Sterling and the Indian Rupee to the ratio prevailing before September 1949.

The major reasons behind the exchange rate decision may be summarised[17]. As discussed earlier, important factors in the 1949 non-devaluation decision had been the concern with the domestic price level and the desire to keep capital goods imports cheap in order to encourage industrialisation. By the middle of 1955 conditions had changed in many respects. The economy had already undergone a fairly significant change of structural character. There was a substantial increase in the domestic industrial capacity. The country had achieved self-sufficiency in cotton textiles, paper and a number of consumer goods and developed an export potential in jute goods and cotton yarn and piece goods. On the whole, these developments increased the elasticity of domestic output and by diminishing the country's dependence upon consumer goods imports, tended to lessen the significance of the prices of imported goods as a determination of the domestic price level. This structural change in the domestic economy was, as we have seen above, accompanied by a significant change in the international markets for raw materials. The balance of payments considerations, less vital in 1949, had become paramount in 1955. The sharp decline in the prices of export commodities underlined the need for increasing the return to the primary producers so as to maintain the export capacity in the face of sharply rising domestic utilisation of raw materials.

The immediate results of the devaluation were quite favourable. Export earnings increased by nearly 10 per cent in terms of foreign currencies during

17. For a fuller appraisal of the devaluation decision. *See* S.A. Meenai, Devaluation—An Assessment, *Selected Papers on Pakistan Economy*, Volume IV, State Bank of Pakistan, Karachi.

1955-56 as compared with the previous year. However only a part of this improvement could be attributed to the exchange rate change because the elasticity of the supply of exports, even of manufactured goods may be quite low in a period of one year. It is significant nonetheless that Pakistan was able to dispose of substantially higher crops of raw jute and raw cotton without any difficulty. Expansion of the exports of jute manufactures was facilitated and a small beginning was made in the export of cotton manufactures. On the payments side, there was a decline in foreign exchange terms of 17 per cent in private imports. But here again, it must be mentioned that import policy rather than landed cost was the main determinant of the level of imports. The reduction in private imports from Pakistan's own foreign exchange resources was made possible because of larger aid availabilities. But in so far as the internal prices of imported goods increased, the unsatisfied demand for imports must have contracted[18].

(In Million Rs.)

Year	Current account balance	Changes in gold, dollar and sterling	Foreign Aid Utilization
1955-56	+361.8	+698.0(a)	373.3
1956-57	—269.1	—194.2	706.0
1957-58	—335.7	—320.0	1194.4

(a) Including adjustment of Rs. 296 million for the revaluation of assets following devaluation on 1st August, 1955.

The favourable balance of payments developments in the year immediately following devaluation which culminated in a current account surplus of Rs. 362 million did not, however, prove lasting. Exports receipts dropped by 22 per cent between 1955-56 and 1957-58 touched a new low[19]. Meanwhile, with the emergence in early 1956 of an acute food shortage in both wings of the country, sustained foodgrains imports became an important drain on the balance of payments.

18. Generally speaking the rise in domestic prices of imported goods at least in the first year after the devaluation was less than proportionate to the increase in landed costs. Profit margins on import licences were definitely squeezed.

19. The comparison of the rupee figures with pre-devaluation period is made after due adjustment for the change in the exchange rate.

Foodgrain Imports

		Million Rs.
1955-56	...	61.3
1956-57	...	638.5
1957-58	...	543.7
1958-59	...	317.8
1959-60	...	517.9

During 1956-57 and 1957-58 the Current Account deficit averaged Rs. 300 million annually. This was notwithstanding a marked increase in the inflow of aid financed imports which rose from Rs. 373 million in 1955-56 to Rs. 1,194 million in 1957-58. For the three years mid-1955 to mid-1958 total foreign aid utilizations amounted to Rs. 2,274 million as compared to Rs. 315 million in the preceding three years. Despite large aid imports, imports control had become extremely restrictive by 1957-58. The volume of private imports (other than foodgrains) showed little increase between 1954-55 and 1957-58, the rise in import prices and smaller foreign exchange allocations almost offset the larger commodity aid availabilities in the private sector. The fall in private imports signified a greater severity of the import controls particularly because the scope for net import substitution appeared to be limited in this period. Releases for invisibles notably for travel had also to be tightened considerably. The gold, dollar and sterling reserves at Rs. 880 million at the end of June 1958 were, in foreign exchange terms, not much higher than the all time low level reached in September, 1954.

In retrospect the three-year period from mid-1955 to middle 1958 must be regarded as a critical period for Pakistan's balance of payments. Perhaps the *most* important cause of the recurring balance of payments crises in this period was the monetary imbalance which emerged particularly during 1956-57 and 1957-58. The money supply expanded by 37 per cent over the three-year period, even though the foreign sector was, on the whole, contractionary and large accumulation of counterpart deposits (totalling Rs. 642.3 million) were an important offset to monetary expansion. The major causes of excessive money creation were the deficit financing operations of the Government. The creation of the money in the Government sector (unadjusted for accumulation of counterpart deposits) amounted to almost Rs. 1,900 million during these three years. Against this background of rapid money expansion, the output growth was quite slow and compared unfavourably with the preceding three-year period. Industrial expansion slowed down both as a result of the shortages of imported raw materials and spare parts and the squeezing of the private sector investment goods imports. The index of manufacturing production which had more than doubled between 1952 and 1955 rose by only 33 per cent between 1955 and 1958. Th trend in agricultural production was also extremely disappointing. The average production of foodgrains during the three years 1955-56 through 1957-58 was no higher than the average in the preceding three years. The rapid monetary expansion as well as growing population pressure in the face of relatively stagnant national output resulted in an acute internal inflationary pressure which had serious repercussions on the balance of payments.

The internal inflation was the major factor in the decline in exports earnings between 1955-56 and 1957-58. This is evident from the fact that two-thirds of the decline in export receipts over the period was attributable to a drop in earnings from raw cotton. The decline in the exportable surplus of raw cotton was directly related to an increase in its domestic absorption, as there was no corresponding increase in the export of cotton textiles.

Position of Raw Cotton

(000 *bales*)

Year	Production (Sept.-Aug.)	Domestic consumption (July-June)	Exports (July-June)
1954-55	1,602	800	723
1955-56	1,740	810	948
1956-57	1,575	950	664
1957-58	1,675	1,125	447

The import substitution which had basically strengthened the balance of payments during 1952-55 was a source, in a sense, of aggravating the effect of internal inflationary pressures on balance of payments during 1955-58, as it permitted a much greater substitution between export goods and home goods in excess demand conditions. The maintenance of large foodgrain imports was also the result in part of excessive money expansion, and the failure to let prices rise sufficiently in response to demand pressures. The subsidy on foodgrains which involved a drain on Government revenues during the two years 1956-57 and 1957-58 certainly accentuated balance of payments difficulties.

(*March* 1948-*April* 1949 = 100)

Year	Terms of Trade	Import Prices	Export Prices
1955-56	67.8	120.8	81.4
1956-57	63.4	143.6	91.0
1957-58	59.1	153.1	90.1
1958-59	53.3	154.9	82.5
1959-60	52.2	156.3	81.5

Internal inflation was, however, by no means the sole factor in the chronic shortage of foreign exchange resources which was experienced during 1955-58. Terms of trade deterioration which had contributed to the disequilibrium in the preceding period continued and was indeed accelerated in this period. The terms of trade had declined by 25 per cent between 1949-50 and 1954-55 deteriorated another 26 per cent by 1957-58. This further decline was attributable both to a reduction in export prices and a rise in import prices[20]. The latter was, however, by far the more important factor. The index of export prices, in terms of foreign exchange, showed only a relatively small decline of 6 per cent over the period. In contrast, import prices in terms of foreign currency moved up sharply by 32 per cent. The fact that it was the large increase in import prices rather than a sharp reduction in export prices which caused deterioration strongly suggests that devaluation itself was not a major factor in the terms of trade developments. Even the modest drop in export prices could be traced entirely to lower foreign prices obtained for raw cotton due to the persistent weakness of the international cotton situation. However, it may be added that the present series of the Pakistan's terms of trade have become increasingly inadequate as a measure of 'gains from trade' in view of the fact that important shifts in the structure of imports and exports have taken place in recent years while the weights have not been changed.

VII

Anti-Inflationary Measures and Export Drive

The payments pressures which had been growing during 1956-57 and 1957-58 reached a peak in July-September 1958, as the current account deficit rose to Rs. 163.2 million, the highest level since the corresponding period of 1952. The gold, dollar and sterling reserves at Rs. 726.2 million at the end of September, 1958 touched, in terms of foreign currencies, a new low. It is not surprising, therefore, that the foreign exchange crisis was one of the things to engage the immediate attention of the new Government which assumed power in October, 1958.

The new regime initiated a series of short-term and long-term measures to improve the balance of payments position. In the fiscal field, efforts were made to check inflationary pressures which had come to be a dominant cause of the payments difficulties. Credit creation in the Government sector was sharply curtailed and borrowing from the State Bank of Pakistan

20. Because of depreciation of the rupee in August, 1955 both export prices and import prices show large increase in terms of local currency as compared to the pre-devaluation period.

in the form of *ad hoc* Treasury Bill was stopped. A vigorous campaign was launched against smuggling which was both an important cause and a symptom of leakages from the exchange control. Hoarders of foreign exchange were asked to declare and surrender all foreign assets illegally held by them to the State Bank of Pakistan. An amnesty was granted for declarations made in the specified time[21]. As a short-run measure to increase confidence in the currency, a deliberate policy of building up foreign exchange reserves to a safer level was adopted, even though it involved in the first instance an accentuation of import and exchange restrictions. At the same time, the Government took concerted measures to promote exports. The most important step taken in this direction was the introduction of an Export Bonus Scheme in January, 1959. The main feature of the scheme was that the exporters were entitled to import goods from abroad against bonus licences to be issued upto certain percentage. Items like cotton textiles and jute goods were allowed 20 per cent bonus while other manufactured goods qualified for 40 per cent bonus. The Export Bonus Scheme was designed primarily to encourage industrial exports by enabling domestic manufacturers to compete in the international market. The export subsidy, implicit in the Export Bonus Scheme was provided out of high profits which were available on certain imported goods. At the same time, by applying the bonus licences to a large variety of goods, the Export Bonus Scheme allowed greater play to market forces in the determination of import requirements.

All these measures have met with a good deal of success. The impact of the various anti-inflationary measures was to slow down the rate of monetary expansion considerably. Money supply rose by 9 per cent during the three years, 1958-59 to 1960-61 as against 37 per cent in the preceding three-year period. This change was particularly remarkable because the foreign sector which had actually absorbed a large part of monetary expansion in the previous two years was a source of net money creation in the economy during 1958-61. What is more, the lower rate of monetary expansion has been against the background of a distinctly improved trend in output.

(*Million Rupees*)

Year	Current account balance	Changes in gold, dollars & sterling reserves	Foreign Aid Utilization
1958-59	+ 35.0	+162.7	656.7
1959-60	+127.2	+126.4	940.8
1960-61 (July-March).	+128.8	+386.8	1,018.0

21. An amount of Rs. 82.2 million was declared under the amnesty.

Manufacturing production rose by over 25 per cent during 1959 and 1960 as against the rise of 13 per cent in the preceding two years. Index of agricultural production averaged 114 (1949-50 to 1952-53 = 100) during 1958-61 as against 107 in the 1955-58.

It must be stressed, however, that the improvement in the recorded balance of payments in the first year after the revolution was primarily the result of reduced payments. Export receipts during 1958-59 were only a fraction higher than the record low level reached in 1957-58. The reduced payments were the result in part of lower Government expenditure on foodgrains imports which in turn reflected the success achieved by the new Government in their drive against hoarding and black-marketing of foodgrains. The private sector allocations had, however, to be cut steeply. Despite an increase in commodity aid imports (excluding food imports) the availabilities of imports in the private sector showed a marked decline. The shortages of imported raw materials and spare parts remained serious and continued to hamper full utilization of industrial capacity. It is only since mid-1959; that the Government has embarked on a policy of progressive liberalisation of imports.

(*Million Rupees*)

Year	Private import payments	Commodity aid imports (excluding food)
1957-58	837.7	235.0
1958-59	695.1	307.7
1959-60	908.3	519.7
1960-61 (July-March)	841.1	N.A.

Under the import policy for the shipping period January-June, 1961, the automatic licensing procedure (virtual O.G.L.) which was first introduced in mid-1960 was applied to 62 items. The automatic licensing facilities were available to 118 industries. Besides, 51 industries were licensed on the basis of 100 per cent of their assessed single shift capacity for all items of their requirements. It was estimated that four-fifths of the industrial sector had now been assured of their full import requirements[22].

There were strong indications already that the improved availabilities of imports were favourably influencing both domestic industrial output

22. Economic Survey, Government of Pakistan Budget 1961-62, p. 35.

and prices of imported manufactured goods. The decline in the prices of a number of imported commodities notably iron and steel and chemicals was recorded during 1960-61. The high profit margins on imported goods prevailing in 1958 had also been absorbed to some extent by the premium on bonus vouchers and higher tariffs on luxury items introduced in 1959-60. This suggests that the reliance on quantitative restrictions for restraining imports had considerably lessened.

The rise in imports had been made possible by the satisfactory level of foreign exchange reserves, recovery of exports as a result partly of the operation of the Export Bonus Scheme and substantial increase in aid availabilities. Exports (f.o.b.) at Rs. 1,759.4 million during 1959-60 were 22 per cent of the preceding two years. There has been a further rise during 1960-61.

Recorded Exports[a]

(*Million Rupees*)

	1957-58	1958-59	1959-60	1960-61 (Jan.-March)
Raw Jute	858.0	789.5	760.4	758.6
Jute Manufactures ...	132.8	144.7	223.3	243.2
Raw Cotton	246.4	223.5	171.5	160.8
Cotton Manufactures ...	33.9	68.5	230.4	105.5
Others	257.0	303.5	460.8	302.6
TOTAL ...	1,528.1	1,529.7	1,846.4	1,570.7

(a) On a mixed f.o.b. and c. & f. basis.

A basic expansion in exports of manufactured goods (cotton and jute textiles) was a major factor in the rise of export earnings between 1957-58 and 1959-60. Volume of cotton piece goods and yarn exports at 112 million yards and 80 million lbs. during 1959-60 compared very favourably with the export of 15 million yards and 3 million lbs. in 1957-58. Indeed the expansion in the exports of cotton piece goods and yarn over the period was much in excess of the rise in domestic production so that the domestic consumption was squeezed. The basic conflict between domestic requirements and exports thus continued even though the attraction of the exchange entitlement[23] and improved monetary balance in the economy tilted the balance temporarily at least in favour of the latter. The underlying fact was that the scope for expansion in cotton textile exports was seriously limited by raw cotton production which had remained practically stagnant over the last four or five years[24]. Exports of cotton manufactures actually fell rather sharply during 1960-61 from the high level reached in 1959-60, and the entire improvement in export earnings during the year was attributable to the exceptionally high prices of raw jute and jute goods which prevailed due to scarcity conditions.

VIII

Summary and Conclusions

Pakistan's balance of payments experience has in several ways been typical of underdeveloped economies attempting to achieve rapid economic progress. The balance of payments problems and foreign exchange shortages have been almost a permanent feature of the short-term economic outlook. The balance of payments disequilibria have owed their origin to all the three causes which we briefly referred to in Section 1, though their influence from period to period has varied greatly. On the domestic front, along with the structural changes in the economy, rapid internal monetary expansion and the resulting internal disequilibrium has operated on the balance of payments while in the external sphere the almost persistent deterioration in the terms of trade has been the major influence.

The analysis of Pakistan's balance of payments for the years 1948-50 suggests that payments difficulties emerged early. Pakistan inherited a very great dependence on raw jute exports to India. In the circumstances resulting from the trade deadlock with India following Pakistan's non-devaluation decision in September, 1949, jute sales to India received a severe blow. To some extent the loss of these exports was compensated by higher jute exports to overseas countries, but by the very nature of the almost monopolistic position of India in the world raw jute market, the possibilities

23. The bonus entitlement for cotton yarn exports was reduced to 10 per cent from 20 per cent in early 1960 and in January, 1961 cotton yarn was removed altogether from the Export Bonus Scheme.

24. *Raw Cotton Production*

		000 *bales*
1957-58	...	16,750
1958-59	...	15,220
1959-60	...	16,820
1960-61	...	15,820

(Source : Ministry of Agriculture.)

of such a diversion were limited. There can be little doubt that reduced jute exports to India tended to act as a constraint on raw jute production and thus there was a fall both in the size of Pakistan's jute crop and her share in the world jute production. Lower jute production has implied a net loss of exports because resources thus released could not be easily diverted to alternative uses (mostly rice). In any case, it can be assumed that the other uses were less efficient because raw jute has one of the highest monetary yields per acre.

Since mid-1955 the devaluation of the rupee and the development of export potential in jute goods has enabled Pakistan to push up her jute exports and to expand production. The average annual production of raw jute during the First Five-Year Plan (1955-60) at 5.7 million bales, however, still compared unfavourably with the output in the years immediately before and after Partition.

Like the reduction in jute exports, the secular deterioration in the terms of trade, has, also been an important structural factor adversely affecting the balance of payments situation. The terms of trade improved generally in the period from mid-1949 to mid-1952. This improvement resulted partly from Pakistan's non-devaluation decision and partly from the exceptional conditions created by the Korean War Boom. During 1950-51 the index had risen to the peak level of 124.8 (1948-49 = 100). Thereafter, however, there was an almost steady deterioration from year to year. By 1954-55 the terms of trade index had already dropped to 82.7. The net deterioration as compared to 1948-49 cannot obviously be explained either by the recessionary adjustments following the Korean Boom or the wiping out of the temporary gains resulting from 1949 exchange rate decision. The terms of trade deteriorated further between 1954-55 and 1959-60. This decline was attributable mostly to a rise in import prices and, therefore, was not the result of the devaluation of the rupee in August, 1955. By the same token the deterioration in the terms of trade was not a vehicle of pushing the volume of exports and, therefore, meant a net decline in the import capacity of the economy. The major factors behind the long-run deterioration in Pakistan's terms of trade were the exceptional weakness of the international fibres market, particularly the imbalance in the cotton situation and the existence of wage-cost push pressure in capital goods exporting countries.

The sizeable foreign exchange reserves and temporarily high export earnings during the period of the Korean Boom sustained balance of payments deficits upto 1952. Thereafter, the reliance was placed largely on quantitative restrictions on imports. The rapid industrial growth, particularly the development of the cotton textile industry following the imposition of restrictions, made possible net import substitution on a very large scale and in a very short period and thus greatly strengthened the balance of payments. Imports of cotton goods and yarn which had accounted for 33.8 per cent of private imports during the three years 1949-50 to 1951-52 were almost eliminated by 1954-55. This suggests, however, that benefits from net import substitution had already been largely utilised by mid-1955. Thereafter, the diversification of the production structure which came about actually implied greater susceptibility of the balance of payments situation to domestic pressures.

The serious monetary imbalance which developed during 1955-58 seriously aggravated balance of payments position which remained basically weak due to declining terms of trade. Devaluation under the circumstances had little effect. The failure, in this period, of import restrictions was evident because these restrictions were impinging directly on the private sector investment programme[25].

Since the assumption of power by the new Government in October, 1958, the immediate causes of the balance of payments disequilibrium have been removed. Inflationary pressures have been brought under control. The rate of monetary expansion has slowed down considerably and the growth in output has been satisfactory. Even in the relatively short period of less than three years this has led to a distinct improvement in the foreign exchange position. Exports particularly of manufactured goods have improved and have made possible a substantial liberalisation of imports, thus reducing reliance on quantitative restrictions as an instrument of control. Notwithstanding higher imports, the gold, dollar and sterling reserves at Rs. 1,256.6 million on 27th June, 1961 were nearly 75 per cent higher than the low level reached just before the revolution.

But while the immediate payments position gives no cause for concern, the basic balance of payments problems remain. A large part of the improvement in export earnings during 1960-61 has been due to the exceptionally high raw jute prices which led to a reversal of the declining trend in the terms of trade. This improvement in export price may not be sustained; a much larger raw jute crop is anticipated for 1961-62 and would inevitably tend to reduce raw jute prices. There is no reason to assume that the basic deterioration in Pakistan's terms of trade has been halted. Pakistan still relies heavily on the export of raw cotton and raw jute and their manufactures. International markets for these commodities may remain bearish for a considerable time to come. Furthermore the present balance of payments

25. For detailed discussion, *see* Parvez Hasan, *Deficit Financing and the Rate of Capital Formation in an Under-developed Economy: The Pakistan Experience* 1951-59 (To be published).

position is extremely dependent on foreign aid. This dependence is not only for development imports but also for current needs. The reduction of this dependence in the long run must be an important goal of balance of payments policy.

The fundamental condition for strengthening the balance of payments is the increase in exports. However, the expansion of exports involves formidable problems. The rapid growth in industrial output and exports does not depend on the availability of raw materials alone. The competitiveness of industries inevitably determines their growth and export potential. The basic problem now facing our large scale industry is cost competitiveness. Industrial development in Pakistan has taken place under extremely sheltered markets. There is need for all round cost reduction and rationalisation of the structure of industries. The outlook for agricultural output also remains somewhat uncertain. Even though the last two years have witnessed a healthy expansion in production, it is difficult to judge how far this was due to permanent improvements in agriculture. Advance in agricultural productivity would determine not only the expansion of export of commercial crops such as the raw cotton and raw jute, but also the extent to which net import substitution can be achieved by reducing foodgrain imports.

Finally it may be emphasized that due thought needs to be given to instruments of balance of payments policy best suited for strengthening the payments position in the long-run. For the present, the Export Bonus Scheme, which has been extended upto mid-1965, appears to be working satisfactorily. But complications cannot be ruled out. As mentioned above the export bonus provides a subsidy which is met through import profits. The liberalisation of imports is tending to reduce these profits and thus the extent of the subsidy. An undue fall in the premium on the bonus voucher is bound to affect exports adversely. What is more, the sharp fluctuations in the price of the bonus voucher increase uncertainty and render investment and output decisions hazardous. In the short-run a more conscious decision about the extent of the export subsidies required or feasible is necessary. For the long-run the desirability of a uniform exchange rate adjustment *vis-a-vis* the multiple exchange rates which are now implicit in the Export Bonus Scheme must be considered.

TABLE 1

PAKISTAN'S BALANCE OF PAYMENTS

(Rupees in Million)

Heads/Years (July-June)	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59	1959-60
Goods and Services												
Exports F.O.B. ...	+804.6	+869.6	+2271.7	+2137.2	+1297.5	+1268.1	+1180.3	+1812.3	+1621.4	+1425.3	+1440.5	+1759.4
Imports on Private A/c ...	—755.8	—749.3	—1169.3	—1758.7	—1110.7	—676.2	—676.7	—769.8	—800.9	—837.7	—695.1	—912.8
Imports on Govt. A/c	—	—	—	—	—	—	—	—	—	—	—	—584.4
Aid Financed Expenditure ...	—	—	—0.4	—2.1	—76.2	—138.3	—100.6	—371.7	—706.0	—1194.4	—656.7	—988.7
Non-Monetary Gold (Net) ...	—	—	—	—	—	—	+0.5	+2.0	—	+2.0	+5.4	+12.9
Foreign Travel (Net)	—8.6	—25.9	—26.4	—42.0	—30.3	—34.0	—45.7	—66.7	—71.5	—56.7	—23.2	—24.8
Transportation and Insurance (Net) ...	—27.4	—29.6	—99.5	—194.3	—118.6	—77.4	—69.2	—62.5	—87.4	—84.0	—73.2	—132.4
Investment Income (Net) ...	—7.1	—18.4	—19.0	—12.8	—12.6	—29.0	—4.3	—30.0	—31.1	—6.9	—19.3	—33.2
Government Expenditure excluding Official Donations (n. e. i.) (Net) ...	—434.1	—340.2	—428.4	—582.7	—524.9	—494.0	—357.5	—510.2	—891.6	—759.8	—672.7	—10.9
Miscellaneous ...	—0.1	—28.5	+71.1	+32.8	+60.8	+19.4	+6.5	+8.0	—4.8	—75.0	+72.8	+50.3
Total Goods & Services	—428.5	—322.3	+600.2	—422.6	—514.7	—161.4	—66.7	+11.4	—962.1	—1517.2	—621.5	—864.7

(Contd.)

TABLE 1—(*Contd.*)

PAKISTAN'S: BALANCE OF PAYMENTS

Heads/Years (July-June)	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59	1959-60
Donations (Net)												
Private Remittances & Migrants' Transfers ...	—26.9	—26.3	—22.6	—19.5	—28.1	—36.6	—24.0	—21.3	—13.0	—12.9	—0.2	—6.0
Official Donations ...	—	—	+0.4	+2.1	+76.2	+138.3	+100.6	+371.7	+706.0	+1194.4	+656.7	+988.7
Total Donations ...	—26.9	—26.3	—22.2	—17.4	+48.1	+101.7	+76.6	+350.4	+693.0	+1181.5	+656.5	+982.7
Total Current Account ...	—455.4	—348.6	+578.0	—440.0	—466.7	—59.7	+9.9	+361.8	—269.1	—335.7	+35.0	+118.1
Capital and Monetary Gold (Net)												
Direct Investment ...	+6.1	+4.1	+5.5	+13.5	+19.6	+22.5	+24.1	+8.7	+21.2	+28.3	+10.7	+14.1
Private Short-term ...	—	—1.1	—45.0	+6.3	—28.8	—4.6	—11.1	—11.8	+14.7	—5.8	—9.3	—6.9
Total Private Capital ...	+6.1	+3.0	—39.5	+19.8	—9.2	+17.9	+13.0	—3.1	+35.9	+22.5	+1.4	+7.1
Official Loans & Long-term Obligations ...	—	—	—	+2.4	+69.1	+42.4	+65.0	+100.6	+56.7	+62.1	+153.5	+79.0
Contractual Repayments ...	—	—	—	—	—	—1.1	—9.9	—10.4	—33.0	—32.4	—44.2	—41.1
Other Long-term, Short-term Claims and Monetary Gold(a)	+449.3	+345.6	—538.5	+417.8	+406.8	+0.5	—78.0	—448.9	—209.5	+283.5	—145.7	—163.2
Total Official & Monetary Gold	+449.3	+345.6	—538.5	+420.2	+475.9	+41.8	—22.9	—358.7	+233.2	+313.2	—36.4	—125.3
Total Capital & Monetary Gold	+455.4	+348.6	—578.0	+440.0	+466.7	+59.7	—9.9	—361.8	+269.1	+335.7	—35.0	—118.1

(a) Including Suspense Items.

Source: State Bank of Pakistan, Statistics Department, Pakistan's Balance of Payments, July 1948—June 1959, and 1959-60.

TABLE II

Recorded Exports Receipts[1]

(Rupees in Million)

Years (July-June)	Jute	Jute Manf.	Cotton	Cotton Manf.	Hides & Skins	Wool	Tea	Misc. Exports	Total
1948-49	390.4	—	237.9	—	49.7	35.7	—	90.9	804.6
1949-50	304.4	—	411.4	—	38.3	41.2	—	74.3	869.6
1950-51	863.0	—	1,095.4	—	74.5	96.4	—	178.4	2,307.6
1951-52	1,160.0	—	809.6	—	44.3	45.6	—	127.4	2,186.9
1952-53	532.6	—	648.1	—	44.8	51.4	21.7	43.0	1,341.7
1953-54	589.5	3.6	512.2	—	43.1	46.1	34.4	73.7	1,302.6
1954-55	594.6	11.3	343.4	—	31.6	55.8	49.0	130.9	1,216.7
1955-56	927.1	85.2	493.2	31.8	47.9	84.5	29.7	199.4	1,898.7
1956-57	808.5	101.9	362.0	95.1	50.8	95.9	48.5	137.9	1,700.5
1957-58	858.0	132.8	246.4	33.9	49.5	78.5	19.5	109.4	1,528.1
1958-59	789.5	144.7	223.5	68.5	60.5	80.6	16.2	145.9	1,529.7
1959-60	760.4	223.3	171.5	230.4	93.7	82.5	46.5	238.0	1,846.5
1960-61	—	—	—	—	—	—	—	—	—

[1]On a mixed f.o.b. and c & f basis (Source: State Bank of Pakistan, Statistics Department).

TABLE III

Recorded Payments for Imports* on Private Account

(*Rupees in Million*)

Commodities	1954-55	1955-56	1956-57	1957-58	1958-59	1959-60
Food ...	13.4	18.5	12.5	9.5	14.4	16.2
Beverages and Tobacco	14.4	11.6	9.2	7.4	6.8	14.4
Crude Materials: Inedible except Fuels	29.8	42.2	51.7	31.2	32.0	43.8
Mineral Fuels, Lubricants and related materials ...	117.0	175.5	211.1	228.5	231.6	231.3
Animals and Vegetable Oil and Fats ...	6.3	8.3	11.4	10.6	10.7	22.6
Chemicals ...	77.1	90.2	96.9	108.2	68.4	121.5
Manufactured Goods	207.3	249.8	217.9	192.3	131.3	197.6
Machinery and Transport Equipment ...	242.5	200.7	222.7	283.6	224.0	276.0
Misc. Manufactured Articles ...	20.5	25.7	34.4	29.2	25.6	49.8
Others ...	9.9	11.8	1.9	9.2	11.5	18.3
Total ...	738.2	834.5	869.5	909.5	755.8	991.4

(Source: State Bank of Pakistan, Statistics Department).

Note: Break-up prior to 1954-55 not available.
*On mixed f.o.b. and c. & f. basis.

TABLE IV

Gold, Dollar and Sterling Reserves

(Rupees in Million)

Years	AT THE END OF			
	March	June	September	December
1950	N.A.	958.5	870.7	941.6
1951	1,381.6	1,513.1	1,490.0	1,481.1
1952	1,344.9	1,045.7	662.3	606.1
1953	674.8	668.8	669.4	688.9
1954	719.6	630.5	560.6	631.0
1955	677.1	696.4	1,000.5*	1,156.2
1956	1,348.1	1,394.6	1,271.3	1,262.9
1957	1,257.0	1,200.5	1,029.4	1,021.4
1958	956.3	880.5	726.2	765.8
1959	908.4	1,043.2	1,121.2	1,227.2
1960	1,321.5	1,169.6	1,180.2	1,294.0

N.A.—Not available.
*Including appreciation of Rs. 296.6 million due to the devaluation of rupee in August, 1955.
Source : State Bank of Pakistan, Report on Currency and Finance.

TABLE V

Indices of Exports, Imports and Terms of Trade

(March 1948-April 1949=100)

Years (July to June)	Terms of Trade	Indices of Imports	Indices of Exports
1949-50	111.3	79.4	87.8
1950-51	124.8	84.5	106.2
1951-52	118.1	94.6	111.5
1952-53	84.7	77.7	65.8
1953-54	75.4	85.4	64.0
1954-55	82.7	81.2	67.1
1955-56	67.8	120.8	81.4
1956-57	63.4	143.6	91.0
1957-58	59.1	153.1	90.1
1958-59	53.3	154.9	82.5
1959-60	52.2	156.3	81.5
1960-61	—	—	—

Source: Central Statistical Office.

TABLE VII

Commodity Aid Imports* (Excluding Sugar, Wheat, and Rice)

(Rupees in Million)

Years		Value
1954-55	...	5.0
1955-56	...	186.5
1956-57	...	270.0
1957-58	...	235.0
1958-59	...	307.7
1959-60	...	519.7
1960-61		

*Accruals to counterpart aid funds.
Source : State Bank of Pakistan.
Reports on Currency and Finance.

TABLE VIII

Value of Total Food Grains Imported in Pakistan

(Rupees in Million)

Years		Wheat	Rice	Total	Against Own Resources	Against Aid & Loans
1951-52	...	10.58	—	10.58	—	10.58
1952-53	...	308.03	—	308.03	238.04	69.99
1953-54	...	153.02	—	153.02	19.90	133.12
1954-55	...	—	—	—	—	—
1955-56	...	35.71	25.58	61.29	0.40	60.89
1956-57	...	301.02	337.52	638.54	185.18	453.36
1957-58	...	276.08	267.67	543.75	217.51	326.24
1958-59	...	199.18	118.61	317.79	90.29	227.50
1959-60	...	336.68	181.29	517.97	180.66	337.31
1960-61	...	331.28	130.31	461.59	122.97	338.62

Source : Ministry of Food.