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PAKISTAN: APPROACH PAPER FOR PLANNING
POST FY 1987 U.S. ECONOMIC ASSISTANCE

SUMMARY

Pakistan's economic performance rebounded in 1985 after cotton and wheat crops in 1984 were damaged by bad weather and pest infestation. However, in spite of overall GDP growth of 8.4 percent (and 6 percent over the past seven years), Pakistan faces severe economic problems. Lower export earnings, steadily declining remittances and increased imports have sharply eroded foreign exchange reserves and added to the overseas debt burden. High government expenditures for defense, for domestic subsidies and for imports of petroleum and edible oils have resulted in a record budget deficit. The GOP continues to delay policy reforms which would liberalize the economy, deregulate the private sector, reduce subsidies and mobilize domestic resources. Meanwhile, Pakistan's capital infrastructure continues to deteriorate.

The U.S. economic assistance program was renewed in 1982, after a three year hiatus, following agreement on a \$1.6 billion package to be obligated over a six year period (FY 1982-1987). The objective is to help offset Pakistan's defense expenditures, shore up its balance of payments and address priority development needs.

AID has designed and approved twenty of twenty-three projects focused on agriculture, irrigation, rural development, energy and to a lesser extent, the social sectors. Technology transfer, institution building and private sector development are central to all of the projects. Through the projects and through annual PL 480 Title I agreements, AID carries on a wide-ranging policy dialogue with the GOP.

Our experience with the current program yields a number of observations:

1. Project assistance is slowed by USAID staff constraints, the complexity of U.S. and GOP regulations, lack of GOP counterpart financing and, in some cases, by GOP reluctance to accept policy and other conditions.
2. The projects are dependent upon hundreds of long and short term U.S. contractors dispersed throughout Pakistan. The number and location of contractors presents a management burden, a potential security problem, and an issue of acceptance by the GOP.

3. The AID/GOP policy dialogue covers a myriad of issues, ranging from disinvestment of public sector enterprises to energy pricing to irrigation cost recovery to opium poppy eradication. The policy agenda may be too broad for effective dialogue.

4. Only ten percent of our program supports the social sectors, where Pakistan lags behind the rest of South Asia, in spite of having the region's highest per capita income. With population growth running at close to 3 percent annually, with infant mortality at 120 per thousand, with female literacy at five percent, Pakistan's social sector performance since independence has been miserable. Our current aid levels are perhaps too small to make much of an impact. On the other hand, increasing them would accomplish little without greater GOP commitment. End Summary.

A. Pakistan Economic Situation and Development Performance

1. Overview

During the first half of the current decade Pakistan achieved rapid economic growth without excessive accumulation of debt. Economic performance during the FY 80-83 period reflected rising remittances, favorable weather, and improved policies. Then the pace of policy reform slackened as remittances and reserves peaked in FY 83. During FY 84, remittances fell, inflation rose, and there was a sharp decline in agricultural output exacerbated by weather and pests. This was reflected in lower overall growth and in the widening current account deficit. Rapid output growth resumed in FY 85, with the notable exception of wheat. However, pressures on the balance of payments increased sharply as remittances fell by 10 percent, leading to a further significant deterioration in the current account that was fully reflected in declines in foreign exchange reserves. For FY 86, the GOP anticipates GDP growth at over six percent, including an increase of 4 percent in agriculture, and a sixteen percent rise in exports. However, these projections appear overly optimistic, and in any case will not significantly improve Pakistan's foreign exchange position. In sum, the strong momentum generated during the late 1970s and early 1980s has weakened significantly. In the absence of favorable exogenous developments -- a resurgence of remittances, fortuitous terms of trade movements, dramatic increases in petroleum production, etc. -- renewed momentum depends on improved policies. Otherwise development progress will be sharply curtailed by resource constraints, particularly foreign exchange.

2. Macro-Economic Performance and Policy

Since the latter years of the 1970's economic growth in Pakistan has proceeded at an average annual rate of about 6.5 percent, which compares very favorably both with earlier years and with other countries. With population growing at about 2.9 percent, per capita income has increased at a relatively fast pace. The year-to-year pattern of growth has been fairly stable, except for a decline to 3.5 percent in FY 84, which was largely compensated for in FY 85, when output increased by 8.4 percent. While the official data are limited in their accuracy and coverage, indications are that the rate of increase in unrecorded economic activity has been at least as high as official growth rates. Labor absorption has generally not been regarded as a major problem in Pakistan, mainly because of the large increase in overseas migration.

From the standpoint of sustainability the pattern of growth has been increasingly problematic, reflecting emerging foreign exchange and capital constraints. Between FY 78 and FY 83, growth in sectors that produce tradeable commodities was impressive, and merchandise exports grew more rapidly than imports. Remittances increased, the debt service ratio declined, and reserves rose. Since FY 83 these trends have been reversed. Investment performance has also been deficient. Gross fixed investment has grown more slowly than GDP; the quality of public investment has been poor; and maintenance of the existing capital stock has been inadequate. Private investment has maintained a relatively stable relationship to GDP, (about 5 percent) whereas the share of public investment has declined.

During FY 80 - 82 there were clear improvements in fiscal, monetary and exchange rate policy, reflected in a rising ratio of public savings to GDP, a steady decline in monetary growth rates, and a depreciation in the real effective exchange rate. By FY 83 inflation had fallen sharply, to single digit levels. However, monetary growth accelerated in FY 83 (reflecting the surge in remittances rather than excessive monetization of the deficit) and there was a substantial increase in the inflation rate in FY 84, which apparently was only partially reversed in FY 85. The real effective exchange rate has appreciated significantly since FY 83.

Balance of payments performance from FY 79 to FY 83 was quite positive, reflecting rapid average annual growth in merchandise exports (12.5 percent) and in remittances (20 percent). However, since FY 83 exports have been flat and remittances have declined by 17 percent. Imports grew by 10 percent per

year between FY 79 and FY 83, and then rose by 9 percent (total) from FY 83 to FY 85. The combined result of these trends has been sharp increases in the trade and current account deficits in each of the past two years. The FY 85 current account outcome was not much worse than in FY 82 but it is difficult to see where a significant improvement will come from unless effective policies to promote exports and curb imports are introduced, including first and foremost exchange rate adjustment. GOP trade projections for FY 87 at this point look very optimistic.

The export growth that occurred up to FY 83 was broadly-based, including both manufactured goods and primary commodities. Declines in exports of primary commodities, particularly cotton and rice, have dampened export performance since FY 83. Over the first half of the decade the share of manufactured goods in total exports rose sharply, and the share of primary commodities dropped.

Trends in the structure of imports include an increasing role for tea and edible oil over the first half of the decade; declining imports of wheat and fertilizer; and fairly stable levels of crude oil/POL product imports.

The debt service ratio (debt service as a share of current account receipts) fell during the early years of the decade from about 14.5 percent to 13.2 percent in FY 83. Since then it has risen significantly, to roughly 16.5 percent in FY 85, reflecting mounting debt service payments and stagnation in current account receipts.

3. Sectoral Trends

a) Industry/Manufacturing

Growth in manufacturing output has been rapid during the first half of the 1980s, but with a declining trend during this period. Growth in the FY 80-82 period was at about 11.5 percent per year, compared with about 8.5 percent in the FY 83-85 period. Manufactured exports increased rapidly in the latter 1970's and early 1980's, but have slowed more recently.

While the role of the private sector in investment and production has increased, the industrial sector in Pakistan is highly controlled and regulated. During the FY 80-85 period the GOP took a number of initial steps in the direction of liberalization and increased efficiency, but progress in terms of meaningful policy reform has been very slow. The Industrial Policy Statement issued in July 1984 represented more of a

statement of intent than specific concrete measures. Movement in the area of import liberalization has been uneven and generally slow. A "signaling system" designed to improve public enterprise performance has been instituted, but with undiscernible results so far. Divestiture activity has been limited. The GOP narrowed somewhat the range of investments subject to sanctioning, but coverage is still broad. Cost-plus pricing regulations govern a number of important industries, with adverse effects on efficiency. Exchange rate policy provided favorable incentives to manufactured exports in the early 1980s, but more recently has resulted in declines in competitiveness.

b) Agriculture

Agriculture dominates the economy of Pakistan. It accounts for 30 percent of GDP and 50 percent of all employment in the country. Approximately 72 percent of Pakistan's population of 93.3 million (1984) is rural based. During the GOP Fifth (FY79-83) Plan, agriculture grew at approximately 4.2 percent annually. Most of the gains have come from increased acreage and cropping intensity rather than yield increases. The four major crops -- wheat, rice, sugarcane and cotton -- accounted for a major portion of the agricultural growth.

Irrigation is the backbone of Pakistan's agriculture; increased agricultural performance has been directly related to an expansion of irrigated area. With the exception of wheat, crop yields are stagnant and remain below those achieved under comparable conditions in other countries. In 1982, Pakistan achieved self-sufficiency in wheat and sugar, although with respect to sugar, it was achieved at a very high subsidized price.

Prior to the Fifth Plan period, the Government's agricultural policies stressed large water sector projects (e.g., Tarbela, Mangla, link canals, and salinity control and drainage projects) and food and input subsidies (e.g., wheat, edible oils, fertilizers, pesticides, and water charges). Some essential requirements for increased agricultural production were relatively neglected: agricultural research, water management at the farm level, operations and maintenance of the existing irrigation system, and training and agricultural extension programs. This unbalanced approach, even though accompanied by substantial investment in agriculture and water, was considered a major factor in retarding agricultural growth during the 1960s.

Upon completion of a major study (IBRD/UNDP) of Indus Basin irrigated agriculture, the Government announced a new National Agricultural Policy (NAP) in February 1980. The NAP has since

guided government policies and investments. The major elements are: (1) progressive adjustment of prices of key agriculture inputs and outputs to reflect real resource costs and phasing out input subsidies and providing incentives for increased production; (2) transfer of certain operations from the public to the private sectors (agricultural inputs and ground water exploitation); and (3) reorientation of public expenditures to use existing facilities.

Since the NAP was issued, a number of actions reflect the new policies. Subsidies on pesticides have been eliminated in two provinces (Punjab and Sind) and are being phased out in the remaining provinces. Fertilizer prices have been raised on several occasions to bring them more in line with real costs. Water charges have been increased to reflect real costs. Crop support prices have been increased to bring them more in line with international prices.

Investments in water have emphasized rehabilitation, operation and maintenance of the irrigation system, while investments in agriculture have stressed grain storage, research and extension, improved seeds, credit facilities and rural roads.

As important as these developments are, their impact on agricultural yields has been below expectations. Part of this may be due to the fact that only 42 percent of the Fifth Plan's proposed expenditures for agriculture (excluding fertilizer subsidies) and 49 percent of irrigation (excluding repairs for Tarbela/Indus Basin) were actually achieved.

The potential impact of fertilizer, improved availability and control of water, and improved seed on agricultural yields in Pakistan is documented and well-known. However, the Government has as yet been unable to devise and implement an effective strategy for providing these inputs in adequate amounts with such supporting measures as information and credit.

Considering the economic importance of agriculture, the achievement of creditable growth despite adverse circumstances during the Fifth Plan period points to an increasing resilience in Pakistan's underlying economic structure. Undoubtedly the economy has benefited from government efforts in recent years to improve overall macroeconomic management and to begin removing market distortions. Over the longer term, sustained agricultural growth will only be achieved through increases in crop yields. Reforms to improve institutional support, pricing policies and public investment should receive priority. Pakistan's agricultural output must increase to meet increased

demand for food and employment. Growth in the Agricultural sector must sustain growth of 4 percent to stay ahead of the population growth (estimated at 2.9 percent) and generate the surplus necessary for overall economic development.

c) Energy

Crude oil and petroleum imports remain a critical factor in Pakistan's balance of payments and budget expenditures. Import volumes increased for both crude oil and petroleum products in 1983/84 compared with 1982/83 and total petroleum import costs represented 23 percent of total imports and 46 percent of exports. While this is down from the peak year of 1981/82, it is still a substantial drain on reserves, especially in light of the sharp drop-off in worker remittances. Energy is the largest single element in Sixth Five-Year Plan expenditures, accounting for over 40 percent of the total. The bulk of these expenditures are in the power sector where large investments will be necessary to meet the severe shortfall of electricity (load-shedding in 1985 reached 2000MW out of a system capacity of about 5000MW.) The economic and political disruptions from this situation are becoming more severe.

Pakistan is one of the largest oil-importing countries in the developing world, despite its significant natural gas, hydro and probable coal resources. Petroleum accounts for over 38 percent of total commercial energy consumption, while natural gas supplies about 41 percent and hydro 15 percent. Coal and nuclear supply the remainder. Traditional energy sources continue to play a major role in meeting requirements for cooking and heating and supply an estimated 40 percent of total energy consumption. A mix of wood, agricultural residues and dung is consumed that varies according to region and season. Pakistan has very limited forest resources and pressure on wood supplies is extreme. Pakistan wood imports amount to over \$100 million per year.

With sustained economic growth over most of the past five years, energy growth has averaged over 8 percent per year. Per capita commercial energy consumption in Pakistan is low relative to other developing countries at comparable income levels and the prospect is for continued steady growth in energy demand. Neither natural gas nor electricity supplies have matched demand. Until recently, government policy has been to insulate consumers from international oil price increases and provide natural gas and electricity at levels substantially below their economic cost of supply. Incentives for new exploration and production as well as conservation were inadequate. Over the past two years the government has moved to

raise natural gas producer and consumer prices and has signed an \$178 million Energy Sector Loan with the World Bank that calls for electricity tariff increases that will enable WAPDA to finance from internally-generated funds at least 40 percent of its investment program in FY86.

d) Social Sectors

Pakistan's social sector performance is low by South Asian standards, although its annual per capital income is the highest in the region.

Although per capita GNP approached \$400 in 1983, the country's rapidly expanding population suffers from lack of access to safe drinking water and sanitation facilities, low literacy and primary school enrollment, high infant mortality and short life expectancy. The following selected social indicators depict a nation enjoying high rates of GNP growth while, at the same time, neglecting its human capital:

Population	Pakistan	Low Income Average	Middle Income Average
Pop. Growth (% per year)	2.9	1.9	2.3
Crude Birth rate (per 1,000)	42.0	27.7	30.1
Crude Death rate (per 1,000)	15.4	10.1	9.5
Infant Mort. rate (per 1,000)	120.9	83.8	66.3
Health			
Percent Access to Safe Water	29.9	32.9	37.0
Percent Access to Excreta Dispo.	6.0	18.1	41.32
Pop. per hospital bed	1560.0	1066.5	1044.2
Pop. per nurse	5820.0	4793.1	2460.4
Years Life Expec. at birth	49.8	60.0	60.4
Education (1978)			
Adult Literacy Rate	24.9	53.4	72.9
Primary School Enroll. Ratio	56.0	97.4	102.0
Female Prim. Schoo. Enroll.	31.0	83.7	98.2

Pakistan's Sixth Five Year Plan for the period 1983-1988 proposed to address this situation by greatly increasing development expenditures in the social sectors.

The Plan placed education and training at the center of the country's development strategy. Public expenditures on education were to rise about 160 percent in real terms over

those of the Fifth Plan, increasing from 3.7 percent to 6.5 percent of total public development expenditures. The plan emphasized a rapid expansion of primary and secondary education, growing educational opportunities for girls and the launching of a program of mass literacy. Plan targets included universal primary education with all boys beginning school by the middle years of the plan and all girls by the terminal year. Mass literacy campaigns were to raise the adult literacy rate to 50 percent (covering 15 million people) by plan's end.

Plan priorities included health and population. The plan recognized that half of all deaths occur in children under five years of age from diarrheal disease, respiratory infections, measles and other childhood infectious diseases, which can be largely prevented. It noted that malnutrition is an important underlying cause of death in young children and that malaria and tuberculosis continue to be major public health problems for all age groups. The plan's principal objectives in health were to reduce infant mortality from 100 per thousand live births to 60 per thousand; to increase life expectancy from 55 years to 60 years, to immunize all children against infectious childhood disease; to eliminate third degree malnutrition among children; and to provide assistance by trained birth attendants to every mother during childbirth.

The population of Pakistan, currently estimated at 97 million, has increased by almost 40 million over the past 20 years. It continues to grow unabated at an annual rate of nearly 3 percent. This rapid rate of increase is the result of large reductions in the mortality rate unaccompanied by significant fertility decline. Illustrative population projections show that if the growth rate continues at present levels, the population will reach 135 million in the year 2000. During much of the fifth plan period, the national family planning program was inactive. The Sixth Plan called for a multisectoral approach involving active participation of the local community and all relevant government departments, public institutions and the private sector. The specific objectives were to increase contraceptive prevalence from 6 percent to 14 percent of eligible couples and to decrease the crude birth rate from 42 to 37.5 per thousand.

Sixth plan targets for increased social sector investment were ambitious, but the plan itself has now been drastically revised as a result of a shortfall in domestic resources. The social sectors have taken a disproportionate share of the cuts in planned allocations.

B. Current AID Strategy and Program

The Mission's FY 1986 Country Development Strategy Statement (submitted January 1984) is still valid and need not be summarized here. However, it may be appropriate to make the following observations:

The Pakistan program is heavily concentrated in agriculture, irrigation, rural development and energy. About ten percent of project assistance goes to the social sectors. (An education sector assessment scheduled for early 1986 could lead to changes in this percentage.)

The composition of the currently authorized program (by Mission estimate) is as follows:

Technical Assistance-----	11.85 percent
Training-----	4.52 percent
Commodities-----	62.83 percent
Contingency-----	3.39 percent
Other Costs (local expenditures)-----	17.41 percent

Sector by sector, the current AID strategy emphasizes the project approach to economic assistance, complemented by large commodity import programs in agriculture and energy. Project assistance depends to a great extent on technical assistance from hundreds of long and short term U.S. contractors. AID works in close coordination with the World Bank, the Asian Development Bank and other members of the Aid-to-Pakistan Consortium. The Mission conducts a continuous policy dialogue with the Government of Pakistan in the context of its 23 projects, in negotiating PL 480 agreements and through annual meetings of the Consortium.

Program Accomplishments

The program has provided critical balance-of-payments support to Pakistan, meeting year by year obligation targets: \$150 million (FY 82), \$250 million [FY 83], \$275 million (FY 84), and \$300 million (FY 85). Actual disbursements have been lower, due to the normal lag time between project design and implementation, due to the linkage of project assistance to policy and other conditions and due to GOP implementation bottlenecks. The project pipeline over the past year has grown from \$300 million to beyond \$500 million.

(Note: Specific instances of successful project implementation should be supplied by Mission, especially as these impact on project goals.)

1) Agriculture, Irrigation, Rural Development

AID concentrates over sixty percent of the current program in agriculture, irrigation and rural development, channelling assistance through seven relatively large and complex projects, through the \$375 million commodity import program and through annual PL 480 Title I agreements. AID focuses upon four subsectors: fertilizer, oilseeds, irrigation, and institution building for agricultural research and human resource development. Rural development projects focus on Pakistan's lagging areas: Baluchistan, North West Frontier Province, and the Tribal Areas. Opium eradication is a priority objective addressed through development efforts linked to GOP enforcement activity. AID provides assistance through the United Nations Fund for Drug Abuse Control, as well as through direct bilateral assistance.

AID-financed studies of fertilizer and edible oil policies have been completed and shared with the GOP. Study findings support recommendations that the GOP systematically reduce and eliminate subsidies and undertake other politically sensitive pricing and structural reforms. Reforms would encourage an estimated \$2 billion in private sector investment required over the next decade to sustain necessary growth in oilseed and fertilizer production. Reforms would also bring about annual savings of hundreds of millions of dollars in import bills by the early 1990's, while stimulating modernization and growth of domestic production.

AID agriculture assistance is carried out in close coordination with the World Bank and Asian Development Bank. The World Bank's sector loan for agriculture, now under negotiation with the GOP, contains conditions with respect to subsidies, user fees and other issues which are of direct relevance to the AID strategy and program. Medium term lending by the Asian Development Bank is increasingly concentrated on irrigation canal rehabilitation, command water management, agricultural research and other areas of AID emphasis.

Agriculture

Policy Reforms and Other Favorable Developments

a) Fertilizer

. Incidentals allowed for marketing imported fertilizer have been made uniform for both private and public sector distribution. Previously, private agents were at a disadvantage.

. Private distributors now pick up imported fertilizer at dockside rather than through public agencies in the provinces. This change benefits the private sector and makes distribution more efficient.

. Private distributors' share of imported fertilizer have increased from one-third to one-half (July 1984 - present). Under the 1985 ACE agreement, the private sector's share is to reach 60 percent this fiscal year.. As a result of the IBRD's policy dialogue with the GOP which the Mission reinforces, retail fertilizer prices were increased by 15 percent in March 1982 and 8.5 percent in June 1983.

b) Edible Oils

. In 1983, the GOP raised both producer and consumer prices for domestic edible oil, the latter by 26 percent. Further increases are needed to reduce subsidies and provide incentives to local producers.

. The GOP accepts in principle the need for greater private sector participation in the production of ghee. During the last five years, more than a dozen private sector plants have started operations, while two inefficient public sector units have closed. Under one of the self-help measures included in the 1985 PL 480 Title I agreement, the GOP has agreed to leave all future production expansion to the private sector. Implementation of this policy should reverse the current 65/35 ratio of public to private sector capacity within five years.

. Private sector distribution of edible oil is also being increased. Under one of the self-help measures included in the 1985 PL 480 Title I agreement, the GOP is committed to permit and publicize the free movement and sale of vegetable ghee among provinces and districts.

c) Water

. The GOP has agreed in principle to progressively increase water rates until O and M costs for the irrigation system are completely covered. Punjab increased water rates by 25 percent in April 1981 and is expected to approve further increases this year. Sind increased water rates by 25 percent in July 1982 and is increasing charges by another 10 percent this year. Baluchistan raised water rates by 25 percent in July 1984, and increases are also expected in the NWFP. At present, GOP collections, on average, are running at 45% of expenditures.

2) Energy

At present, almost twenty-five percent of the AID program goes for energy assistance. The current AID strategy aims at developing Pakistan's indigenous energy resources to meet growing energy demands in agriculture and industry, to reduce oil import dependence, to improve the efficiency of energy resource use, to expand on-farm production of fuelwood and other tree products, and to mobilize private investment into this strategic sector. The Mission is implementing four major projects and designing a fifth.

The \$30 million Energy Planning and Development project seeks to build a capacity for integrated national energy policy analysis and planning. In the past energy planning has been fragmented between the Ministry of Petroleum and Natural Resources and the Ministry of Water and Power. The project is also developing vital information on Pakistan's indigenous coal resource base and financing feasibility studies for Pakistan's first major power plant to be fired with domestic coal and to be funded by a consortium of private sector and government investors. In collaboration with the World Bank, the project has developed a national energy conservation program with the potential to save \$2.6 billion in energy costs over the next eight years.

The \$165 million Rural Electrification project supports improved management and efficiency in the power sector, as well as expansions of generating capacity. It aims to increase efficiency of Pakistan's thermal generating plants by 300 MW (out of present 1600 MW) within two years through rehabilitation. Together with the ADB, the project funds a large combined cycle gas plant that will come on line in 1986.

To support the entire energy sector, the Mission has developed a \$100 million, three-tranche Energy Commodities and Equipment project that helps cover foreign exchange import costs for both public and private sector organizations. The second tranche was contingent on the successful conclusion of the World Bank Energy Sector Loan. The final tranche will be contingent on GOP progress toward the Sector objectives.

The \$30 million Forestry Planning and Development projects seeks to improve national forestry and wood energy policy and planning capabilities of the central and provincial governments, with an emphasis upon research and extension.

Advanced feasibility studies are underway for an additional project, Lakhra Coal/Power, which, if approved, would be co-financed with the World Bank, the Asian Development Bank and

private investors. In energy as in agriculture, commodities represent the bulk of AID assistance in dollar terms, but AID projects in energy are critically dependent upon contract technical assistance.

Energy Policy Reforms and Other Favorable Developments

a) Energy Pricing

. Consumer electricity rates were raised 10 percent in June 1985, the first increase since FY 1982. The new tariff rate is part of an agreed upon formula which states that at least 40 percent of WAPDA's investment financing requirements in any given year will be met from user charges.

. Consumer gas prices have been raised five times since January 1982, including a 20 percent price hike in June 1984. Prices for commercial and industrial users were raised by an average of 50 percent in July 1985. The increases are part of an agreement expected to move consumer natural gas rates to two-thirds of the border price of fuel oil by 1988. After 1988, the GOP is to review measures to encourage consumers to use this resource more rationally.

. Distortions in the producer price of natural gas have been reduced to increase incentives for the exploration and development of new gas fields. Producers of new non-associated gas will receive 66 percent of the international price of fuel oil at main consumption centers, adjusted for the transport cost of gas, less a discount to be negotiated. This new formula comes into effect in September 1985.

. Reduced distortions in electricity and natural gas pricing is making coal more competitive as an alternative source of energy. Mission contacts with private coal mining firms suggest this change in relative pricing, combined with more stable and substantial coal demand, will increase the attractiveness of this important domestic energy source.

b) Energy Conservation

. The GOP has agreed in principle to embark on a national energy conservation program. The program is to be coordinated by ENERCON, a national energy conservation effort funded by AID which is to be given autonomy, high visibility, and a mandate to promote energy conservation throughout the country. Major activities will include planning, training, data base development, and technical support. The center will also prepare new initiatives and recommend policy reforms needed to encourage new conservation measures.

. Measures for undertaking energy audits in major industries in both the public and private sector are already underway. A program of energy audits in at least 20 of the largest public sector and 15 of the largest private sectors energy consuming plants is beginning this year. Work will be performed by local and foreign consultants and should be finished by 1987. With IBRD and AID support, WAPDA is also designing a comprehensive energy conservation program for its thermal power generation plants. Under a recent agreement with the Asian Development Bank, the GOP will keep energy losses in electric power generation at no greater than 27 percent through June 1986, and reduce them to 25 percent by June 1987 and 23 percent by June 1988.

3. Institutional Development, Energy

. With Mission support, the GOP has established ENERPLAN, a high level energy planning cell. Responsibilities include data collection and preparation of the energy component of the Seventh Five Year Plan. Research is to be policy-oriented and will include an examination of pricing issues as well as ways to increase use of Pakistan's indigenous energy supplies.

. Needed managerial and operational improvements in WAPDA, Pakistan's major public sector utility, are taking place. The Mission is sponsoring a series of studies of key issues such as financial management, personnel management, information management, power distribution, loss reduction, and load shedding. The April 1985 decision to divide WAPDA's power wing into two separate parts -- a Power Generation wing and a Transmission and Power Distribution wing -- is a direct result of the policy dialogue and suggests the kind of management changes needed for efficient operations. Over the next two years, the Mission's technical assistance team will help WAPDA reduce losses caused by administrative inefficiencies, which could raise revenues by as much as 25 percent.

3) Social Sectors

AID earmarks less than ten percent of the six year program for population and health. We have no program in the education sector apart from training programs which involve post graduate technical education. Training represents about five percent of the total AID economic assistance to Pakistan.

a) Population

AID's objective is to support the Government of Pakistan's policy to reduce the rate of population growth. Related to

this is the objective of reducing the excess infant and maternal mortality which is associated with high fertility. The core of the GOP's population strategy is supply of safe and effective means of contraception. On the demand side, GOP strategy involves provision of information, both through the mass media and person-to-person. The message emphasizes benefits of birth spacing and limitation and explains contraceptive methods.

In order to implement its strategy, the GOP (through the Population Welfare Division) has established a network of Family Welfare Centers (FWC), staffed by non-physician health personnel, who provide temporary methods of contraception. FWC staff are also expected to visit the homes of prospective clients in their area to provide information, counseling, and to resupply continuing users. Couples desiring a permanent method of contraception are referred to district or provincial hospitals, though availability of such services remains limited. The FWC also distributes contraceptives through pharmacies nationwide, where they are sold at a nominal price. Finally, a number of private voluntary organizations (PVOs) also deliver both permanent and non-permanent methods of contraception, though primarily in urban and semi-urban areas.

AID's assistance to GOP population program dates back to the mid-1960's. It continued uninterrupted until the end of 1977 when it was suspended because of serious concerns about poor program performance. Following several important organizational and leadership changes, the structure of a new program emerged in the 1980 Population Welfare Plan. On the basis of this and other encouraging developments, AID resumed assistance in 1982.

AID currently supports the GOP program through two bilateral projects and a growing number of centrally-financed projects managed by AID Cooperating Agencies. The Population Welfare Planning Project, most of which finances contraceptives, is designed to complement the considerable assistance provided by other donors. The Project includes funding to strengthen local institutions involved in planning, evaluating, and conducting research related to population. The Social Marketing of Contraceptives Project is to use the expertise and marketing network of an established private firm to greatly expand access to temporary contraceptive methods. Through a variety of mechanisms, the AID Mission is encouraging increased PVO involvement in the delivery of family planning information and services.

Population Policy Reforms and Other Favorable Developments

PC-1 approval of the AID-funded Social Marketing of Contraceptives project was received in April 1985. The project builds on private sector marketing strengths to increase the demand for and distribution of contraceptives. PC-1 approval means implementation of this pioneering pilot project can begin.

A nation-wide family planning publicity campaign began in April 1985 and included for the first time in many years a television and radio advertising campaign developed by commercial advertising firms. Approval of this media campaign is a major policy development and provides the kind of visibility needed to make family planning programs more acceptable and effective in Pakistan.

Establishment of an AID-funded National Institute for Population Studies (NIPS) in Islamabad was approved at the same time the PC-1 for the Social Marketing of Contraceptives was granted. The institute will monitor population trends, evaluate population programs, and offer policy guidance to both the Population Division and the Ministry of Planning and Development. Additional funding links NIPS to provincial population planning councils and should broaden the information and policy guidance role which the institution will play.

The GOP is now giving high priority to including NGOs in its population welfare programs. An NGO coordinating council was inaugurated in January 1985 and is supporting training and reviewing and approving numerous projects submitted by private voluntary organizations. Expanded NGO involvement in population activities throughout the country marks a change from past GOP policy in this area. The Mission is supporting this effort.

b) Primary Health Care

AID continues to pursue a long term strategy of support to the federal Ministry of Health for the expansion and improvement of rural health services. The focus is upon improved program management, training and provision of key preventive health measures: immunization and oral rehydration. Construction and commodities account for over half of the AID dollar assistance.

c) Malaria Control

Of \$40 million allocated for this program during the current six year program, nearly \$35 million is for insecticide and other commodities. AID also supports research on parasite

resistance to chloroquine and vector resistance to pesticide. About five percent of AID assistance is for training of GOP malaria program personnel.

4. Opium Eradication

Accomplishments

. With Mission support, the GOP developed a Special Development and Enforcement Plan (SDEP) to attract multilateral and bilateral support for a comprehensive development and enforcement program in Pakistan's opium producing areas. A Special Development Unit (SDU) to plan and coordinate all projects having opium eradication objectives was also established.

. The SDEP now receives international support, with funding from both multilateral (UN Fund for Drug Abuse Control) and bilateral (Italy and the United Kingdom) sources.

. Mission-funded activities in agriculture, infrastructure development and off-farm employment in the Gadoon-Amazai area of the Northwest Frontier Province (NWFP) are demonstrating that development programs can help reduce opium production. The first half of an enforcement plan for progressively banning poppy cultivation in the project area is being implemented on schedule.

. Poppy clauses have been included in all appropriate Project Agreements and have been invoked when necessary. For example, poppy crops in the area covered by the Bara Irrigation Scheme under the Tribal Areas Development project in the NWFP were destroyed in compliance with the poppy clause in that project agreement.

. Opium production in Pakistan was reduced from approximately 800 tons in 1978 to some 45 tons in 1984. Most of this reduction occurred when the GOP removed opium production from the irrigated areas of Pakistan in 1978, prior to the resumption of our bilateral assistance program. Recent indications suggest production may once again increase, although not to former levels. Enforcement is especially difficult in isolated tribal areas that have never been fully under government control, and even a successful crop diversification project in one area can be offset as poppy cultivation shifts to other areas. Opium produced in neighboring Afghanistan poses further difficulties and is probably the major source of heroin processed in or transported through Pakistan.

5. Private Sector Development

AID encourages private sector involvement, both U.S. and Pakistani, in all of its projects -- earmarking significant portions of its commodity import programs for Pakistani private sector borrowers who wish to import U.S. equipment. In addition, AID is developing a Commercial Finance and Investment Corporation (CFIC) to attract foreign private sector funds and technology to assist in meeting Pakistan's financial service needs. CFIC, which is to be privately owned and operated, would also provide techniques for more efficient use of domestic capital in Pakistan's recently reformed Islamic financial system. The elements of GOP macro policy upon which USAID is seeking to have sustained policy impact include:

1. Policies to curb new capital spending on public sector production enterprises especially in sectors where the U.S. is active.
2. Policies to limit capacity increases in existing public sector plants in sectors especially where the U.S. is active.
3. Policies which move Pakistan away from the cost-plus approach to regulating returns to private investors, with particular reference to sectors such as fertilizer where the AID program is directly engaged.
4. Policies which seek to provide a fair and competitive environment, or in the words of a recent demarche to the GOP by local bankers, a quote level playing field unquote for public, private and international financial institutions in Pakistan.
5. Policies to remove inequitable credit access currently favoring public sector enterprises over private enterprises.
6. Policies to properly price capital so as to reflect its opportunity costs.
7. Policies which remove administered prices to the maximum extent possible and remove barriers to private entry into industrial sectors.
8. Progressive disinvestment of inappropriate public sector assets, especially in the edible oil sector.
9. Equitable investment rules and tax treatment for private sector productive investments.
10. Equitable pricing of inputs (e.g., electric power) to private users.

11. Policies designed to enhance private sector resource mobilization.

C. Lessons Learned

The GOP/Donor Joint Task Force on Implementation is currently addressing impediments to the effective use of foreign assistance in Pakistan. Current estimates place the total donor pipeline in excess of \$5 billion at a time when Pakistan is under acute balance of payments pressures and is seeking ways to expedite the net flow of resources. The GOP preference is for more commodity and program (as opposed to project) assistance, and less burdensome conditionality.

In conjunction with the overriding issue of assistance flows, AID experience over the the past several years in the implementation of its program several years yields a number of related concerns and observations:

1) Management Concerns

A Mission assessment is scheduled for November 1985 and will address this topic in systematic fashion. However, it is clear even at this point that some consolidation of our current program is indicated. Twenty-one projects have been designed and authorized over the past four years through sustained intensive effort. Each project represents a complex web of conditions and agreements, accompanied by the standard comprehensive AID and USG regulations with respect to procurement and contracting. Given AID staffing constraints, given the slow movement of some projects, and given the GOP need for faster-disbursing balance-of-payments support, the number of projects should probably be reduced, with concomitant expansion of our commodity import programs and perhaps a sector loan program if these changes can be conditioned upon significant GOP policy reforms.

The heavy construction component across sectors (roads, irrigation systems, buildings, etc.) puts a severe strain on GOP design, maintenance, monitoring capability and has overloaded Mission engineering staff. Post FY 1987 planning must take this factor into account in proposing any expansion of construction effort.

-- USAID Staffing - There are eight DH officers in the Office of Agriculture and Rural Development managing and monitoring a \$610 million portfolio in addition to PL 480. The Energy

Office has a similar workload. USAID may be unable to manage its labor intensive projects and a further shift to other assistance modes may be indicated.

-- GOP absorptive capacity - This is a concern, particularly in the areas of technology transfer and manpower development. Pakistan's ability to produce human capital for agricultural and energy development is currently inadequate.

-- Recurrent cost - The GOP has limited ability to support various donor projects and to finance them once donor assistance is terminated. USAID must assess the advisability of entering into new project and program activities which will force the GOP into additional recurrent cost activities, i.e. increased numbers of permanent civil servants, additional management costs related to physical infrastructure, etc.

-- U.S. technical assistance - There has been increasing resistance on the part of the GOP to approve U.S. technical assistance for projects. This reflects negative appraisal of some U.S. technicians already in country as well as the high cost of U.S. technicians compared to those of other nationalities.

The contracting/procurement build-up severely strains Mission capacity, and the burden grows with the increase in program size and complexity. Contracting for Afghan humanitarian assistance will impose further complications. Post FY 1987 planning must come to grips with this problem in finding ways to reduce the contract/procurement burden while maintaining technical assistance and commodity flows.

AID project activity is dispersed throughout Pakistan's 900,000 square kilometers, but gives special emphasis to the frontier of Baluchistan, NWFP and the Tribal Areas where access is difficult for political as well as geographic reasons. Although the Mission has maintained regional offices in Peshawar, Quetta, Lahore and Karachi, at considerable cost and inconvenience, it is doubtful that such arrangements can adequately cope with the problems of project implementation.

2) Policy and Other Issues

The USAID July 1985 report, "Policy Dialogue Issues in Pakistan: Background, Accomplishments, Targets," contains a comprehensive overview of these issues. In brief, AID has made progress in identification and analysis of basic issues in agriculture (especially with respect to fertilizer, edible oil and water use policies) and energy (pricing, conservation and institutional development). Social sector

issues are less well developed. Narcotics control issues are well understood and action is well underway to resolve them. Private sector development will depend in large part upon action by the recently established GOP National Deregulation Commission and a GOP Disinvestment Committee.

Sector by sector, the situation is as follows:

a) Agriculture

GOP agricultural research strategy is unclear, with attention diffused among a myriad of topics.

-- The link between research and extension is tenuous at best. The weakness of the government extension service was demonstrated during the pest infestation which helped devastate the 1984 cotton crop.

1. Fertilizer

Pakistan has been highly successful in developing a domestic fertilizer industry. Fertilizer use has increased 1,000 fold since the late 1950's, and commercial fertilizer is used by 70-85 percent of Pakistan's farmers. Nonetheless, several problems -- including expensive subsidies, production surcharges which discourage private sector expansion, and uncoordinated policy formulation -- constrain more rapid growth of the industry and impose a heavy financial burden on the GOP.

The Agricultural Commodities and Equipment (ACE) Program serves as the Mission's main vehicle for addressing policy issues in the fertilizer sub-sector. Mission-funded fertilizer studies provide the analytical framework for developing the Mission's negotiating strategy and for defining conditions precedent and benchmarks included in the annual ACE policy performance. Major themes emphasized include deregulation and an expanded role for the private sector in the production and distribution of fertilizer.

2. Edible Oils

Domestic production of edible oils in Pakistan is stagnating. Imports have increased in each of the last several years and now cost \$500 million annually in scarce foreign exchange.

Approximately \$140 million is also spent each year in subsidies to keep the price of edible oils artificially low. Policy changes -- including deregulation and an expanded role for the private sector -- are needed to encourage domestic production

increases. The Mission is supporting such changes through the PL 480 Title I Program which finances about 12 percent of Pakistan's annual edible oil imports.

3. Water

Pakistan has the largest contiguous irrigation system in the world, with 40,000 miles of canals and 750,000 miles of publicly owned watercourses channeling water to 34 million acres of land. However, maintenance has deteriorated and the efficiency of the system is low. Inadequate attention to operation and maintenance (O and M) means canals and watercourses are not kept in good working order.

Under the Irrigation Systems Management (ISM) Project, the Mission emphasizes the need for more GOP attention to two main areas. First, irrigation O and M must receive adequate budgetary support. Second, this support should be financed by a rate structure that reflects the true cost of irrigation services. Since irrigation is a provincial responsibility, much of the AID/GOP policy dialogue takes place at the provincial level.

b) Energy

-- Energy pricing policy is a key issue in Pakistan. Pakistan is in the process of restructuring its key pricing formulas to provide rational and effective incentives for domestic resource development and efficient fuel mix and consumption decisions. The GOP has agreed to increase consumer prices for natural gas to two-third of the equivalent border price of fuel oil by FY 88. When the agreement was negotiated the border price was over \$6 per million cubic feet. By end of 1984, it was below \$5 per mcf. The price of fuel oil is falling rapidly due to oil price drops and programs to replace fuel oil in power generation. The Energy Sector Loan reinforces this formula. A key issue therefore is whether the government will use the falling oil prices to delay increases in consumer gas prices. Similarly, electricity tariffs must be increased to cover the costs of the large expansion of electric generating capacity needed to meet demand.

-- Related to the above is the issue of the best approach to expanding the electricity generating system. AID and the World Bank are carrying out computer scenario analyses based on various assumptions to determine the least cost generation expansion scheme and the appropriate marginal cost level to use in determining tariffs. Because of their large capital costs, key to the analysis are assumptions about the Kalabagh Dam,

Chasma Nuclear, and Lakhra Coal. It also appears inevitable that investments in imported coal and oil plants will have to be made to meet demand. In the short to medium term, the highest payoffs would appear to be in improving the efficiency and availability of the thermal plants. These plants are operating at 400 MW below their related capacities. A crash program could improve capacity by 300 MW within two years.

The power shortage is leading companies to buy their own generating capacity. The mobilization of private capital to meet electricity demand is an issue both in terms of feasibility and in terms of cost. Buying captive diesel power may reduce the shortfall but may be more expensive than other options. The Ministry of Finance has asked WAPDA to prepare a mechanism whereby private electricity producers can sell excess power to the WAPDA system. AID is sending a team to Pakistan in the near future to begin to assess this opportunity and transfer knowledge gained from the PURPA experience in the U.S. The potential for greater oil and gas development in Pakistan appears promising and it is essential to mobilize private resources in exploration and production to reduce direct drain on government finances. AID has been working with the GOP on approaches to investment in the Dhodak condensate field. The issue is what actions GOP must take to improve the climate for private investors and what role AID should play in furthering policy reforms. This is of critical importance in thinking through our post-87 strategy in the energy sector.

-- The Sixth Five Year Plan places major emphasis on village electrification. Only eight percent of Pakistan's rural population has access to electricity and only 16,500 out of 45,000 villages have been electrified. The Plan set a target of adding 4,000 villages per year over the plan period. AID played a critical role in convincing the government to reduce its target from 5,000 villages per year and in highlighting the need for attention to both the large energy losses in distribution, the tremendous load-shedding and the need to reform tariffs and promote productive uses of electricity. AID is continuing major assistance to the development of a Master Plan for rural electricity expansion. With the continuing power shortage, the expansion of the rural electrification system will continue to be a sensitive political issue rivalling that concerning large price subsidies to tubewells. Since tubewells account for 25 percent of total electricity consumption in Pakistan, the subsidies have tremendous impact on WAPDA revenues as well as upon the efficiency with which electricity is used. Management of the distribution system will continue to be a major concern during the post-87 period.

c) Population

Pakistan's population has tripled in 38 years and now approaches 100 million. The annual growth rate of at least 2.9 percent is the highest in Asia and one of the highest in the world. The need to lower this rate has long been recognized by the GOP, but little progress has been made. Sixth Five Year Plan (1983-1988) targets include an increase in family planning practice from 9.5 percent to 18.6 percent of married women of Reproductive Age, a reduction in the crude birth rate from 40.3 per 1,000 to 36.2 per 1,000, and a decline in the population growth rate from 2.9 percent to 2.6 percent by the end of the plan period. Given past performance, these goals are optimistic.

After twenty years of population programs in Pakistan, a number of issues continue unresolved, both with respect to supply of and demand for contraceptive services. On the supply side, most would agree that to date contraceptive services have yet to be made readily available, in a manner acceptable to clients (and in particular to women). Failure in most instances stems from the generally poor quality of program implementation as well as to faulty program design. While the socio-economic situation may place constraints on rapid increase in contraceptive use, there seems to be substantial latent demand for family planning. Variation in the level of receptivity to family planning has not been well documented.

Population Supply-Side Issues

(a) Instead of continuing to search for "the ideal" administrative structure for family planning, the GOP should concentrate on implementation of the current model with perhaps minor modifications. Major recommendations over the past 20 years have sapped morale, wasted money and contributed nothing to program effectiveness.

(b) There is a need to identify and to systematically address the bureaucratic and administrative constraints to successful implementation.

(c) A substantial number of poorly qualified, inappropriate, or uninterested officials have been assigned to various levels of the program. This undermines the morale and basic commitment of others involved in the program.

(d) Unrealistically high targets have generally had a negative effect. Again, such targets undermine morale and frequently lead to falsification of reporting.

(e) In a conservative Muslim culture, a delivery system which relies largely on clinic-based services, or on contraceptives available through urban or semi-urban pharmacies, will fail to reach the bulk of the target population. The Pakistan program lacks a culturally-acceptable means of delivering basic family planning services to rural women.

(f) Research and evaluation has generally been of little use to the program.

Population Demand-Side Issues

(a) The combination of poverty, illiteracy, high infant and child mortality, poor communications/transportation, and the status of women all militate against adoption of family planning in Pakistan. The same combination of factors has a direct bearing on the ability of the program to effectively reach the target population.

(b) An effective communications strategy in support of family planning must be based on knowledge of the target audience [i.e., market segmentation], and must emphasize the most important communication media (i.e., TV, radio, and person-to-person). Very little high quality client or consumer-oriented research has been conducted to date.

(c) Without relatively dramatic changes in the role and status of women, strong social barriers to demand for and access to contraceptive services are likely to persist.

In sum, though significant latent demand for family planning may exist, a carefully planned and well-implemented strategy is necessary to reach this group. Implementation must proceed in careful phases, with careful monitoring to permit continuous modification and adaptation. The most important lesson-learned in this sector may be that no amount of donor-financing will be effective in the absence of a strong and sustained GOP commitment and the absence of full community participation.

d) Health

Many of the supply side issues that affect the population sector also apply to government efforts to provide primary health care to rural areas. In general, rural health facilities are poorly staffed and grossly under-utilized. A concerted effort is needed to identify and address those factors which affect provider performance and client utilization. Since mothers of small children are the primary

health providers in Pakistan as in other South Asian countries, Pakistan must formulate a strategy to reach them with accurate, culturally sensitive information and services.

The issue of recurrent cost financing (and community contribution to health sector financing) has yet to be adequately addressed.

The Mission's policy dialogue on population issues emphasizes two broad areas. First, existing family planning programs need to be improved and should be based on more creative approaches. Examples include well-designed public media campaigns and greater private sector participation in order to increase the demand and distribution of contraceptives. Second, greater attention needs to be given to other social sectors including health and education. Lessons learned elsewhere strongly suggest population growth rates will not decline until improvements also take place in other fertility determinants such as improved literacy (especially for women) and reduced mortality rates.

d) Narcotics

The need for development-linked narcotics control commanded immediate attention following renewed U.S. economic assistance to Pakistan in 1981. The GOP has been kept aware of the importance the U.S. government attaches to this issue. AID strategy consists of two parallel but mutually supportive approaches. First, AID stresses the need for multilateral solutions and emphasizes drug abuse as a problem not only for the U.S. but for Pakistan and Western Europe as well. Second, the Mission seeks to demonstrate that viable alternatives to poppy cultivation do exist in even the most backward and isolated areas of Pakistan.

e) Private Sector Development

There is a wide gap between rhetoric and performance on private sector issues in Pakistan. Official statements often refer to quote deregulation unquote and quote liberalization unquote as well as the need for private sector involvement in a variety of sectors. The Sixth Five Year Plan (1983-1988) places great emphasis on the private sector's part in mobilizing new investment and assigns it a lead role in most areas of industrial expansion during the rest of the 1980s. Nevertheless, excessive regulation continues to place serious constraints on private sector initiative in Pakistan. So far, the forces for reform seem outmatched by the opposition.

CLEARANCES: ANE/SA: PMBoughton ^{prop} ~~(copy draft for museum comment)~~
 DAA/ANE: JNorris ~~(copy)~~
 ANE/DP: BSidman (Draft)
 ANE/PD: RVenezia (Draft)
 ANE/TR: BTurner (Draft)
 ANE/PD: PMatheson (Draft)

DRAFTED: ANE/SA: DMutchler: ANE/DP: MCrosswell: ANE/TR: DOot:
 ANE/TR: DAlverson: ANE/TR: HGunther: al: 09/20/85: Doc. No. 6674j