BRIEFING BOOK

UNITED STATES ECONOMIC ASSISTANCE PROGRAM IN PAKISTAN

PREPARED FOR THE PAKISTAN BANKING TEAM

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TABLE OF CONTENTS

PART B - AID, THE HISTORY OF U.S. ECONOMIC ASSISTANCE TO PAKISTAN, AND RELATED BRIEFING MATERIALS

LIST OF TABLES

PART A

1982-1987 PROGRAM

PROPOSED ECONOMIC ASSISTANCE FOR PAKISTAN
FY 1982 - FY 1987
(Million U.S. $)

		FY 1982	FY 1983	FY 1984	FY 1982-FY 1987
I.	AGRICULTURAL INPUTS	60.0	60.0	70.0	300.0
	Fertilizer	(34.0)	(40.0)	(30.0)	(197.0)
	Agricultural Equipment	(26.0)	(20.0)	(40.0)	(103.0)
II.	AGRICULTURAL PRODUCTION, DISTRIBUTION AND STORAGE	0	0	5.0	35.0
III.	RURAL ROADS*	0	0	0	40.0
IV.	ENERGY DEVELOPMENT	8.0	70.0	61.0	448.0
V.	WATER MANAGEMENT	7.0	33.5	19.4	100.0
	On-Farm Water/Planning	(7.0)	(3.0)	(0)	(10.0)
	Canal Rehabilitation, Anti-Waterlogging & Salinity Programmes	(0)	(30.5)	(19.4)	(90.0)
VI.	AGRICULTURAL EDUCATION, RESEARCH AND EXTENSION	3.2	0	9.0	88.2
VII.	POPULATION AND HEALTH	11.3	22.5	35.0	129.8
	Population & Rural Health	(9.8)	(4.8)	(28.3)	(85.6)
	Malaria	(1.5)	(17.7)	(6.7)	(44.2)
VIII.	PRIVATE SECTOR MOBILIZATION	0	0	0	50.0
IX.	BALUCHISTAN AREA DEVELOPMENT*	0	0	5.1	40.0
X.	TRIBAL AREAS DEVELOPMENT*	3.0	5.0	5.0	24.0
XI.	DEVELOPMENT SUPPORT TRAINING*	0	4.0	6.0	25.0
XII.	PROJECT DESIGN FUND	7.5	2.5	0	15.0
XIII.	PROJECT RESERVE	0	0	0	0
XIV.	PL 480	50.0	50.0	50.0	300.0
XV.	GADOON-AMAZAI AREA DEVELOPMENT**	0	2.5	9.5	30.0
	TOTAL:	150.0	250.0	275.0	1625.0

* Project Titles revised to reflect planned activities.
** This project was added to provide resources to support activities directed at eliminating poppy cultivation.

NOTE This Chart was presented originally by Mr. Peter McPherson, Administrator, Agency for International Development before the Subcommittee on International Security and Scientific Affairs; the Subcommittee on International Economic Policy and Trade; and the Subcommittee on Asian and Pacific Affairs of the House Foreign Affairs Committee on September 16, 1981.

(Updated August 1984)

CHAPTER I: BACKGROUND

A. The Origins of the Program

US economic assistance to Pakistan was suspended in 1979. This hiatus in our thirty year bilateral economic assistance relationship, however, was shortlived. Events on the regional and global scene in the period immediately following suspension of aid underscored the long-term strategic and political interests which have importantly shaped our bilateral relationship since the 1950's. The Iranian Revolution and the Soviet invasion of Afghanistan were primary factors leading to the re-establishment of our relationship with Pakistan. The objective was and remains to strengthen Pakistan's ability to defend itself against the threat arising from the Soviet invasion of Afghanistan. Even before the September 1981 agreement, Pakistan had taken the lead at the Islamic Conference and the United Nations in calling for the restoration of an independent and non-aligned Afghanistan. It was also recognized that the US had an important interest in supporting Pakistan's massive humanitarian efforts in providing sanctuary to what has grown to more than two million temporary refugees from the Soviet occupation of Afghanistan.

US initiatives to identify and define an appropriate assistance relationship began in the winter of 1980. Working level exploratory talks were held on both economic and military assistance. It was recognized from the outset that mutual strategic interests between the two countries depend upon Pakistan's maintaining a strong and modern defence capability buttressed by a strong and growing national economy. Agreement on a mutually acceptable package of economic and military assistance was reached in September of 1981. On the military side, the package spanned five years and had a total value of $1.575 billion (largely in FMS credits on near-commercial terms). The economic assistance package totalled $1.625 billion over a six year period. The combined economic and military package reflected the understanding of both parties that the equipment modernization programs on the military side would have short-term balance-of-payments (BOP) impacts which could be significantly offset by an economic assistance program with an appropriate mix of fast disbursing investments.

Under Secretary of State Buckley led an initial negotiation team which defined the broad parameters of a bilateral relationship with Pakistan to be supported by both military and economic cooperation. AID Administrator M. Peter McPherson, led the US team which negotiated with the Government of Pakistan a framework for programming $1.625 billion of economic assistance from FY 1982 through FY 1987. The framework included understandings on the sectoral composition of assistance, the broad outlines of some 20 investment packages which would be financed by the program and a number of technical issues relating to the mode of assistance. Explicit understandings included the principal that the bulk of resources would come from the Economic Support Fund (ESF) of the Agency for International Development, and that these ESF funds would be provided in the proportion of one third loan assistance (on AID's standard, highly concessional loan terms) and two thirds grant-assistance. It was also explicitly agreed that quick disbursing modes such as local cost financing (wherein the US assistance dollars buy rupees from the GOP to meet domestic project costs) would be an important part of the program and that mutual agreement on all investment decisions would be required before funds could be committed. The negotiations took place in the context of the regional political circumstances discussed above. The presentation to Congress by the Executive Branch requesting authorization for the resumption of military and economic assistance to Pakistan also highlighted these developments.

B. The Six Year Program at Mid Term

The years since Administrator McPherson negotiated the $1.625 understanding with the GOP have witnessed the rapid development of an effective, professional and cordial economic cooperation relationship between the USG and the GOP. The letter and the spirit of the understanding have been honored fully by both sides and AID is now implementing or completing design on a total of 23 projects concentrated heavily in two sectors: (1) Energy and (2) Agriculture and Irrigation. Pakistan has launched a new Five Year Plan spanning the 1983-1988 period which reflects and strengthens the development priorities identified and agreed upon in 1981. The unique character of the six year agreement has provided both sides with unusual and valuable flexibility to adjust AID's financial programming decisions to changes in the implementation requirements of Pakistan's development agencies. Where opportunities to move funds faster and more efficiently in one sector have necessitated short-term reallocations from other sectors, the six year program frame has permitted AID to be responsive without raising fears that downstream funding of later programs was being jeopardized. The rationale for AID's initial sectoral concentration has been borne out by Pakistan's performance since 1981. AID has been an active party to a rigorous but collegial policy dialogue aimed at assisting Pakistan to move away from the over-regulation of the economy which characterized much of the 1970's. The dialogue has been fruitful. Both past achievement and future goals in this ongoing policy dialogue are discussed below. In short, 1984 finds the second largest AID program worldwide well along in implementing the six year program identified in 1981. The major features of our cooperative investment program for the period through FY 1987 are clear and well understood by both sides. Shifts and refinements will occur, but we are very much in the mature design phase of this program.

C. Macroeconomic Review

1. Overall Growth Performance

The Pakistan economy has been growing at a steady pace since the advent of the current regime in 1977. The Zia government shifted towards a course of greater fiscal restraint, introduced more cautious economic policies and made modest moves towards economic liberalization. Real annual growth rates in GDP since 1977 have averaged more than 6 percent. The growth reflects a number of positive factors including policies that have improved price incentives, restrained budgetary expenditures, reduced deficits, emphasized completion of public sector industrial projects, adjusted exchange rates, improved the climate for private enterprise, and increased labor peace. These policies and circumstances have reduced inflation and increased foreign exchange resources. A five year period of generally favorable weather and a rising level of remittances has also contributed to sustained economic growth. Nevertheless, the economy is still fragile. Key areas of weakness include: (1) low savings and investment rates, (2) sluggish growth in agricultural yields, (3) an unresponsive public revenue system, (4) energy shortages, (5) a less than vibrant private sector, (6) vulnerability in terms of possible declines in remittances, and (7) weak public sector performance in key sectors such as irrigation and industry.

Table 1 sets out the growth rate by sector for selected periods and years since 1969. The acceleration since 1977 is pronounced and underscores the fact of economic mismanagement in the pre-1977 period.

TABLE 1

GDP GROWTH BY SECTORS, 1969/70-1982/83
(Annual growth rates in constant 1959/60 prices)

	1969/70-1973/74	1973/74-1976/77	1976/77 1979/80	1980/81	1981/82/a	1982/83/b
Agriculture	1.5	1.6	4.2	4.0	3.3	4.8
Industry/c	4.1	1.0	8.0	10.0	11.7	8.2
Construction, electricity & gas	6.4	8.0	9.1	6.7	3.1	5.5
Trade & Transport	5.1	1.6	7.9	7.2	7.3	8.3
Public Administration & Defense	9.4	11.5	8.0	6.4	1.6	0.2
Other services	5.6	5.2	5.6	3.9	5.6	5.6
GDP at Factor cost	4.1	3.3	6.5	6.1	5.6	5.8
Indirect Taxes less subsidies	- 4.3	11.3	11.9	11.7	-11.3	16.1
GDP at market prices	3.4	3.8	7.0	6.6	3.8	6.8

/a Revised
/b Provisional
/c Includes manufacturing, mining and quarrying

Source: Planning and Development Division/IBRD

The rapid growth represents economic recovery and consolidation as much as it does a genuine broadening of the productive base of the economy. There are no significant trends that can be detected from the aggregate growth figures other than a continuation of current rates.

Agriculture represents about 30 percent of GDP at factor cost and employs more than 50 percent of the economically active population. Small percentage increases in output have resulted in large absolute increases in income, consumption, input requirements, exports and savings on imports. Good weather, improvements in incentive prices, and increased availability of agricultural inputs have all contributed to these increases. Much of this gain has come from increased acreage and crop intensity, especially in sugar and cotton. Yield increases have been important only in wheat.

Growth rates in industry have been considerably higher than in agriculture, averaging about 9 percent p.a. since 1977. This growth has been concentrated at the extreme ends of the scale: in the large scale public sector and in small scale private sector activities. Domestic production of sugar, cement, fertilizer, vegetable ghee, steel and textiles has grown rapidly. The public sector continues to dominate these industries, although less so in the case of fertilizer and textiles. The private steel re-rolling mills and cottage sector textile mills have contributed to rapid industrial growth as well as a variety of small firms producing for export. Much of the growth in cement, sugar and fertilizer reflects public investment during the Bhutto era aimed at import substitution. The growth in refined sugar production reflects a doubling of sugarcane production brought about by very high incentive prices. The other industrial sectors expanded in line with overall trends.

2. Consumption, Investment and Savings

Pakistan is characterized by savings and investment rates which are relatively low for a country at its level of development. However, gross national savings did rise last year to 14 percent of GDP from the 11-12 percent average of the last five years. Private savings accounted for almost all the gain, rising from 7.8 percent to 12.5 percent; public savings are still only 1.6 percent. The jump in the private savings rate was due to special savings schemes that provided over 15 percent compound rates of return, tax free, for medium and long-term deposits. Private savings are more than double private investment with the obvious implication that newly mobilized private savings are used to pay for public investment needs. Private consumption declined last year as a percentage of GNP. Public consumption rose while gross fixed investment declined.

Investment rates also are low in Pakistan, particularly in the private sector. These rates have not recovered to the levels recorded in the 1960's despite the overall growth in the economy for the last six years. The loss of confidence has not been restored and is compounded by infrastructure constraints and continuing bureaucratic controls.

3. Public Finance/Monetary Aggregates

The cornerstones of the economic program of the GOP and of the recently-completed three-year IMF Extended Fund Facility arrangement have been first, control of government expenditures and, second, control of the money supply. Fiscal and monetary restraint are intended to reduce inflation and promote the growth of the private sector. The program has been effective at reducing total expenditures as a percentage of GDP. Unfortunately, the restraint has occurred mainly in development expenditures. Development expenditures only rose by 34 percent from 1970/80 to 1983/84, thereby falling from 9.2 percent of GDP in the former year to 7.0 percent in the latter. Current expenditures increased by 101 percent during the same period, with the share of GDP rising from 14.2 percent to 16.2 percent over the same time period.

Revenues have succeeded in holding a steady share of GDP, and this has translated into an overall deficit averaging over 5 percent of GDP. The percentage financed by inflationary bank borrowing has dropped below 1.7 percent. However, the GOP in the last two years has been able to do this by financing a growing share of the deficit from savings schemes, i.e., from private savings. This has been necessary because tax revenues have been growing at about the same rate as GDP due to the tax system's heavy reliance on customs duties on imports; import growth has slowed since mid-1981.

Domestic credit expansion during the last 3-4 years has fallen to half the average rate of the mid-1970's. This factor plus the slowdown in government expenditures and decline in the budget deficit have helped to bring about a reduction in inflation rates. The GNP deflator fell from 16 percent in 1973-77 to 9.8 percent in 1981-82; preliminary figures suggest a current figure of 6-8 percent. There may be an upturn in the near future, however, due to supply shortages of various food items and cotton and the major increase in foreign assets associated with the favorable balance of payments results in PFY 83.

4. International Trade and Balance of Payments

The trade account in Pakistan has been severely out of balance since the oil shock of 1973. In 1972/73, exports were 86 percent of imports. By 1982/83, this ratio had fallen below 50 percent (see Table 2). The deficit in the trade balance in the former year was less than 2 percent of GNP compared with 10 percent in the latter years. The large deficit obviously reflects the failure of exports to grow as rapidly as imports. Although higher petroleum volumes and prices were responsible for the large increases in imports in the 1973-75 and the 1978/80 periods, this does not explain the entire deficit. For example, net oil and oil products in 1981/82 were 27.4 percent of total imports and the figure has fallen slightly since then; petroleum imports were equal to about 49 percent of the deficit. In 1972/73, net oil products were 6.1 percent of total imports but were equal to 43 percent of a much smaller deficit. Non-oil imports rose by 420 percent during the period while total exports increased by 202 percent, a clear failure of exports to keep up with imports.

The last few years have been characterized by a flattening out of import growth. Exports, however, dropped sharply in 1981/82 and then partially recovered in 1982/83. Rice and cotton, the two largest exports, fell sharply due to price and volume reductions. Other exports also declined because of the world recession and the overvaluation of the rupee prior to January 1982. The delinking of the rupee from the dollar in that month and subsequent depreciation provided a stimulus to exports later in the year. Unfortunately, the increase in manufactured goods was offset by decreases in raw cotton and petroleum product exports (Pakistan exports surplus fuel oil).

The deficit in the current account has been much smaller than the trade deficit because of the large net surplus on invisibles. Workers' remittances account for virtually all of this category. Remittances in 1982/83 were $2,886 million which is more than total exports and much larger than interest payments of $424 million. Remittances have helped to keep the current account balance within manageable proportions. The current account deficit declined very little until 1982/83 when it fell sharply, largely because of remittances and stagnant imports. Both of these factors are unstable, however, and can change rapidly. The rise in edible oil prices and the failure of the cotton crop will cause edible oil imports to nearly double. Raw cotton exports have been curtailed for 1983/84 and yarn and cloth exports could also be lower. Remittances could be affected by the declining surpluses of the Gulf states and GOP planning estimates anticipate lowered growth rates of total remittances.

The current account deficit has been financed from three major sources: (1) long-term capital inflows (mainly foreign assistance), (2) IMF credits, and (3) drawdowns of foreign exchange reserves. Debt rescheduling in 1980-82 and commercial borrowing also were significant factors in the current account balance. The IMF credits were critical to maintaining reserves in the 1980/82 period and contributed to the large increase in 1982/83. The cessation of the EFF and a growing debt repayment schedule could combine with the trade effects to reduce the reserves almost as quickly as they increased.

TABLE 2

TRADE AND BALANCE OF PAYMENTS, 1978/79-1982/83
(Million current US Dollars)

	1978/79	1979/80	1980/81	1981/82/a	1982/83/b
Exports (f.o.b)	1,644	2,341	2,798	2,318	2,628
Imports (f.o.b)	3,816	4,854	5,563	5,691	5,532
Trade balance	-2,172	-2,513	-2,765	-3,373	-3,096
Workers' remittances	1,395	1,748	2,097	2,225	2,886
Current account balance	-1,110	-1,140	- 991	-1,530	- 433
As % of GNP:					
Trade balance	- 10.3	- 9.9	- 9.2	10.3	- 10.2
Current account balance	- 5.3	- 4.5	- 3.3	- 4.7	- 1.4
Long term capital (net)	635	837	581	730	1,145
Gross disbursements (official)	888	1,054	956	1,102	1,124
Amortization	- 235	- 305	- 516	- 492	- 407
Other (incl. private)	- 18	88	141	120	328
Other capital	414	272	410	818	435
IMF (net)	- 14	78	315	358	424
Other	- 71	290	336	274	11
Net reserve change	- 308	362	291	- 198	1,147

/a Provisional
/b Revised government estimate

Source: Ministry of Finance, Planning and Economic Affairs/IBRD

5. Macroeconomic Prospects

The Sixth Five Year Plan (FYP) has set ambitious growth targets. Sixth Plan projections are presented in Table 3 below:

TABLE 3

GDP GROWTH RATES
(Percent)

	FIFTH PLAN Actual	SIXTH PLAN Proposed
AGRICULTURE	4.4	4.9
Major Crops	(4.8)	(3.6)
Minor Crops	(3.1)	(7.0)
Other	(4.3)	(6.0)
MANUFACTURING	9.0	9.3
Large Scale	(9.7)	(10.0)
Small Scale	(7.3)	(7.3)
OTHER SECTORS	6.0	6.4
GDP (factor cost)	6.0	6.5
GDP (market prices)	6.2	6.5
GNP (market prices)	6.3	6.4

Source: Sixth Five Year Plan/Pakistan Economic Survey 1982/83

GDP is expected to grow more rapidly than GNP because of a projected slowdown in real remittances to a 4.3 percent rate of increase per year. The Plan calls for substantial changes in the amount and composition of investments and savings. The absolute amount of real investment is planned to be more than twice as large in the last year of the Plan as in PFY 1983. Investment as a share of GNP is supposed to increase by one-fourth. The rate of growth of private investment is planned to grow 25 percent p.a. overall during the Plan period, with investment in large scale industry growing at 34 percent p.a., agriculture at 27 percent and transport and communications at 33 percent.

Increased national savings are expected to finance most of this investment. The share of savings in GNP is supposed to rise from 12.6 percent to 16.6 percent during the Plan period. (11.0 to 13.1 percent for private savings). The consumption share, of course, will decline. Overall consumption is projected to rise at 5.4 percent annually compared to 6.4 percent for GNP. Private consumption will rise by 5.1 percent while public consumption will go up 7.5 percent annually. The combination of rapid private investment and savings will be difficult to achieve based on the experience of the last ten years. In PFY 1970, however, private investment was 7.3 percent of GNP which is close to the 8.0 percent called for in PFY 1988.

The Sixth Plan calls for a continuation of the budget deficits at about the same level, about 1.5 percent of GNP. Out of Rs 215 billion in the annual development plans, domestic bank borrowing will account for Rs 43 billion or about 20 percent of the total. Gross external resources are put at Rs 80 billion or about 37 percent. In 1982/83 gross external resources were expected to be half of development expenditures. The projected greater reliance on national resources will be a challenging target to achieve.

Aside from the difficulties associated with meeting saving and investment projections, the other major macroeconomic constraint is likely to be the balance of payments. The current account deficit could grow from 4 percent in PFY 84 to 5 percent in FY 88 and 6 percent in PFY 92 if exports and imports of goods and non-factor services grow at the same rate. The unfinanced gap quickly grows from Rs 175 million in 1984 to $1,400 in FY 88 and $4,400 in FY 92 based on trends.

CHAPTER II: SECTORAL POLICY OVERVIEW

While macro analysis helps to define the setting for AID assistance programs, and is particularly important in ESF programs which incorporate macro objectives such as BOP support, it is at the sectoral and subsectoral level that a project financing agency such as AID looks for strategic objectives and seeks funding opportunities which service those objectives. USAID/Pakistan has adopted a sectoral framework which is consistent with the framework GOP planners and budgeteers use to organize their own resource strategies. The essence of the sectoral frame is threefold: economic infrastructure, commodity producing sectors and social infrastructure. Non-economic sectors such as defense expenditures and public administrative overheads are consciously ommitted in order to highlight the elements of the economy and of the investment agenda which bear directly upon social and economic development. Table 4 sets the stage for an overview of sectoral performance and prospects. It shows GOP investment plans and the Sixth Plan's intended shift in priorities.

Outlined below are summary sectoral perspectives on all the three major sectors which bear directly upon the development prospects of Pakistan.

A. Economic Infrastructure

The economic infrastructure sectors dominate Pakistan's public investment agenda. The country's size and its large and growing population (which soon will exceed 100 million) pose impressive challenges in the selection of optimal investment paths from the competing claims of energy, transport, irrigation and communications. Although all are vital, AID shares the GOP view that energy should be first on the investment agenda. It is there that this overview begins.

1. Energy Policy Overview

The energy sector of the Pakistan economy is growing rapidly. It is critical to continued development. Per capita consumption of commercial forms of energy is only half of the average for low income countries. The traditional energy resources such as firewood, charcoal, animal and agricultural wastes meet about 40 percent of energy demand. Even though the share of energy in GDP is modest, it has become a binding constraint to growth in the rest of the economy. Tight gas supplies and a shortfall in electricity have caused substantial load shedding. This in turn has led to factory stoppages, and reduced irrigation. Load shedding has almost certainly lowered industrial investment, particularly in large scale manufacturing, because of the inability to obtain utility connections. Petroleum imports now equal about three-fourths of merchandise exports. Consumption expenditures are shifting toward energy intensity. The growth in energy consumption has been forty percent above the real output growth of the economy. This energy/output elasticity highlights the real cost of energy shortfalls in Pakistan, and underscores the need for management and engineering improvements in the system. The energy sector has moved to the top spot on the agenda of GOP planners and the large economic assistance programs in Pakistan.

TABLE 4

SECTORAL PRIORITIES FOR PUBLIC INVESTMENT
1978-83 Actuals and 1983-88 Planned
(current Rs billions)

	1983-1988 Planned		1978-1983 Actual	
	Amount	%of total	Amount	% of total
I. ECONOMIC INFRASTRUCTURE				
Energy	116.50	38.2	38.83	25.4
Water	32.10	10.5	15.77	10.3
Water excl Tarbela	(29.41)	(9.6)	(10.22)	(6.7)
Tarbela	(2.69)	(0.9)	(5.55)	(3.6)
Transport & Communications	57.52	18.9	35.21	23.0
II. COMMODITY PRODUCING SECTORS				
Agriculture	15.35	5.0	14.86	9.7
Less fertilizer subsidy	(12.35)	(4.0)	(6.06)	(4.0)
Fertilizer subsidy	(3.00)	(1.0)	(8.80)	(5.7)
Industry	20.50	6.7	25.40	16.6
Minerals	5.75	1.9	0.40	0.3
III. SOCIAL INFRASTRUCTURE				
Education and Manpower	19.85	6.5	5.64	3.7
Urban Development	15.50	5.1	9.00	5.9
Health	13.00	4.3	4.58	3.0
Population	2.30	0.7	0.60	0.4
IV. OTHER	6.63	2.2	2.52	1.7
TOTALS	305.00	100.00	152.81	100.00

Over the period 1972 to 1982, the supply of commercial energy grew at 7.5% p.a. During that period, the shares of total energy supplied by natural gas and hydroelectric power increased while those supplied by petroleum and coal fell. Despite this performance, consumption growth in recent years has outstripped supply, leading to growing petroleum imports. Despite substantial government and donor assistance, the energy gap will most likely widen.

Pakistan will, therefore, remain heavily dependent on oil imports to meet its internal requirements for commercial energy. Although oil has been produced in Pakistan for over 70 years, oil reserves appear modest. Until recently, Pakistan has been successful in developing its domestic natural gas resources in step with demand. However, demand has overtaken supply, and, despite some switching of thermal power generation to fuel oil, substantial load shedding was necessary during the 1981 and 1982 winters. The total fully proven coal reserves of Pakistan are some 640 million metric tons, (estimated reserves are greater than 1 billion MT) from which 1982 reported domestic production was 1.7 tons, a 4.5 percent increase over the previous year. The production of coal has expanded much less rapidly than other energy forms and currently supplies a lower proportion of total domestic energy requirements than it did two decades ago. Since large capital outlays and long lead times are involved in expanding energy supplies from coal, hydroelectric and nuclear resources, GOP's medium-term response to the prospects of continuing energy supply gaps is focused upon the accelerated development of Pakistan's proven oil and gas potential.

It is these longer lead time activities in coal-based and hydro-based energy which commend themselves to external financiers in the sector. The World Bank, the Asian Development Bank, the European bilateral donors and AID are all currently appraising potential capital investments in these areas. Resource planning by the GOP for the second half of the 1980's requires a reasonably firm picture of external resources for new energy investments. The energy section below explains AID's current involvement in gas and coal-based electric power generation and even more importantly, in the institutional and policy areas of the sector.

2. Water Sector Policy Overview

Irrigation is the backbone of Pakistan's agriculture. Improved agriculture sector performance has been directly related to improved levels of farmgate water delivery over the past five years. During this period efforts have focused on physical improvements to the irrigation distribution channels at the farm level in order to decrease water losses and provide a more equitable share to farmers at the tail end of channels. Despite these improvements, a major factor preventing higher agricultural production in Pakistan has been the lack of integrated management of water, as well as other inputs, by farmers, government agencies and others. Due to inadequate management, it is estimated that more than half of the water diverted into the system for surface supplies is lost. These losses, together with unpredictable variations in water supplies, cause considerable uncertainty at the farm level as to whether water will be available at periods critical to crop development. The situation largely reflects the poor condition of watercourses and the lack of arrangements effectively to ensure each farmer an appropriate share of available water. In response to this situation, substantial private investment has been made in groundwater exploitation and about 160,000 private tubewells have been installed. Nonetheless, the inability of the surface irrigation system to deliver an adequate and assured supply of water is responsible in large measure for the low crop yields currently achieved in Pakistan. Pakistan's agriculture is based on an extensive system of farming. Available water and other inputs are spread as widely as possible. Farmers find this preferable to intensive cultivation, which depends upon timely supplies of water and other inputs. Achieving management improvements will be a major undertaking involving the need to mobilize farmer participation through some 80,000 wateruser associations, re-orient the objectives and procedures of provincial irrigation departments, improve the effectiveness of extension, and improve management of the macro-level water delivery and storage system. Programs to increase the efficiency of water use are of the highest priority and ways are being explored to introduce them as widely and as quickly as possible.

The Sixth Five Year Plan lays out the GOP's threefold water strategy for the 1980's:

a. protection of fertile land and infrastructure from waterlogging, salinity and floods by completing repair work on Tarbela and the Indus Basin Program, giving priority to severely waterlogged areas having saline groundwater and replacing deteriorated tubewells;

b. improvement of existing irrigation and drainage facilities by canal remodeling, rehabilitation of the irrigation system, command water management, on farm water management and reorganization of the institutional framework; and,

c. extension of irrigation and drainage through new irrigation schemes, medium sized reservoirs, public tubewells in underdeveloped areas, and new schemes in Baluchistan and the Federally Administered Tribal Areas.

AID and the other major donors share the view that this approach is commendable but insufficient. It does not make explicit the necessity for bringing private sector resources and management into the water sector and neglects the crucial cost efficiency questions associated with the sector:

d. how to insure that the farmer has an economic incentive to use water efficiently;

e. how to insure that system managers in irrigation have incentives to allocate and deliver water efficiently;

f. how to insure that the system rewards maintenance and sound stewardship of public irrigation assets; and,

g. how to insure a sustained flow of revenues for irrigation O&M.

It is against this added agenda that donor resources will be increasingly targeted, although the GOP also is continuing to seek direct capital contributions to major irrigation and drainage projects.

3. Communications and Transportation Policy Overview

Independence left Pakistan with a vast physical territory and limited transport and communications capacity. Colonial investment in these areas was largely limited to the needs of military, and law and order agencies, with little consideration given to resource development. The past thirty years has witnessed slow and costly progress towards redressing this deficiency but Pakistan still lacks the road or rail base commensurate with its economic demand for transport. Limitations on the telephone, telegraph and microwave communications system are not only a hinderance to civil administration, but a significant constraint on economic activity - particularly industrial and commercial activity in the private sector.

Pakistan has set an ambitious agenda in roads, rail and telecommunication for the 1980's. Traditionally rail has taken the lion's share of new development resources, and rail and road have both been severely underfunded on the O&M side. Deteriorating rail service, decaying highways and rising commercial transport costs all reflect the cumulative effects of underbudgetted maintenance in this sector. Telecommunications have traditionally done less well in securing new investment resources, but have benefitted from relatively better maintenance and more adequate O&M funding.

In telecommunications, the GOP has established the following targets:

a. bringing all larger towns in every province into the automated dialing network;

b. meeting at least half of the unmet backlog demand for telephone installations over the next five years;

c. developing increased local manufacturing capacity for telecommunications equipment; and

d. improving financial management in the telecommunications sector.

The total cost of these programs is estimated by the GOP to be on the order of $200 million (in 1983 Rupees). This figure probably greatly understates the real costs of a program which involves a total new installed capacity greater than the entire installed plant now operating in Pakistan.

In the road and rail sector, GOP plans are similarly ambitious. Donor interest has however waned in these sectors because of consistent failure to address the recurring cost requirements of both existing capital stock and planned new investments. The IBRD is spearheading a move to sharpen government attention to these policy issues. AID is beginning a dialogue on management and recurring cost issues relating to rural roads.

The GOP is attempting to reverse the trend from rail to road, especially in the area of long-haul freight. Capacity expansion would stress optimal intermodal allocations based on relative transport costs and improved utilization of the existing system through better rehabilitation and maintenance, management and operational techniques. GOP policy makers indicate a desire for reducing O&M constraints through improved cost recovery, greater self-financing by public corporations, and inducements to the private sector to fund investments in roads, air freight and civil aviation.

Projects for new roads are to be limited to the opening up of isolated areas. The investment program will assign priority rankings based on actual traffic needs and projected economic returns. A major will would be for the proposed Second Carriageway for National Highway N-5 from Karachi to Peshawar, to the construction of which the private sector is expected to contribute about Rs 5 billion which is to be reimbursed from tolls. While the Plan rightly stresses the importance of maintaining and rehabilitating the existing road system, only about one-fifth of planned expenditures on national highways is for rehabilitation, the remainder being mainly for the Second Carriageway. A number of factors suggest that a reordering of priorities would be desirable: (a) available evidence suggests that rehabilitation expenditures have a higher benefit-cost ratio; (b) only a small proportion of the total length of the N-5 has a traffic density sufficient to justify construction of a second carriageway; and (c) Pakistan's construction industry and relevant government agencies do not have the capacity to carry out major programs of rehabilitation and construction simultaneously. To improve the efficiency of the highway system, the Government should undertake programs to strengthen and rehabilitate the existing system and to reduce truck overloading. It is in this area as well as in the area of maintenance and financial management of road assets, that foreign technical skills and donors resources are potentially most important.

B. The Commodity Producing Sectors

1. Agriculture Policy Overview

Agriculture dominates the economy of Pakistan. Accounting for some thirty percent of GDP and more than half of all employment in the country, it remains the cornerstone of any feasible development strategy over the next decade. At the same time, AID fully recognizes that economic growth is invariably accompanied by a declining share of agriculture in total output, total income and total employment.

Pakistan is still a decade or more away from the time when there will be an absolute decline in the share of the total labor force in agriculture. This process comes about classically from the interaction of two forces:

a. a decline in the domestic demand for non-food agricultural output which dampens production increases

b. the growth of demand which is limited by the decline in the proportion of household income devoted to food. This occurs as median incomes rise and discretionary consumption becomes more diverse

Neither of these forces is yet significant in Pakistan. Thus, near to medium term planning can operate on assumptions of strong domestic demand.

Despite the recent improvements in agricultural output, the last decade has been characterized by stagnating yields, with the exception of wheat. The disturbing fact is that, even for new varieties, yields have remained well below those achieved under comparable conditions in other countries. Much of the output growth in the last decade has been made possible by continued acreage expansion, especially in rice and wheat, as a result of extensive investments in the Tarbela Dam and in public and private tubewells to augment water availability. The response, however, to improved water availability, in terms of increases in cropped areas and cropping intensities has been inadequate. Overall production has been well below the potential implied by the inputs and technologies available. Given resource limitations, substantial increases in water availability and cultivated acreage are unlikely to take place. Increases in agricultural production, therefore, must be achieved principally through increasing per-acre yields. Technology and net capital investment will drive growth in the agriculture sector over the next decade.

The potential for increased agricultural production in Pakistan, notably through the more efficient exploitation of available resources and technology, is considerable. Recent studies in Pakistan conclusively demonstrate that increased inputs, especially fertilizer, combined with better timing of water releases and simple improvements in farm practices such as regular weeding and increasing plant densities, can substantially increase production in the short to medium term. However, longer-term growth requires a broadening of agricultural strategies to complement the provision of key inputs and ensure their efficient use. This will involve major efforts to strengthen the institutional framework for research, extension, water management and other programs and necessitates a reappraisal of priorities within the agriculture and water sectors. The need for these fundamental shifts in policies is recognized by the Government.

Despite a strong concensus among donors and the GOP on the critical role of technology (generation, application and extension of new technology), the institutional environment is weak. AID is the lead donor in the agricultural technology area, although the UN agencies and the multilateral development banks are looking to increase their financing in this sector over the balance of the 1980's.

2. Industry Policy Overview

The industrial sector of Pakistan has not been a significant part of the AID investment program either in the pre-1979 relationship nor in the 1982-1987 package of economic assistance. This reluctance is not because the sector is inconsequential. Indeed, large and small scale manufacturing employ more than three and one half million Pakistanis and accounts for some 17 percent of GDP. Textiles, food processing and other agribusiness dominate private sector manufacturing while government investment has been particularly concentrated in capital intensive areas such as steel, fertilizer, cement and metallurgical and chemical industries. Through AID involvement in such areas as fertilizer procurement, power generation, oil and gas exploration, and private sector industrial finance, we have opened a substantial policy dialogue with the GOP on matters of direct relevance to the industry sector.

The GOP has formally reversed previous industrial sector policies by assigning to the private sector the leading role in industrial development. To encourage the private sector, the Government: denationalized most agricultural processing as well as a few industrial units, introduced limited safeguards against nationalization, widened areas open to the private sector, restricted public sector industrial investment to the completion of ongoing projects, adopted a more liberal trade policy, and introduced a number of industrial incentives.

The Sixth Plan's industrial strategy places even greater emphasis on the role of the private sector. The major elements of the Plan strategy are: a leading role for the private sector in industrial development; a large increase in foreign investment; greater attention to export promotion than in the past; and, emphasis on the development of agro-industries, engineering goods and small-scale industries. While more than half of new industrial investment in the past decade was undertaken by the public sector, the Sixth Plan anticipates that only about 25 percent of industrial investment will be made by the public sector, with the remainder coming from private sources.

For the meaningful growth of the industrial sector, substantial policy and institutional reforms are essential. Aside from infrastructure deficiencies, which are discussed below and represent one of the major constraints to industrial development, improvements are needed in policies regarding incentives, regulations, finance and pricing. The Sixth Plan addresses the infrastructure constraint by increasing outlays for energy and water. Nonetheless energy shortages will continue throughout the Plan period. To minimize the adverse effects on the industrial sector, the Government will need to improve load shedding management as well as institute measures to encourage increased energy efficiency and conservation. To encourage efficient industrial development and to maximize the impact of increased private participation, tariffs, domestic indirect taxes and other incentives need to be rationalized to provide a generally lower, more uniform degree of effective protection to improve Pakistan's competitiveness in international markets. As part of this process, the liberalization of imports needs to be continued. Rapid industrial growth led by the private sector will require the removal of unnecessary Government regulations and a clear commitment by the Government to rely on market mechanisms for the allocation of resources. Deregulation is perhaps the most important element of GOP industrial strategy. A committee on deregulation has been formed and a number of important measures were announced in the 1984 budget. Much action on deregulation is still needed however to streamline the investment sanctioning process, and to set guidelines for foreign borrowing and contracts for the transfer of technology and employment. Deregulation in the financial sector is also a pressing need.

Pricing formulae in a number of key industries covering most public enterprises and part of the private sector (e.g., cement, fertilizers, petroleum products, vegetable ghee) involve a modified form of "cost plus" incentives. These incentives are inadequate to minimize operating costs, allocate resources efficiently, or encourage optimal location decisions. This approach attempts to regulate the producer's rate of return within a range of 15-20 percent (net of taxes) on net assets employed (or on equity or shareholder's assets) for a given rated capacity utilization. In order to arrive at the price to be allowed a specific producer, the desired rate of return is applied to total fixed costs divided by a fixed rated capacity, plus unit variable costs. In addition to setting the price, the Govenment may utilize subsidies, tariffs, indirect taxes and a "development surcharge" to obtain the target rate of return for individual producers. Both AID and the Embassy have suggested alternative, market-oriented approaches to price policy. We have underlined that the "cost plus" approach to pricing and the regulation of profits has costly drawbacks for Pakistan's development: the system provides insufficient incentive for efficiency, requires frequent reviews and negotiations in times of inflation, and eliminates the signaling function of the pricing mechanism. Although these formulae often create incentives to produce at a level above rated capacity, there is no incentive to do so efficiently since variable costs are automatically covered. Despite the shift towards a larger private sector in industry the vast "sunk costs" in Pakistan's industrial public sector makes its performance a matter of concern. The efficiency of public manufacturing enterprises is also of critical importance for the balance of the 1980's because of their central role in key products (e.g., fertilizers, cement), effects on downstream industries (e.g., steel) and their heavy demands for credit. Public sector industries remain burdened by overcentralized decision-making, non-competitive managerial salary structure, weak financial structures, lack of incentives for improved performance and government price controls. The Government has recently announced the adoption of performance criteria designed to reward managers in relationship to performance achieved. While this bonus system does not address many structural problems facing the public enterprises (e.g., poor location, inappropriate technology), it will strengthen management's case for increased autonomy and decentralization as well as contribute to placing these enterprises on a more sound commercial basis.

Over recent years, the lack of infrastructure in areas including water, gas, electricity, roads and telecommunications, has been a serious constraint to industrial expansion. This lack is particularly acute because of GOP interest in promoting investment in "lagging areas" such as Baluchistan where, in many areas, these facilities do not exist and/or the supplying agencies do not find it economic to service individual project sites. Power failures are imposing substantial costs on industrial production and efficiency and will continue to do so in the coming years. New private investment sought in the Sixth Plan may be severely constrained by lack of on-site power.

AID and the Embassy are engaged in a low key but sustained dialogue with GOP on a number of industrial sector policy issues. Expanding the role of private sector participation in fruit and vegetable marketing has been a consistent theme as has been increasing the role of private sector fertilizer distributors. In vegetable oil processing, AID has been encouraging deregulation of the sector with progressive denationalization of oil processing plants and institution of a broad range of liberalization measures in oilseed production and processing. AID is actively working with the GOP to develop alternative sources of private capital mobilization for both debt and equity financing of private sector manufacturing. The infrastructure element of the current AID package, however, will probably be our largest tool for stimulating long-term industrial growth. Relieving power constraints and improving power sector policies which permit energy supplies and industry to grow in tandem are central goals of the current AID program.

C. Social Infrastructure

1. General Policy Review

The social sectors present more perplexing problems to development planners than any other area of the socio-economic scene in Pakistan. While most of the sectors described thus far have been presented in terms of moderate to strong performance with even greater potential if policies are better aligned, it is simply impossible to cast Pakistan's social sector performance in other than disappointing terms.

Despite a rhetorical tradition in all the five previous five year plans and a succession of policy pronouncements expressing the need to provide a basic safety net of social infrastructure for all of Pakistan's population, social sector allocations have been grossly inadequate even to approach that goal. Repeated sector analyses by the multilateral donors have found that primary schooling, basic health services, clean drinking water, basic sewerage, and special maternal/child health programs reach very few among the poorest 40 percent of Pakistan's population. While the expansion of "free" or "nearly free" health and educational services has been emphasized as a means to reduce the social service gap between the poorest 40 percent and the wealthiest 20 percent, these "free" services have only succeeded in transferring even larger shares of public welfare to the better off. The poor simply have not had effective access to these programs. Infant mortality levels and literacy levels closer to those of Nepal than to Pakistan's economic peers reflect continued poor performance in the social sectors.

Over the past decade the largest share of the budget for health has gone to the training of doctors and to hospital facilities, neither of which effectively serve the poor. The largest portion of the education budget has maintained the university system, to which only children from medium to high socio-economic households have reasonable access. This approach to providing social services has done little to reduce the gap between the rich and the poor. Because the status of the lower socio-economic groups has not improved, Government policies have also made more difficult the creation of an environment receptive to lower fertility. In the final analysis, the main reason that the poor have not been reached through past programs has relatively little to do with a failure of policy makers to understand the problems or with their inability to propose solutions but, rather, reflects a lack of firm commitment on the part of past administrations to implement proposed plans and an unwillingness to confront pressure groups who oppose implementation.

Against this bleak record, the Sixth Five Year Plan sets out very ambitious objectives in health, education and population planning. It promises a change in priorities and an increase in the proportion of the budget benefiting the poor through provision of social services. More importantly, it proposes innovative and low cost solutions, abandoning past top-down orientations and accepting the possibility of equally effective but less sophisticated solutions to the problems.

An even more basic departure in social sector policy reflected in the Sixth Plan is an emphasis on community management and local resource mobilization for social programs. The innovative role proposed for PVOs in family planning is a case in point. Local participation is proposed not just to help finance capital and recurrent expenditures but more importantly, to make programs more responsive to local needs. The Social Sector policy framework in the Sixth Plan offers communities at least some degree of participation in policy formulation and programming, as well as in the direction and control of programs. Experiments in other countries indicate that, when the communities are given responsibility for their own programs, those programs tend to be more effective and responsive to the needs of the community. Pakistan, however, is turning towards a more community oriented approach to social investment at a time when the local institutional base is very weak. Accordingly, the challenges to successful innovation are great.

Providing social services for the poor is not an easy task. It demands strong commitment and direction on the part of the Government, more coordination between central and local governments, and participation of the population. Improved quality of life is necessary not only for the material wellbeing of the existing population but also as the basis for attitudinal changes toward fertility which can lead to lower levels of population growth which, in turn will eventually make Pakistan's long range development objectives more achievable.

The Sixth Five Year Plan reflects a new recognition in Pakistan that basic social improvements are necessary not simply for the sake of Pakistan's poor, but because they are a basic prerequisite for national development. Pakistan cannot continue to develop with a largely uneducated workforce, weakened by endemic disease and largely uninvolved in the planning of its own social development.

The goals of the Sixth Plan to double literacy and to nearly halve infant mortality are laudable. If achieved, they would bring Pakistan's social performance more nearly in line with its economic performance. The rhetoric is promising. The focus on community management and local resource mobilization is appealing. The reviews of the policy issues in education and in health which follow suggest, however that progress may not come easily. The population section of the also describes other difficult policy hurdles.

2. Education Sector Policy Overview

Perhaps in no other sector of the Pakistan economy is there such a divergence among (1) public rhetoric, (2) public policy, (3) sectoral performance, and (4) political realities than in the education sector. Like most developing countries, Pakistan embarked upon independence with an education system designed by colonial authorities to train sufficient numbers of clerks and middle level civil servants to keep the recurring cost of colonial administration manageable. The system was also intended to train a small indigenous elite to play a broader, but essentially conservative, role in the social and political evolution of the colony. Unlike the experience of many other LDCs, however, political forces in Pakistan have tended to perpetuate these colonial orientations of the system. The results of thirty five years of independent management of the education system in Pakistan are a literacy level under 25 percent and primary school participation rates under 50 percent. These results have not passed unnoticed by Pakistan's education sector planners and policy makers. The National Education Policy published by the Government of Pakistan in 1972 after a lengthy sectoral assessment concluded that economic growth had been stunted by Pakistan's imbalanced educational investments and laid out a bold policy framework for education over the coming decade (1972-82):

a. the goals of the education sector were to improve income distribution and to contribute to national economic growth objectives

b. to achieve this end, development expenditures on education were to increase by 33% annually over the decade. Recurring cost expenditures were to increase by 15% annually over the decade

c. universal primary education would be achieved by the end of the 1972-82 period

d. the structure and content of the education system would be tailored to the economic and manpower requirements of the nation, moving away from the colonial foci of the past

Nine years after this ambitious National Education Policy of 1972 had been promulgated, the IBRD reported in the country assessment materials prepared for the 1981 Paris Consortium meetings that:

> Over the past 25 years, several themes have run through the successive five-year development plans: (a) universal primary education as soon as possible; (b) the development of the technical and vocational training to meet requirements for middle level skilled manpower; (c) improving the relevance of curricula in secondary and higher education to employment needs through greater emphasis on science, math and technology; and, (d) a more balanced development of the education system at all levels by reducing the dominance of higher education in resource allocation. These themes remain the broad objectives of the Fifth Five-Year Plan (1978-83) and the National Education Policy statement.

No more succint assessment of Pakistan's performance in education need be cited than the text which introduces the education component of Pakistan's Sixth Five-Year Plan (published in October of 1983). The Planning Ministry writes of sectoral performance since independence:

a. Thirty-five years after independence, Pakistan has a literacy rate below 25 percent and less than half the primary school going age children are in schools. These indices place Pakistan amongst the least developed nations, far below its rank acording to other criteria, including the aggregate measure of per capita income. This status must be changed for several reasons. Literacy enriches life and enhances the learning capability of workers. Access to primary education is the key to equality of opportunities. The quality of university students visibly immproves as result of wide choice provided by primary education. At the scale at which it persists, illiteracy is a blot on our social image and the chief impediment to our long-term economic and technological advance.

b. Except for the Second Plan, the performance of education sector in the planned and non-plan period ending 1977-78 remained utterly deficient. The Second Plan largely achieved its physical and financial targets. Overall, the participation rate of primary school age population improved from 17 percent to 48 percent during the first thirty five years of our independence.

c. During the last year of the Fifth Plan, the position did improve a little as a result of the implementation of the Priority Sector Special Development Programme of Primary Education in the last year of the Plan. The mosque schools opened during this year of the Plan alone constituted 45 percent of the total primary schools opened during the entire Plan period. Despite higher investment and realization of 80 percent of the target of opening new schools (excluding mosque schools), the enrollment increased only marginally. Worse, the participation rate actually declined from 54 percent in 1977-78 to 48 percent in 1982-83 and the female participation rate remained far less than the average. The problem partly emanated from inadequate allocation of funds but more from the absence of a suitable machinery for planning, implementation and supervision of schools. The share of government expenditure on education as a proportion of the GNP also declined from 1.8 percent in 1977-78 to 1.5 percent in 1982-83.

d. Moreover, while the base of the pyramid did not expand satisfactorily, its top was raised further by the opening of new colleges and universities. Four new universities were established against none provided in the Fifth Plan. Nothing could portray the upside-down state of our education priorities better than the Fifth Plan experience - the co-existence of the quantitative expansion of the consumptive higher education and the falling participation rates of primary education. The key note of the Sixth Plan strategy is to reverse this trend.

The policy changes envisioned in the Sixth Plan outlined below are appealing and exciting, but the sectoral record demonstrates that there is a powerful and conservative technocratic lobby within the educational establishment and a powerful political lobby both within and without government endeavoring to maintain the status quo. While there is a strong and able cadre of development planners who have an interest in designing, supporting and financing educational reforms, they have not yet built effective lines of communication to and influence with the reform-oriented constituency within the educational establishment. The aims and policy shifts envisioned by the Sixth Five Year Plan must find responsive chords within the education system itself to succeed. The second prerequisite for success is to identify and validate alternative models for implementing educational changes. The most exciting aspect of the Sixth Plan's approach to the dual problems of winning political support for reform and validating feasible models of educational system reform lies in the dramatically new (for Pakistan) emphasis on Community Management in education. The 1983-1988 education plan recognizes that neither the full financial costs nor the full management burden of primary schooling can be effectively carried by the Federal and Provincial governments and that both financial and managerial responsibility must be shared with local communities and with the organs of elected local government. It is proposed that responsibility for primary schools be transferred to local communities although it is not clear precisely how the support and financial resources of the local community will be mobilized. Sensitizing communities to the need for basic education will call for new talents and new operating skills on the part of school administrators, teachers and local leaders. The process is likely to be a long and difficult one but the potential benefits are great, not merely in terms of financial support but because of the improved quality of education that can be expected when communities have direct responsibility for establishing and maintaining local schools.

Community management of primary education, as presented in the Sixth Plan, will be reinforced by a policy of levying more realistic fees, especially for higher education. To the extent that enrollment in higher education comes disproportionately from wealthier groups, higher fees have the virtue of taxing the beneficiaries who can most afford to pay. In the interest of equity, this policy will be combined with expanded scholarships for underprivileged students. The move to allow re-establishment of private schools during the Sixth Plan again has the virtue of passing more of the burden of education on to those who can best afford to pay. The specifics of the Sixth Five-Year Plan, with the exception of the emphasis on community management and local control, are not unlike the goals of preceeding plans and preceeding Education Sector Policies in Pakistan. The seven major sector objectives in the new plan are:

(1) universal compulsory education with all boys of the relevant age group being placed in Class 1 by the middle years of the Plan and all girls by the terminal year; at first a minimum of five years of schooling will be obligatory, gradually raising over time;

(2) the use of special programs, such as mosque schools or mobile schools staffed with teachers of lower qualifications, to obtain improved coverage for scattered rural settlements;

(3) the continued expansion of secondary schools with increased emphasis on rural areas and the enrollment of women;

(4) a mass literacy program aimed at covering 15 million persons aged 10 to 19 years, using a variety of teaching methods and utilizing interested individuals, non-government organizations (especially women's groups), and local governments;

(5) a modified system of teacher training to meet shortages. Untrained matriculates are to be sent for training after recruitment, trained at periodic intervals over the first two years of service and paid the salaries of fully trained teachers;

(6) continued expansion of the training of engineers, technicians and skilled workers; and,

(7) consolidation of existing universities, with emphasis on improvement in quality, especially in the fields of science and technology.

To implement this strategy and to achieve these goals, the Plan proposes dramatically higher outlays for all levels of education, with the greatest increases at the primary level. Table 5 on the following page compares planned outlays for the sector over the 1983-88 period with actual expenditures in the preceeding five years.

Less clearly articulated in the Plan is the way in which these resources will be managed to insure that there is:

a. an increase in the efficiency with which education investment resources are used (more output per Rupee)

b. an increase in the quality of product from the system (higher educational valued-added per Rupee of investment)

c. an increase in "rated capacity" of the system to achieve the targets (e.g., adequate numbers of staffed, equipped and financially sound primary schools to achieve the doubling of output proposed for the next five years)

AID was not asked by GOP to make commitments to education sector investments in the 1981 negotiations of the six year program of US economic assistance to Pakistan. We likewise, did not propose programs in the sector because of the weak policy environment, the poor track record and the inevitably long lead times involved in mounting a meaningful sectoral intervention. The Sixth Five Year plan raises possibilities for a reappraisal of that initial sectoral choice. AID has commenced thinking about what would be the next steps necessary to frame a thoughtful decision process about AID involvement in the sector. The planned shift of GOP resources to the education sector invites us to reconsider AID investment priorities. In any reconsideration, account should be taken of the fact of low absorptive capacity in the very sub-sectors which are most important -- primary and middle schooling. This situation may make significant resource transfers arduous and frustrating undertakings if not infeasible. At the same time, AID recognizes that an educated population, a literate work force, and a cadre of technically skilled professionals are all pre-requisites to social and economic development in Pakistan.

TABLE 5

FINANCIAL ALLOCATIONS FOR EDUCATION

	Fifth Plan Expenditure	Sixth Plan Allocation	Percentage Increase	Percent Shares /a Fifth Plan	Percent Shares /a Sixth Plan
		(in 1983 Rs billion)			
Total-education & manpower	5.6	19.9	252	4.6	9.5
Primary, secondary and other basic education programs	3.0	11.4	280	2.4	5.4
Technical and vocational education programs	0.6	2.3	283	0.5	1.1
Higher and miscellaneous education programs	2.1	6.2	195	1.7	3.0

/a As percentages of total ADP

Source: Sixth Plan, October 1983

3. Health Sector Policy Overview

Pakistan in 1984 faces essentially the same health risks which prevailed at the time of independence in 1947. These include widespread, but preventable, communicable diseases; mild to moderate malnutrition, particularly among growing children and women of reproductive age; lack of, or inadequate, facilities for waste disposal and clean water supply; and high health risk for mothers and their offspring. The dominant disease patterns are amenable to simple treatment, both curative and preventive. Existing medical services, however fall short of fulfilling this purpose, especially for the rural poor, few of whom now have meaningful access to health care. Moreover, the existing facilities are frequently understaffed and poorly equipped; these factors contribute to their low utilization by the target population. The leading causes of death in Pakistan are common respiratory infections, diarrheal diseases, birth traumas, tuberculosis and malnutrition. The appropriate focus for health programs is not death prevention, but rather maintenance of productive life. The quality of morbidity data in Pakistan is poor; however, it is widely agreed that the major contributors to morbidity are gastro-intestinal, parasitic and respiratory diseases.

Health services in Pakistan date back to very early times, as evidenced by the still popular hakims and vedic practitioners. Western medicine introduced under British rule did not supplant this indigenous system but was limited principally to caring for government servants and their dependents in the major cities. Over time the British did provide some health services to the general population by means of hospitals and dispensaries established through local governments. As a result, the tradition was established of local government responsibility for medical care to the people. This pattern is seen today where a "fee for service" approach to public sector medicine is still unusual in Pakistan, although the (fee-charging) private sector accounts for at least four times (valued at cost) the total publically provided health services in Pakistan.

In viewing the total system of health services in Pakistan, practitioners tend to divide the health sector along technological lines: Western practitioners, traditional practitioners and Western and traditional dispensers of pharmaceuticals. Planners and resource allocators tend to divide the health sector along economic lines, distinguishing between public and private sector elements of the health service system.

The private health sector encompasses both Western and traditional medicine and is by far the larger part of the national health system. Besides some six thousand medical doctors in private practice there are an estimated 40,000 private sector indigenous health workers in Pakistan. Some four thousand of these are physicians or Hakims trained in the Graeco-Persian Unani medical system. Indigenous midwives, Dais, still preside over the majority of births in Pakistan.

About 500 physicians (Western system) join the ranks of the private sector medical practitioners each year, a number which would probably be larger but for the costs associated with initiating private practice and the lack of financial institutions (other than friends and family) to whom to turn for capital to launch a medical practice. Local manufacture, distribution and sale of pharmaceuticals is a thriving component of the private sector medical system, accounting for perhaps $200 million in turnover annually. As with private medical practice, private pharmaceutical sales are biased towards urban and peri-urban settings where consumers have higher incomes to support medical costs.

Health services in the public sector are provided through a network of about 600 teaching, district, and tehsil hospitals, about 1000 Rural Health Centers and sub-centers, some 2000 Basic Health Units, and numerous rural dispensaries and Maternal Child Health centers. Teaching hospitals are attached to medical colleges. There are an inadequate number of specialized tuberculosis, leprosy, and mental hospitals to meet the demand for curative and preventive services. About 95 percent of the hospital beds are in urban or peri-urban areas with all teaching hospitals, medical schools and post-graduate institutions situated in towns or large cities. New post-graduate medical institutions are being developed at Hazara and Multan, existing centers strengthened at Lahore and Karachi and a major new tertiary hospital is being built in Islamabad. There is, in addition, a new privately financed Aga Khan teaching hospital and medical school being completed in Karachi. These new medical schools come on stream at a time when more than one thousand doctors are unemployed in Pakistan, and the present medical education system is graduating more than 4,000 doctors per year.

For rural areas and towns, the GOP has begun (since 1977) to implement a health structure, called the Basic Health System (BHS). The aim of the BHS is to provide a systematic link between village communities and hospitals of the modern health system, with services planned to be provided as follows:

LEVEL	CLIENT POPULATION	PUBLIC FACILITIES
Village level	1,000 population	2 community health workers
Basic health units	10,000 population	1 doctor, 2-3 health auxiliaries
Rural health centers	100,000 population	3 doctors, 8 auxiliaries, 10/20 beds
Tehsil hospitals	380,000 population	2 doctors, surgical, medical lab and x-ray facilities
District hospitals	1,160,000 population	Main specialities
Teaching hospitals	Province	All modern facilities

4. Health Sector Finance

Three economic policy issues dominate the agenda for Pakistan's health sector:

a. cost recovery to insure that growth in health services is not forever doomed to move in line with increasing but grossly inadequate resource availabilities from Pakistan's public finances;

b. managerial efficiency and O&M financing to insure that both the massive sunk costs in capital plant and new capital investments in the health sector are efficiently and prudently operated to maximize returns and to extend the useful life of capital assets; and,

c. broadening the role of the private sector in both medical services delivery and pharmaceutical supply to provide a wider spectrum of quality to a wider clientele than currently serviced by the private sector.

The Government has announced its intention to increase cost recovery in health services. Fees for outpatient consultations in urban areas will be raised to Rs 5 per treatment by the end of the Sixth Plan period, and in rural areas the fees will be half as much as in the urban areas. For inpatients there will be Rs 10 admission charge, and a further Rs 10 charge per inpatient day (half of which will go toward the costs of diets). There will also be charges for x-ray and laboratory services. However, indigents will have their fees paid through Zakat funds, while no fees will be charged for preventive services.

The Government estimates that the revenues from these measures by the last year of the Sixth Plan period would be equivalent to over one-fourth of operating and maintenance expenditures, although there is no mechanism to feed these revenues back to the O&M budget of specific facilities. From the present situation where fees cover only 2 percent of O&M costs, this would clearly be a major increase. Other policy changes must still be made to ensure that service delivery is efficient and cost-effective. Optimal use must be made of both financial and human resources, especially in hospitals which consume the bulk of operating and maintenance budgets. AID has financed a preliminary examination of policy options for improved cost recovery in the health sector. This analysis points to a number of options beyond simply adding a fee-for-service to conventional public health operations.

In the area of improved O&M budgeting (which is, of course closely linked to the question of cost recovery) the Sixth Five Year Plan points to some important policy shifts over the 1980's. The Plan projects a growth in O&M expenditures to about forty percent of total health sector recurring cost expenditures by 1988. AID and the major multilateral donors estimate that this may still be insufficient O&M financing, but recognize that it marks major progress from a low base. A recently completed IBRD health sector assessment reached several conclusions about health sector finance policy in Pakistan:

(1) The development of the health sector should be planned around the certainty of limited operating and maintenance funds. This implies an investment strategy involving considerably less investment in new infrastructure and more attention to the development of appropriate training, organizational arrangements and logistics;

(2) there is scope for innovative financing schemes in the private health sector;

(3) the health services in Pakistan are certainly under-financed, but not as much as is sometimes argued (about 3.2 percent of GNP goes to health, but of this a large amount is spent in the private sector);

(4) there are significant operational and allocative inefficiencies with respect to both capital and recurrent expenditures;

(5) there are inequities in that about six times as much per person is spent by the Government on health services in urban as in rural areas;

(6) the proposed health investment program in the Sixth Plan is a substantial increase over previous capital expenditures in the health sector; but even the indicative allocation of Rs 14,000 million would be insufficient for the proposed projects as these have been costed in 1983 prices apparently without allowances for anticipated inflation (unlike the macro economic framework in the Sixth Plan); and,

(7) a more detailed analysis is needed of projected operating and maintenance budgets. Attention should be given to the feasibility of the planned 20 percent p.a. real growth rate in O&M budgets, and to how new financial resources will be linked to provincial operating and maintenance responsibilities.

5. Population in the Economy

a. Population Overview

The population of Pakistan was estimated at 81.5 million in mid-1980, a five-fold increase since the beginning of this century, making Pakistan the ninth most populous country in the world. Moreover, the annual average population growth rate (APGR) has accelerated from 1.7 percent in the first half of the century to approximately 3 percent. The size of the population is now doubling approximately every 23 years. This explosive rate of increase is clearly unsustainable both from an economic and a social point of view.

Current estimates indicate a crude birth rate (CBR) of 41 per 1,000 population and a crude death rate (CDR) of 12 per 1,000. Although there is evidence of a decline in fertility from an average of 7.1 children per woman in 1960-70 to 6.3 in 1970-75, several factors interact to maintain a high CBR and, consequently, a high rate of population growth. These factors include a young age structure resulting in a growing number of women of reproductive age; a low mean age of marriage of about 17 years and a concomittant long exposure to childbearing. The other determinant of population growth -- the rate of mortality -- still has considerable scope for declining further, given the high infant mortality (above 100 per 1,000 live births) and the prevalence of infectious diseases that can be controlled with better sanitation and other preventive interventions such as immunizations. This situation emphasizes the critical importance of increasing programs which will encourage lower fertility.

Based upon projections prepared by the Futures Group for their Rapid presentation on Pakistan, if the APGR remains constant, i.e., 3%, the population would grow to about 145 million by the year 2000, 200 million by 2010 and over 390 million by 2030. If, however, the APGR would drop to 1.6 percent by the year 2000 and 1.4 percent by 2010, the population would still grow to 125 million by 2000, 145 million by 2010 and over 170 million by 2030. The above assumptions assume that the net number of workers and dependents going abroad declines to 50,000 by 2000 and to zero by 2020.

The stress on the country's social and economic systems by rapid population growth is evident from the projected number of persons who in the next two decades will require basic needs in schooling, health care, water, electricity, housing and jobs. Currently less than one half of the 13 million children aged 5-9 years attend primary school. The objective of the Government of universal education will become increasingly more difficult to achieve as the numbers in this age group grow to 15-17 million 15 years from now. Requirements for new jobs at current levels of population growth would be 1.5 million in the year 2000 and 2.2 million in 2010. Even with a drop in the APGR to 1.6 percent by 2000, 1.0 million new jobs still would be required in that year and 0.9 million in 2010.

Pakistan was one of the first developing countries to recognize the problem of rapid population growth and to initiate a program intended to lower fertility rates. The program has operated in an environment in which most of the factors generally associated with high fertility rates have coexisted and reinforced one another, e.g., high illiteracy, poverty, isolation and few opportunities for women's personal growth, and prestige associated with a large number of sons. In addition to the antipathetic environment, the program over the past 20 years has been fraught with difficulties and controversy. Most problems have had their roots in frequent, sometimes ill-advised and sudden changes in program thrust and direction.

Evaluations of past program activities by the Government have concluded that the impact of the program on birth rates has been minimal. The small decline in fertility witnessed in the last 20 years may be attributed only marginally to program effects; other factors such as some increase in the age at marriage, the rural-urban migration, and some employment opportunities for women may have been equally influential in lowering fertility. The major program shortcomings identified included a dilution of efforts because of: thinly spread resources; weak management; faulty selection of staff; inadequate and unplanned communication efforts; inadequate training and supervision of field staff; and, a narrow family planning approach in an environment where behavioral changes must precede acceptance of methods and family planning practices.

b. Current Situation

The Government has recognized that, for development to succeed, it is essential that it is accompanied by changes in demographic behavior. Drawing upon past experience, a new Population Welfare Plan has been formulated and was approved by the Cabinet in November 1980. The new Plan is a comprehensive program which is focused on behavioral changes and aims to establish a "small family" norm within an acceptable socio-cultural framework.

Underlying the Plan is the premise that the GOP's population program should not be confined to single purpose birth control activities. Accordingly, the Plan's approach is multisectoral; it calls for the active participation of other government departments, autonomous agencies, and non-governmental (NGO) agencies each of which will be made responsible for implementing programs to inform and change attitudes towards family planning among the individuals that constitute their respective audiences or clientele.

The strategy also involves community involvement through local leadership to make the program more responsive to local needs and to enhance its acceptability. Effectiveness of the national population program will depend in large measure on improvements in such areas as education and maternal and child health care, and in programs geared to improving conditions of women. The Plan therefore aims to promote the support of these activities as part of broader government development policies.

The Population Plan emphasizes the need to inform and educate the public on population and family planning issues in order to encourage changes in attitudes toward family formation and acceptance of contraception as a means of planning families. Information, education and communication will be central to most of the activities of the population program.

c. AID Perspective on Population

Upon resumption of U.S. assistance to Pakistan in FY 1982, AID developed bilateral assistance projects in such areas as agriculture, energy, water management, rural electrification, primary health care and family planning. While the ultimate goal of each of these projects is to improve the country's economy and indeed the living conditions of the people of Pakistan, AID believes that the prevailing high population growth rate, unless checked, will erode whatever economic development can be achieved as a result of the AID development portfolio. Therefore, U.S. assistance for population activities is of critical importance and commands the highest priority in the entire Mission project portfolio.

AID is in broad accord with GOP strategies as adopted in the Population Welfare Plan, and has developed both short and long-term approaches based on the most current scientific knowledge of the processes of fertility change. AID's short-term approach is aimed at assisting the GOP in improving delivery of family planning services to clients through public sector programs as well as through Social Marketing of Contraceptives (SMC) in the private sector. However, to realize an effective and lasting fertility decline, AID's long-term strategy is based on a recognition that availability of effective family planning services is but one of the determinants of fertility patterns. In Pakistan, as elsewhere, the broader socio-economic factors which affect fertility are as important as providing family planning services. Changes must occur in such socio-economic variables as infant mortality, age at marriage, social and job status of women, household income levels, and increased education especially among females. Consequently, AID views its entire project portfolio as a means of bringing about changes in some of these broader fertility-related variables.

d. Current AID Population Program

The current 5-Year Population Welfare Planning (PWP) Project, signed in August 1982, provides $25.6 million ESF Grant and Rupees equivalent to $2 million. The PWP project will partially fund those components of the GOP Plan that fall largely in the "Support Activities" category of the Plan. While the Rupees will be used for construction of warehouses and research buildings, the ESF grant will be used for technical assistance, training, contraceptives, evaluation and local staff support for demographic surveys and other research proposals. As success of any population program largely depends upon continued availability of contraceptive supplies and services, $20.6 million or 80 percent of the ESF grant will be used for procurement of contraceptives. Technical assistance will largely be for research and demographic analysis.

Our strategy recognizes that active involvement of the private sector is indispensable to an effective program to deliver family planning commodities. Therefore, AID and the GOP have agreed to initiate another population project in the private sector for the Social Marketing of Contraceptives (SMC). The SMC project will draw upon the strengths of a well-established commercial system of retail outlets for promoting and distributing brand-name contraceptives through the private sector. AID plans to provide $20 million grant assistance for the SMC activity through FY 87. If this initiative is successful, additional funds will be provided in later years.

The AID project will directly and indirectly benefit millions of couples, mostly in low income groups in the urban as well as rural population. The AID-financed contraceptives, in order to be accessible to the poorer segments of Pakistan, will be distributed at highly subsidized prices.

D. Sectors of Special AID Interest

1. Narcotics Policy Overview

Pakistan is a signatory of the Single Convention on Narcotic Drugs and the 1971 Accord. In conformity with the Convention, Pakistan promulgated a Prohibition Ordinance which is strengthened by a ban on poppy production dating from 1979. A 1983 amendment to the Dangerous Drugs Act provides for a maximum punishment of life improvement and a miminum punishment of 2 years in prison and fines for trafficking in opium, coca leaf and their derivatives.

The reduction of opium production from 800 tons produced in 1978 to some 60 in 1982-1983 demonstrates Pakistan's increasingly firm policy against opium production. In this success, significant enforcement efforts were assisted by unfavorable weather conditions and low prices with the result that opium poppies were eliminated from all major irrigated areas. Production is increasingly limited to small pockets in remote and isolated areas of NWFP where marginal lands offer few economic alternatives and enforcement is extremely difficult.

To press the elimination of poppy production in these difficult areas, the GOP has adopted a policy of enforcement combined with development. This policy recognizes the limited economic alternatives available to the inhabitants of these areas and the consequent need to deliver development benefits while enforcing the ban on opium production. At the December 1983 Paris Consortium meeting, in pursuit of this policy, the GOP unveiled its Special Development and Enforcement Plan for the Opium Producing Areas of Pakistan (SDEP) which is intended to focus GOP efforts, with donor assistance, on the eradication of the remaining centers of poppy cultivation.

Implicit in the SDEP is a GOP policy that seeks international support for a comprehensive attack on opium production. Both AID and the Embassy recognize and support multi-lateralization of the effort as a means of marshalling the substantial resources needed for a comprehensive effort and as a way to demonstrate that it is not only the U.S., but also other Western nations and Pakistan itself, that suffers from Pakistan's production, processing, and trafficking in opium and heroin.

2. Finance for the Private Sector: A Policy Overview

The Sixth Five Year Plan places great emphasis on the private sector in mobilizing new investment resources and in taking the lead role in most areas of industrial activity over the balance of the decade. The private sector emphasis of the plan has been hailed in the international donor community, but experience with the government-dominated financial machinery of Pakistan has given rise to serious questions about the capacity of that system to service the private sector mandate of the Plan. There are significant policy problems in three key areas: (1) domestic financing for private sector activity; (2) equity financing for private sector ventures; and, (3) foreign exchange term financing for private sector projects. There are some interesting potential solutions to these financing constraints in the emerging Islamic Financial Sector which are mentioned briefly below, but which have yet to provide a sufficient track record to permit any meaningful assessment of their implications for Pakistan's private sector.

The growth and distribution of domestic credit in Pakistan is regulated by direct and selective controls. Although the State Bank can employ indirect instruments (liquidity ratios, reserve requirements and rediscount rate), it relies almost entirely on credit ceilings, combined with detailed suballocations. The chief instrument used to direct credit is the Annual Credit Plan which incorporates subtargets for public and private sectors, by economic sector, by large and small businesses, by priority sector financing schemes, by source among commercial and specialized banks and non-bank financial institutions. Within these overall targets, financial institutions can choose the firms and purposes for which they lend. Although efforts are made to monitor progress and improve coordination, this system of credit allocation suffers from a number of difficulties: (a) it limits the allocative functions performed by the financial system; (b) it is slow to respond to changing economic circumstances; and, (c) it can discriminate against the private sector groups when the needs of the public sectors are too large relative to total allowable credit.

In the area of foreign exchange financing for private investors, the constraints are quite serious. The two public sector institutions which have provided most long-term foreign exchange financing, PICIC and IDBP, have been constrained in the amounts of foreign exchange resources they can raise from international commercial sources by a history of internal financial problems. Both survive on concessional resources from the multilateral donors, and both institutions have substantial arrears on outstanding loans. The foreign and domestic commercial banks have not been provided with an interest rate setting which makes them a significant factor in overall term financing in foreign exchange. As a result, the majority of private sector foreign exchange term financing is actually undertaken on a short-term commercial basis with an unwritten commitment from the bankers to continually roll over the commercial notes as long as the borrower's credit standing remains strong. Needless to say, this is not a structure conducive to private sector undertakings with longer payout periods or substantial negative cash flows in the early years.

Equity financing in Pakistan is also an area where the policy setting is poor. Few local private investors are able to provide full local equity from their own resources. Investors argue that equity financing is at a disadvantage relative to other saving and investment instruments available in the country. The returns on government bonds, debentures and various public schemes are relatively high and, in addition, are free from tax up to a certain limit. Furthermore, given the high taxation on corporate savings, the potential for internal financing is limited. Foreign equity, on the other hand, is usually subscribed in the form of machinery and equipment and, much in the same way as suppliers' credits, imposes restrictions on project design and the choice of technology.

Some flexibility is being introduced into the financial system recently through GOP's process of Islamization. Financial institutions will be allowed to negotiate the terms and conditions for leasing and hire purchase and for a number of new financial instruments, such as Participation Term Certificates (PTC) and Musharika which are consistent with Islamic principles. PTCs have replaced debentures and enable the issuing company to raise capital for a specified period not exceeding 10 years excluding the grace period and entitle the holder to a share in the profits of the issuing company. Musharika is an arrangement by which banks provide working capital on the basis of profit and loss sharing rather than on a formal interest basis. Experience with Islamic financial instruments in some Middle Eastern countries suggest that they have the potential to reasonably and accurately reflect market conditions and the real opportunity cost of capital. This evidence, however, comes from settings where the traditional Western banking systems are strong and where governments have been traditionally positive towards the private sector. It remains to be seen whether the same market orientation will emerge in Pakistan's Islamic financial system, given the legacy of centralized government regulation and control of financial markets and the substantial bureaucratic forces opposed to a broadened role for the private sector.

Both AID and the Embassy have been actively engaged in discussions of financial sector policy issues with the Government of Pakistan. AID's emphasis has centered around the deregulation of financial institutions, and has used our proposed financing of a private sector financial intermediary as the basis for policy discussions with senior GOP officials. The Embassy has led a continuing dialogue on the vexing issues related to creating reasonable and fair competitive conditions among the foreign commercial banks, the domestic commercial banks and the public sector specialized financial institutions. Progress on both the AID and Embassy policy dialogues has been painfully slow, but we are satisfied that we have succeeded in sharpening the GOP's appreciation of the issues and in strengthening the hands of those elements in the GOP most favorable to financial deregulation and liberalization.

Despite this limited progress, a potentially extensive policy agenda faces the US Mission in the coming years. We remain concerned that Pakistan's financial sector, as currently structured, will simply prove incapable of responding to the private sector financial requirements of the Sixth Five Year Plan. Issues which remain include:

a. centralized allocation of credit, which largely preempts the intermediating and allocative functions of the financial system;

b. crossing interest rates (deposit rates rise while lending rates fall with maturity), which has created a short-term bias within the banking community;

c. a plethora of institutions with overlapping responsibilities, resulting in unbalanced and fragmented financial, managerial and technical capacity;

d. regulations which discriminate against foreign banks in favor of nationalized Pakistani banks despite the fact that the former banks' performance by any yardstick has been demonstrably superior to that of the nationalized banks;

e. an uncertain capital market characterized by limited trading, concentration on speculative share transactions, limited volume of new issues, and lack of a secondary market for corporate long-term financing through debentures;

f. several government-sponsored savings schemes which offer extremely attractive, tax-free rates of return, to the extent that commercial banks and the stock market are unable to compete, with the result that massive amounts of private savings are being diverted into financing the public budget deficit;

g. lack of programs to channel remittances from overseas Pakistanis (now totalling $3 billion per year) into investment, with the result that the vast majority of these resources is used for consumption;

h. an enormous parallel or "black" market of untapped (or at least unregulated) resources in the form of financial assets which are not declared to the authorities; and,

i. a need for a sounder technical base for financial "Islamization", and a better definition of its place in the overall system.

Since the Government owns all the major financial institutions, controls the rationing system used to allocate credit, sets interest rates and operates several attractive savings schemes, it enjoys a virtual monopoly in savings mobilization and allocation of financial resources. Although the availability of credit to the private sector has improved considerably as a result of the Government's improved fiscal performance of recent years, the dominance of the public sector in resource allocation nevertheless results in a residual allocation to the private sector. Moreover, the financial system as currently constituted encourages private sector activities characterized by risk aversion and short-term, quick-turnover transactions. Without some adjustments, any rapid resurgence of private investment such as the Sixth Plan envisages could be seriously threatened by inadequate financial support.

An important change which the GOP could make without great financial cost would be to begin moving away from direct credit controls towards an interest rate structure which reflects the cost of resources for long-term investment. This will be difficult to accomplish politically, given the impetus toward interest-free operations which Islamization has introduced, but it is essential if the GOP is to realize its Sixth Plan strategy of reinvigorating the private sector. By restoring some element of market pricing for financial resources, the need for mandatory credit ceilings would gradually be reduced. To channel credit toward priority private sector investments the Government could offer some type of refinancing formula for certain types of loans (small industry, agriculture, etc.) which would encourage the banks to seek borrowers and put any subsidy burden on the Government itself.

Short of wholesale interest rate liberalization, there are numerous adjustments in the structure of the financial system which would provide more incentive for banks to look beyond the short-term. There is also a need to review the roles of the specialized financial institutions and redefine their responsibilities. As it stands today, however, Pakistan's financial system may be unable to respond to the private sector mandate of the Sixth Plan. AID progress on developing our proposed private sector financial intermediary will provide an early litmus test of the prospects for policy change in this vital sector.

CHAPTER III: BANKING SECTOR POLICY REVIEW

A. Structure of Pakistan's Financial System

1. Overview

The financial system in Pakistan consists of: (i) five nationalized commercial banks (NCBs); (ii) eighteen foreign commercial banks (FCBs); (iii) two specialized commercial banks; (iv) eight development financing institutions (DFIs); (v) several insurance companies; (vi) two stock exchanges; and (vii) a housing finance corporation. The State Bank of Pakistan (SBP), the central bank, regulates and directs the financial system. Within the overall policies set by GOP and the SBP, the Pakistan Banking Council (PBC), a *de facto* regulatory agency of GOP, guides and regulates the functions of and flow of funds to the NCBs, while the Ministry of Finance monitors the operations of the other financial institutions.

2. Commercial Banks

With total assets of Rs 194.6 billion, or 80% of the assets of the financial system as of June 30, 1983, and a branch network of around 7,200, commercial banks play a dominant role. The five nationalized commercial banks (NCBs) together accounted for about 91% of deposits; 85% of advances, and 82% of commercial bank net profit after taxes.

Allied
Habib

The share of the NCBs in total commercial bank profitability has increased from 72% of the total profits of the system in FY 78 to 81.1% in FY 82. However, the profits of NCBs are still low and performance is mixed. The average return on risk assets last year ranged from 0.09% for Allied Bank to 1.0% for Habib Bank, about one-third of the average returns by foreign banks. While part of the problem is overstaffing in the NCBs, low salary levels reduce the impact of overstaffing; operating costs (staff and other expenses) as a percentage of average deposits of NCBs were 3.8% in FY 78 and 3.4% in FY 82 compared with 5.2% and 5.5% for the foreign banks. The low profitability of the NCBs is caused mainly by three factors: (1) GOP's credit allocation policies which direct the NCBs to finance priority sectors at low interest rates; (2) the establishment and expansion of "low profit" branches in rural areas; (3) non-payment of interest on loans to the public sector; and (4) overstaffing.

Since 1979, a limited number of steps have been taken to improve the overall performance of the NCBs: branch expansion is no longer automatic and a number of branches which were considered uneconomical were closed down; hiring of staff, except for middle level management, has been stopped, a performance review system has been introduced and bank employees can now be fired after three months' notice; promotion is now supposed to be based more on merit than on seniority; NCBs will be allowed to build their capital to a prudent level, by limiting dividends to GOP for the next three years; and central training institutes (e.g., Institute of Bankers) are being strengthened.

In the area of term lending operations, commercial bank long-term lending to the manufacturing sector (37% of total advances) is above the level observed in many developing countries. This is due in large part to GOP's policy of encouraging commercial banks to provide term loans for industry through consortium lending led by ICP, Bankers Equity Ltd. (BEL) and NDFC. From FY 78 to FY 81, advances by the commercial banks increased from Rs 28.5 billion to Rs 57.4 billion, with public sector manufacturing enterprises receiving the major share.

3. The "Specialized Banks"

Four specialized banks: the Agricultural Development Bank of Pakistan (ADBP), IDBP, the Federal Bank for Cooperative (FBC), and the Punjab Provincial Cooperative Bank (PPCB) also fund medium and large industry. ADBP is the largest single financial institution lending to the agricultural sector, while IDBP lends to small and medium-scale manufacturing units. The Federal Cooperative Banks acts as a central bank for provincial cooperative bank and agricultural cooperative credit societies in the provinces.

A number of specialized financial institutions also provide assistance to industry, small businesses and housing. PICIC, the only financial institution with significant private ownership, makes foreign exchange loans to medium and large-scale industry. NDFC provides term financing and working capital to the public and private industrial sectors. Three joint venture companies, Pak-Kuwait, Pak-Libya and Pak-Saudi, have been established recently to provide loans and venture capital to industry. The Small Business Finance Corporation (SBFC) mainly provides short and long-term loans to small-scale industries and businesses. The Investment Corporation of Pakistan (ICP) specializes primarily in arranging equity financing for industrial enterprises and National Investment Trust (NIT) operates mutual funds and unit trust savings schemes respectively. ICP also underwrites equity issues and arranges industrial financing through consortia of NCBs. Bankers Equity Ltd. (BEL) provides risk capital to private industry by underwriting equity issues and arranging consortia finance participation from NCBs while the Equity Participation Funds (EFP) provides direct equity support to small-scale projects mainly in underdeveloped areas. The need for housing finance is met by the House Building Finance Corporation. A new leasing firm, the National Leasing Development Corporation, is just getting underway. They anticipate an AID (PRE revolving fund) loan of $2.5 million this year.

4. The Industrial and Term Financing System

Notable changes in the industrial financing system during the last decade have been, inter alia: the emergence of a government monopoly on credit, the creation of a number of non-bank financial institutions; the decline in the relative importance of established institutions, increasing government intervention in the credit markets and the emergence of the NCBs as a major force in term lending. Initially, PICIC and IDBP were the main institutions providing term financing for industrial development. However, in 1982 NDFC was allowed to diversify its activities to include lending to the large and medium-scale private sector. The government-owned and operated NDFC is now the largest industrial lending institution in Pakistan. Other government-owned and operated institutions such as BEL, ICP and the joint venture companies have also increased their role in term financing for private industry. As a result of these changes, PICIC and IDBP's share of private sector term financing has decreased considerably.

In FY 79-FY 80 GOP through the SBP assigned mandatory fixed investment lending targets to the commercial banks to prevent them from discriminating against term loans for industry bearing the concessional 11% interest rate. The targets were discontinued in FY 81 because the banks found it difficult to meet their allocations due to other constraints on industrial investment, particularly shortages of foreign exchange, and the banks' limited capacity to undertake feasibility studies. In FY 82, based on the Annual Credit Plan for private investment, the SBP provided an allocation for private sector fixed industrial investment lending of Rs 1.7 billion (US$ 134 million). Although the target was not mandatory, unused amounts could not be utilized for other purposes. In FY 82 and FY 83 about 80% of the target was met.

Although the increase in the number of institutions involved in term financing means more outlets, a certain amount of institutional "clutter" has been created in the process. NDFC, while not a scheduled bank, has been allowed to perform most commercial banking functions and its growth has outperformed IDBP and PICIC. IDBP is a scheduled bank but has chosen not to perform full banking operations; while empowered to raise short-term deposits. IDBP's Charter restricted its working capital financing.

PICIC is restricted by the Nationalization Act of 1974 from performing banking functions such as deposit taking, export finance, and participating in the inter-bank market. Thus, PICIC is forced to rely almost exclusively on multilateral lines of credit for its resources. PICIC also is subject to corporate tax whereas NDFC, and the three Pak-Middle East joint investment companies are exempt, although they compete in the same market.

In spite of the government-owned and operated NCBs' increasing involvement in industrial term financing, most have not developed credible project appraisal capabilities. About 80% of the NCBs' lending for fixed industrial investment has been carried out through consortia organized by BEL, ICP and NDFC. While these institutions attempt to provide appraisal and supervision services for large-scale consortium financing, but the NCBs' increasing involvement project financing suffers seriously from a lack of high quality project evaluation and supervision capabilities.

5. The Capital Market System

After a good start in the late 1950s, when substantial savings were invested in new equity issues and dividend rates were high, the capital market experienced a period of stagnation from the late 1960s to the end of the 1970s and played a limited role in providing industrial financing. At present, in spite of GOP's emphasis on private investment, the capital market has not become a significant source of funds for industrial investment. Of all listed shares, 85% are controlled by management groups or by government-owned and operated investment institutions. Highly concentrated asset holding is eased only marginally through floatation of mutual funds. However, most new issues floated in 1982 and early 1983 were oversubscribed and trading volume has increased indicating renewed public confidence.

Public companies (i.e., private sector firms with publically traded shares) have only tapped general savings through issuance of appropriate marketable debt instruments for investment financing to a limited extent. Most issues - debentures - were privately placed with financial institutions and even if listed, their placement has prevented any active trading. Low interest rates have restricted take up and the major reason for Bank participation in these issues is achievement of credit targets. Thus, public companies, faced with financial institutions reluctant to lend, and an absence of a secondary market for corporate bonds are occassionally forced to borrow in the unofficial credit market. Thus changes, (using monetary policy tools), in the existing institutional framework to impart flexibility and responsiveness are necessary. Pakistan needs independent money market trading houses to make markets in corporate commercial papers and debentures; these should have the ability to raise term deposits as well as limited resort to the State Bank. The introduction of leasing as a supplementary source of project finance through independent companies will add to the flexibility of the system as will setting up of independent venture capital companies to complement the role of existing financing institutions. The GOP is aware that the capital market has not been a major source of funds for industrial development and is studying appropriate measures to resolve the situation.

B. Islamazation of the Banking and Financial System

1. Overview

In June of this year the Finance Minister startled Pakistan's Bankers with a timetable for total Islamization of the banking system which went further and faster than almost anyone had expected.

In conjunction with his annual Budget Speech, the Finance Minister instructed the nation's banks to prepare for Islamization of dealings with the Government by the beginning of calendar year 1985 and for completely Islamic transactions (public and private) by the summer of 1985. The only exclusion from his sweeping injunction was financing terms for donor assistance which were to remain on conventional interest terms for the time being until mutually agreeable alternatives could be formulated.

Although many express dismay and discomfort, most bankers taken the timetable seriously and are struggling with its implications for their operations. If adhered to, the timetable would make Pakistan the first and only nation in the world to fully or even largely Islamize its banking and finance system. Significantly, the major OPEC countries in the Arab World have not instituted national Islamic banking. Islamic banks operate in a number of countries, such as Egypt, but they form a minor part of the total financing system. Islamic banks such as the Dar Al Mal in Switzerland have found a niche in the world marketplace, but have not captured a significant slice of international transactions from Islamic countries.

Briefly stated, Pakistan is pioneering in the realm of full national Islamic banking with little evidence of adequate preparation for what will be a very arduous and dangerous expedition. The concepts of Islamic banking are widely known, but the tools remain largely underdeveloped and unseasoned. Early experiments which simply replaced "interest" with "charges and fees" have been abandoned as un-Islamic and fully-vetted, religiously acceptable alternative tools have not been tested by time and the marketplace.

The experience of Pakistan with Islamic banking over the past few years has taught a few lessons. It has also produced a few positive results which should not be discounted. This section of the briefing paper reviews the legal and constitutional background to Islamization of the financial markets, the recent experience of partially Islamic banking in Pakistan and the policy risks associated with comprehensive Islamization.

2. Legal and Constitutional Framework

It is the declared policy of the Government to Islamize all spheres of public life, including economic life. Islamic principles preclude the charging of interest ("riba"), and alternative forms of financing are being evolved as a substitute. Some would say that these new financing methods are being "imposed" more than evolving. The relation of these mechanisms to Western interest-based credit allocation systems has not yet been worked through. The difficulty lies not only in the development of the mechanisms themselves, but also in making them practicable in an existing system that implies approaches and procedures based on the interest-based they are intended to supplant.

Under Chapter 3A of the Constitution of Pakistan, the Federal Shariat Court may decide that any law or provisions of law is repugnant to the injunctions of Islam. Upon such determination the law or provision ceases to have any legal effect. The definition of "law" excludes "financial laws", but only for a specified period, after which the Court will have authority to give judgement on such laws and the arrangements and procedures adopted under them, including determinations whether any of these involve the charging of interest, which will be prohibited. The period was originally to be three years, expiring in February 1982. In 1980, the period was extended to expire in May 1983, at which time it was extended to May 26, 1984. Presumably, another extension will be adopted.

A number of Islamic financial system measures have been introduced in Pakistan:

a. As an initial measure for eradication of interest, "Profit and Loss Sharing Accounts" ("PLS") were introduced as an alternative to fixed interest savings accounts. These provide for return to the depositor only out of profits.

b. Participation Term Certificates ("PTC") were introduced as an alternative to fixed rate debentures. These provide for return to the lender only out of the profits. PTC holders rank equally with shareholders in entitlement to a share of the profits of the venture, and can have a right to convert into shares in specified proportions in case of loss. The terms being used now for PTCs reportedly also allow the tender to appoint directors in case the enterprise suffers specified losses. This has caused a good deal of difficulty, and preference of businessmen not to use PTCs.

c. As a further measure for eradication of interest, a special law has been enacted to encourage "Modarabas". A Modaraba is a form of equity and share investment in an undertaking managed by a separate company. A Modaraba is a legal person and may be formed for a fixed period, at the end of which the undertaking would be wound up or dissolved and the profits (or losses) shared in accordance with the investment of the parties.

d. The "Musharika" has been introduced as a form of partnership in which partners contribute their money, efforts or skill.

These forms and instruments of Islamic finance have not yet become popular, particularly because of unfamiliarity with what they involve and recently because of some dissatisfaction by borrowers with the relatively high costs involved and the requirement of PTCs lenders for a right to participate directly in company management in case of losses. However, pursuant to Government policy, PTCs have now become a standard substitute for debentures financing at the Government controlled financial institutions.

The Company's role as a financier and investor will be affected by the measures taken by Government for eradication of interest and by judgements of the Federal Shariat Court in relation to "financial laws" after the Court is given authority to consider these laws. For example, CCI might insist that the Company invest in PTCs, and not in debentures. It is difficult to determine the effect of the Federal Shariat Court's decisions on financial laws, but it can be imagined that the same shall be radical. Equally important will be the pressure to design Islamic financial instruments, which will involve difficulties and uncertainties, and, as in the PTC, possible conflicts with existing financial instruments. Thus, it should be clearly understood that the Company will not operate as an investment bank or merchant bank in a Western financial center, but must be prepared and able to deal with Islamic financial system approaches and mechanisms, with the complexity and dislocations they can involve.

Another Islamic fiscal measure introduced by the Government is "Zakat", or Islamic wealth tax. This is a tax on investments and other financial assets, to be used for charitable purposes. Zakat is recovered at the rate of 2.5% of the value of an asset determined in the manner laid down in the Zakat and Ushr Ordinance 1980. The First Schedule of the Ordinance sets forth the categories of investments and other financial assets on which Zakat is "compulsorily" recoverable. Briefly, these are: saving bank accounts, deposit receipts and accounts; saving/deposit certificates; NIT units; ICP Mutual Fund Certificates; Government securities; company securities, including shares and debentures (other than those held by companies); and annuities and life insurance policies and provident funds.

Zakat is recoverable only from (a) Muslim citizen of Pakistan and (b) a company a majority of the shares of which are owned by Muslim citizens of Pakistan. Certain sects of Muslims are authorized to be exempt from ZAKAT based on their beliefs.

In all cases, no Zakat will be recoverable in respect of shares and debentures of other companies held by the Company. In addition, no Zakat is recoverable from a company where a majority of its shares are owned by foreign investors. Thus, if the Company is formed as a foreign-controlled company, no Zakat will be recoverable on its investments and other financial assets. However, if it is controlled by Muslim citizens of Pakistan, Zakat will be compulsorily recovered (other than on shares and debentures) from it in the manner laid down in the Zakat and Ushr Ordinance in respect of its investment and other financial asset.

At present Zakat is not compulsorily recoverable on "loan receivables". However, under the Second Schedule of the Ordinance, a Muslim may pay Zakat on loan receivables on a voluntary basis if he feels like paying the same. This voluntary basis is not applicable to banks and financial institutions and companies. Nevertheless, a possibility that cannot be ruled out is that either the Government itself or the Federal Shariat Court may impose Zakat on loan receivables on a compulsory basis, and even from banks and financial institutions and companies. If this is done, a majority of Pakistan-owned company would be very badly hit. In such an eventuality an exemption will be required.

3. Bank Deposits

On January 1, 1981, interest-free counters were opened in most branches of Pakistani banks and one foreign bank. These counters function in parallel with conventional bank operations, giving depositors the choice of operating an interest-free or an interest-banking account. Depositors choosing the interest-free or PLS option share in the profits/losses of investments financed with funds deposited in the PLS accounts of each bank. Since funds deposited in PLS accounts can only be invested in non-interest bearing operations. The SBP has stipulated that a number of operations such as commodity financing, trading operations and import bills can only be transacted on a mark-up or commission basis, which are consistent with Islamic principles using funds from PLS accounts. Five to ten percent of the profits of such operations are kept in a reserve fund to offset possible future losses and equalize rates of return over time. An important incentive to savers is the income tax exemption of up to Rs 15,000 p.a. on PLS accounts.

Since their creation PLS deposits have grown rapidly. On June 25, 1981, total PLS deposits amounted to Rs 2.6 billion and a year later stood at Rs 7.9 billion, with Rs 3.3 billion in savings deposits and Rs 4.6 billion in time deposits and accounting for 10.3% of total deposits in Pakistani banks. Rates of return on PLS accounts are declared every six months and have been consistently higher than the minimum rates on conventional deposits prescribed by the SBP. Annualized rates of return on PLS accounts during FY 82 varied among banks and ranged from 10.75% - 12% for six month deposits to 14.5% - 15.5% for deposits of five years or more. Minimum annual rates on interest-bearing deposits of equal maturity range from 9.0% to 12.75%, respectively.

Bank Lending

Since October 9, 1979, banks have extended a small amount of interest-free production loans to subsistence farmers and fishermen for the purchase of seasonal inputs and to cover maintenance costs. These loans which have a ceiling of Rs 6,000 are mostly disbursed in kind. Borrowers who fail to repay within two months of harvesting have to pay the ongoing interest rate. Since July 1, 1981, the banks have also made interest-free loans to deserving students who must repay when they complete their studies and find employment.

On June 1, 1982, the nationalized commercial banks launched the Musharika financing scheme designed to meet the working capital requirements of trade and industry on a PLS basis. A Musharika can be defined as a business arrangement whereby the parties contribute capital and/or entrepreneurial skills and share the profits according to a pre-agreed formula. A loss, however, is shared in proportion to the funds contributed by each party. As with any other contract the conduct of a Musharika is governed by the terms and conditions of the agreement freely reached by the parties. In order to reward management performance, the banks allow a management bonus to be paid out of realized profits. The pre-agreed bonus is payable upon achievement of projected profits and may vary according to performance. In cases of shortfall, banks may pay the management bonus at a reduced rate instead of forfeiting it completely.

The SBP is encouraging banks to extend Musharika financing to selected customers and so far about 20 agreements have been announced. Although there is considerable uncertainty as to how Musharikas will operate in practice, expectations are that, at least initially the rate of return for banks will tend to be around 14%, which is the current rate of interest on working capital loans. Thus, in terms of return on funds, Musharikas will not differ from conventional working capital hours.

In addition to Musharikas, two other financing arrangements conforming to Islamic principles are being introduced gradually: hire purchase (Bai Salam) and leasing (Baj Muajjal). Under an interest-free hire purchase agreement, in addition to repayment of the principal the financial institution receives a net imputed rental value in price of interest. In the case of leasing, Islamic financial principles are likely to be incorporated by providing for variable and adjustable lease rentals.

On June 26, 1980, the legal framework of Pakistan's financial and corporate system was modified to permit the introduction of a new financial instrument and a new form of company, both conforming to Islamic principles; the Participation Term Certificate and the Modaraba company.

Participation Term Certificates

(PTCs) are transferable corporate instruments based on the PLS principle and are intended to replace debentures for raising medium and long-term local financing for industry and trade. Instead of receiving interest, as in the case of debentures, PTC holders will share in the profits/losses of the issuing companies. PTCs can be issued for up to ten years, are secured by a fixed mortgage on company assets, and the claim on company profits supersedes the shareholders' claim. Although the PTC share of profits should be based on the ratio of PTCs to the company's paid-up capital plus reserves, PTC agreements so far have specified a fixed share of profits. PTC holders are only being allowed to retain an amount of profit equivalent to 17% of the face value of the PTCs in each accounting year. Furthermore, if the company pays the share of profit within 30 days of the close of its annual accounts, the company will be allowed a rebate of 2% and PTC holders will retain a share of profit equivalent to only 15%. Losses in one year can be made up by the company out of profits earned in subsequent years. A small sample of the financial projections of projects requesting PTC financing, however, indicates that project sponsors take 15% p.a. as the cost of PTC funds. One feasibility report, for instance, warns that ".....the project is not expected to pay full return of 15% to PTC holders in the first year ....."

PTC financing was initially restricted to the operations of the ICP, the NIT and BEL, but has been extended to include the NCBs. As a result, most of the NCB consortium term financing is now being done by PTCs. Although this type of lending technically represents higher risk for the banks, returns will be substantially higher than the 11% ceiling imposed by the SBP on conventional term lending. During 1982, PTC financing through ICP and BEL-led consortia amounted to Rs 1.2 billion.

4. The Policy Risks of Full National Islamic Banking in Pakistan

Until June of this year, the Government of Pakistan appeared to be treading a careful path between a political imperative to be seen to be introducing new financial practices consistent with Islamic tenets and a pragmatic requirement to avoid a disruption of the financial flows required by a modern industrializating economy. For institutions dealing with foreign loans and credits, the Government had given an assurance that they will continue to function on the basis of interest. The Government continuously emphasized its determination to continue the process of Islamization but (until June 1984) took pains to underline the need to proceed gradually and cautiously.

The Government's new timetable for full Islamization by July 1985 appears to mark a radical shift in style. Allowing a reasonable margin for electoral considerations (elections are scheduled to take place before March 1985), the timetable still seems to depart from the mix of political craft and pragmatism which had marked the issue until this summer.

Some consequences of the move to full Islamic banking are difficult to predict. There is no precedent or model to look to for heuristic guidance. There is very little experience in interfacing Islamic and international banking tools. While the two systems <u>co-exist</u> in a few countries like Egypt and the Sudan, they do not really <u>inter-relate</u>. Islamic banks do transactions which are, in the main, fully discrete and separate from transactions by conventional banks. Some borrowers <u>do</u> have relations with both types of banks, but seldom is a banking instrument executed across the lines between the two banking worlds. On the other hand, the experience to date in Pakistan and elsewhere with partially Islamic banking suggest some of the consequences we can expect. They are not all negative. Islamic banking does, for example, seem to offer a way out of the trap of managed interest rates which Pakistan has erected around its financial markets over the past fifteen years. Unfortunately, the GOP is not taking full advantage of this opportunity. Some of the policy risks (and benefits) are considered below.

To start with the good news, the most positive effect of Islamization so far has been the freeing of financial rates of return, particularly for term lending. Since GOP has chosen not to impose restrictions on the terms and conditions that can be negotiated between lender and borrower, the new instruments are more responsive to market conditions in the financial sector. This applies particularly to PTCs, hire-purchase and leasing. In addition, evidence gathered from interviews with managers of financial institutions dealing with Islamic instruments, indicates that they have evolved business practices which, while consistent with Islamic principles, reduce considerably the uncertainty inherent in a PLS system. It appears that every effort is made by financial institutions to prevent borrowers from declaring returns which would be lower than the equivalent return obtained under an interest-based operation. At the same time, indications are that in the case of short-term lending, institutions will expect returns not higher than returns available on working capital loans (i.e., 14% p.a.). Returns for term funds are expected to be set at 15% p.a., (possibly higher for leasing), which represents a more realistic pricing of capital than the controlled rate of 11% for interest-based term lending. This development represents a major involvement for the NCBs, which before the introduction of PTCs were directed to provide increasing amounts of term financing for industry at the unprofitable rate of 11% p.a.

Lending and investing on a PLS basis will require considerable strengthening of the project appraisal and supervision capabilities of financial intermediaries, particularly the government-owned commercial banks. Since a lender's return technically depends on the borrower's profitability, the public sector commercial banks, which currently provide most of the working capital financing of trade and industry and a substantial proportion of term financing, will be forced to focus more on the viability of particular projects rather than relying almost exclusively on their clients' creditworthiness. At the same time, because of the higher risk inherent in this participatory mode of financing, lenders are likely to demand greater accountability from the corporate sector. Greater accountability, tighter accounting and auditing requirements, and an improved flow of information from the corporate sector are important themes for the U.S. policy dialogue on banking in Pakistan.

In its desire to move to an interest-free system, GOP has precluded the use of interest rates as a policy instrument, even though most of the financial system continues to operate on the basis of interest. Although the system seems to be evolving alternative means to price control -- which need not be inconsistent with efficient financial intermediation and resource allocation -- the Government has seriously reduced its policy flexibility by abandoning interest rates. As a result, the Government is even more likely to continue to rely on a highly centralized and regulated system of credit allocation to meet its developmental objectives.

There is considerable danger that during the coming twelve month transition period, in which both systems work in parallel, companies with high rates of profit and investors with profitable projects will opt for interest-based financing, while less profitable and more risky ventures will prefer PLS arrangements. Unless considerable control is exercised by the authorities, the PLS segment of the financial system could be burdened with a high concentration of less profitable or more risky operations. The need to prevent this segmentation of portfolios will require the continuation of a high degree of regulation and government intervention in financial markets. In addition, it is possible that the higher involvement of lenders in project appraisal and supervision, as well as the higher risk implicit in the PLS system, could increase the cost of financial intermediation.

A further potential problem relates to the term transformation possibilities of a PLS system. If the use of funds is strictly separated according to their origin, the provision of term lending for investment would be limited by the volume of term deposits and the banks' function of transforming short-term liabilities into long-term advances would be severely constrained. Even where term transformation takes place, because of the need to declare returns every six months and the strong competition between banks to attract PLS deposits, the system has a potential bias in favor of short-term quick-yielding investments. Thus, it is possible that long gestation industrial projects would be disadvantaged in relation to trade financing. In order to prevent this, the Government will continue to intervene directly in financial markets and will continue to maintain a tight control on the system of credit allocation. Here, again, is a major issue for the U.S./GOP policy dialogue on banking.

Pakistan's limited experience with financial Islamization appears to be having both negative and positive effect on the financial system by allowing rates of return to reflect more accurately market conditions, particularly for term lending. It is likely that one of the consequences of the process of Islamization will be a continuation of government intervention and control of financial markets and credit allocation.

CHAPTER IV : POLICY STRATEGIES FOR THE BALANCE OF THE 1980's

A. The Policy Setting

Serious policy dialogue is an arduous and incremental process. While micro-economists can design instant policy interventions which turn on a dime, real world politicians and public servants understand that meaningful public policy analysis and decision-making requires care, caution and time. AID joins the major multilateral financiers and the Government of Pakistan in a multi-year approach to structural reforms and sectoral policy reorientation. All these parties share some common long-term goals. Each of the parties has special areas of concern and at times rather distinctive policy predispositions. More investment, more efficient resource allocation, more efficient resource utilization, a larger role for the private sector and (most importantly) sustained high growth rates are themes common to all parties in the dialogue. AID brings to the dialogue a particular appreciation of the importance of market mechanisms, the allocative efficiencies of market pricing, the resource mobilization power of the private sector and the advantages of government disengagement from many key economic processes. The IMF and the IBRD bring a keen sense of the necessity for fiscal restraint and monetary reforms with a particular concern for the resource side of public finance. The planners in the GOP quite naturally bring to the dialogue a sensitivity to the domestic political environment as well as a strong desire for setting sectoral targets and framing sectoral investment decisions. The dialogue has had its ups and downs in recent years, but all parties bring professionalism and a very long-term perspective to the process.

B. Policy Priorities

AID's policy strategy is necessarily integrated with its resource and investment strategy. While our sectoral interests range more widely than our investment portfolio, our policy emphasis quite naturally is oriented towards the areas of our greatest programmatic involvement.

C. Macro Level Policy Strategy

As is traditional even in large ESF programs, the AID posture on macro policy is to define a role in relationship to the initiatives of the major multilaterals. For the early years of the six year program this role was defined by the fact that the IMF and the IBRD, through the mechanisms of an Extended Fund Facility (EFF) and a Structural Adjustment Program, had set out an agenda of policy reform for the Government of Pakistan.

Both the EFF and the first Structural Adjustment Loan (SAL) have run their course, and neither is currently in force, although discussions continue on both fronts. Nonetheless, the EFF and the SAL continue to frame the basic posture of the multilaterals and define the macro policy agenda for Pakistan. The core of this agenda is major movement towards economic liberalization in which public and private sectors will be increasingly focused upon their areas of comparative advantage, with the public sector concentrating on the provision of public goods and infrastructure and the private sector increasingly responsible for the production and distribution functions within the economy. These goals are to be pursued in a climate of fiscal restraint and with sufficient monetary controls that inflation remains within appropriate bounds. The AID and the Embassy supports the overall IBRD/IMF initiatives in their policy dialogue with the GOP, but we have set our national agenda against somewhat narrower goals than the multilateral donors. AID's macro level dialogue focuses on the key issues of improved delineation of public and private sector roles. Our portfolio is designed to sharpen public/private distinctions at the sectoral level and our macro policy dialogue will be very specifically focused on what the GOP terms "deregulation". The scope of "deregulation" is wide, encompassing trade liberalization and banking reform, as well as industrial liberalization. The elements of GOP macro policy upon which AID and the Embassy will seek to have a sustained policy impact include:

1. policies to curb new capital spending on public sector production enterprises in sectors where the US is active

2. policies to limit capacity increases in existing public sector plants in sectors where the US 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 "level playing field" for public, private and international financial institutions in Pakistan

5. policies to remove inequitable credit access 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

The entire US Mission in Pakistan will be vigorously pursuing forward movement on these issues. These same macro policy themes are reiterated at the sector and micro levels in the policy components of our project portfolio. In the case of the oilseeds industry, for example, our macro dialogue on progressive disinvestment and price deregulation will be reinforced by our PL 480 negotiations which set specific performance benchmarks for privatization in oilseeds processing and in our Food Security Project which will incorporate economic policy analysis to assist the GOP in the definition of a liberalization program in agriculture. We have deliberately chosen to concentrate our macro policy dialogue on those areas where our investment portfolio provides vehicles for sectoral and micro level reinforcement of our objectives. It is the firm belief of the Mission that this complementarity of macro and project policy goals will improve the chances of realizing our policy objectives.

TABLE 6

PROPOSED BILATERAL U. S. ECONOMIC ASSISTANCE FOR PAKISTAN
UNITED STATES FISCAL YEAR 1982 TO 1987
(Millions of United States Dollars)

SECTOR/PROJECT TITLE	G/L	FY82	FY83	FY84	FY85	FY86	FY87	TOTAL
AGRICULTURE AND IRRIGATION:	TOTAL	70.20	93.50	103.40	109.00	70.00	57.60	503.70
Agricultural Research	G	3.20	NA	NA	NA	NA	NA	3.20
On-Farm Water Management	G	7.00	3.00	NA	NA	NA	NA	10.00
Irrigation Systems Management	G	NA	30.50	19.40	18.00	.00	22.10	90.00
Agricultural Commodities and Equipment	TOT	60.00	60.00	70.00	70.00	40.00	.00	300.00
	L	34,00	40.00	30.00	53.00	40.00	.00	197.00
	G	26.00	20.00	40.00	17.00	.00	.00	103.00
Transformation and Integration of the NWFP's Provincial Agricultural Network	G	NA	NA	4.00	11.00	10.00	10.50	35.50
Management of Agricultural Research and Technology	G	NA	NA	5.00	5.00	10.00	10.00	30.00
Food Security Management	G	NA	NA	5.00	5.00	10.00	15.00	35.00
ENERGY:	TOTAL	8.00	70.00	61.00	48.00	142.00	119.00	448.00
Rural Electrification	TOT	8.00	50.00	31.00	.00	22.00	57.00	168.00
	L	NA	27.00	25.00	.00	.00	52.00	104.00
	G	8.00	23.00	6.00	.00	22.00	5.00	64.00
Energy Planning and Development	G	NA	13.00	5.00	.00	5.00	7.00	30.00
Forestry Planning and Development	G	NA	7.00	3.00	.00	8.00	7.00	25.00
Energy Commodities Equipment	TOT	NA	NA	22.00	48.00	30.00	.00	100.00
	L	NA	NA	20.00	30.00	30.00	NA	80.00
	G	NA	NA	2.00	18.00	.00	NA	20.00
Lakhra Coal Power Generation	TOT	NA	NA	NA	.00	77.00	48.00	125.00
	L	NA	NA	NA	.00	22.00	40.00	62.00
	G	NA	NA	NA	.00	55.00	8.00	63.00
POPULATION AND HEALTH:	TOTAL	11.30	22.50	35.00	29.80	17.20	14.00	129.80
Population Welfare Planning	G	4.30	4.80	14.80	11.70	.00	10.00	45.60
Social Marketing of Contraceptives	G	NA	NA	5.50	8.50	2.00	4.00	20.00
Primary Health Care	G	5.50	.00	8.00	.00	6.50	NA	20.00
Malaria Control II	G	1.50	17.70	6.70	9.60	8.70	NA	44.20

Contd.

PROPOSED BILATERAL U. S. ECONOMIC ASSISTANCE FOR PAKISTAN
UNITED STATES FISCAL YEAR 1982 TO 1987
(Millions of United States Dollars)
CONTINUED

SECTOR/PROJECT TITLE	G/L	FY82	FY83	FY84	FY85	FY86	FY87	TOTAL
AREA DEVELOPMENT:	TOTAL	3.00	7.50	19.60	13.20	15.80	34.90	94.00
Tribal Areas Development	G	3.00	5.00	5.00	.00	5.00	6.00	24.00
Baluchistan Area Development	G	NA	NA	5.10	6.00	5.00	23.90	40.00
North-West Frontier Area Development	G	NA	2.50	9.50	7.20	5.80	5.00	30.00
OTHER:	TOTAL	7.50	6.50	6.00	50.00	30.00	30.00	130.00
Private Sector Mobilization	G	NA	NA	NA	25.00	25.00	.00	50.00
Rural Roads	G	NA	NA	NA	20.00	.00	20.00	40.00
Development Support Training	G	NA	4.00	6.00	.00	5.00	10.00	25.00
Project Design Fund	G	7.50	2.50	.00	5.00	.00	.00	15.00
TOTAL AMOUNT PROGRAMMED	TOT	100.00	200.00	225.00	250.00	275.00	255.50	1305.50
	L	34.00	67.00	75.00	83.00	92.00	92.00	443.00
	G	66.00	133.00	150.00	167.00	183.00	163.50	862.50
PROJECT RESERVE	TOT	.00	.00	.00	.00	.00	19.50	19.50
	L	.00	.00	.00	.00	.00	.00	.00
	G	.00	.00	.00	.00	.00	19.50	19.50
TOTAL	TOT	100.00	200.00	225.00	250.00	275.00	275.00	1325.00
	L	34.00	67.00	75.00	83.00	92.00	92.00	443.00
	G	66.00	133.00	150.00	167.00	183.00	183.00	882.00
P.L. 480 TITLE I (edible oil imports)	L	50.00	50.00	50.00	50.00	50.00	50.00	300.00
GRAND TOTAL		150.00	250.00	275.00	300.00	325.00	325.00	1625.00

10/19/84

CHAPTER V: PROJECT DESCRIPTIONS

A. FY 1982 Activities

Agricultural Research

This $3.2 million activity supports Pakistan's national level agricultural research organization, the Pakistan Agricultural Research Council, to strengthen the institutional base necessary to coordinate agricultural research activities throughout Pakistan. The applied research capabilities of provincial research institutions and agricultural universities are being upgraded. Over 200 Pakistani agricultural scientists have received advanced training under this project. Laboratory and other essential equipment and construction of the National Agricultural Research Center as well as specific applied agricultural research activities are being financed. The World Bank and others are taking advantage of the experience gained during the period of AID assistance to continue support to Pakistan's national level research network while AID is refocusing its assistance on provincial and local level applied agricultural research systems.

On-Farm Water Management

This $10.0 million activity finances a program which strengthens Pakistan's capability to plan and deliver on-farm water management services. Approximately 50,000 farmers with small and medium-size holdings have benefitted directly from the 1,319 watercourses which have been improved and the 75,000 acres of land which have been levelled. Training has been provided to 80 water users associations and to 150 officials in water management extension and management, engineering and computer science. A pilot study is underway in each of Pakistan's four provinces to determine the ability of local councils to mobilize farmers to provide water management services.

Agricultural Commodities and Equipment

This $300.0 million activity promotes increased agricultural production and provides needed balance of payments support. Funding is provided annually based on projected needs and after a review of accomplishments in implementing various declared policies of the GOP. For example, more rationale pricing policies for farm inputs and produce, timely allocations of imported fertilizer to the private sector, and reduced subsidies for fertilizer. Local currency generated through the sale of commodities imported under this activity provides a valuable resource for financing priority development activities.

The $60.0 million provided in FY 1982 was used to import 130,000 tons of di-ammonium phosphate ($32.8 million) and essential irrigation canal rehabilitation equipment for the four provincial irrigation departments. The $60.0 million FY 1983 tranche financed the importation of phosphatic fertilizer ($30.1 million), equipment to support irrigation, and cotton ($25 million). The $70.0 million provided in FY 1984 will be used to establish a facility for the private sector to import agricultural machinery and equipment ($10 million) and to import phosphate fertilizer ($30 million), cotton ($10 million) and agricultural commodities required to support other A.I.D. assisted projects.

Population Welfare Planning

This $45.6 million project finances key support activities of the GOP's Population Welfare Plan in coordination with other donors. AID is developing management information, research and evaluation and logistic systems, and is financing bio-medical research, contraceptive supplies and professional staff development.

Project Design Fund

This $15.0 million activity finances the technical assistance needed to design the projects contained in the $1.625 billion six year program of U.S. economic assistance for Pakistan and to carry out priority sectoral studies.

Tribal Areas Development

This $24.0 million project is strengthening the ability of government institutions to implement development activities in the tribal areas of Pakistan's North West Frontier Province. Approximately 160 watercourses and 125 kilometers of new gravel roads are being constructed or rehabilitated to further the development of this region. In addition, a special fund will finance small self-help activities of priority interest to the people in these areas. These will include schools, health facilities, flood control structures and connection to the power and road networks.

Malaria Control II

This $44.2 million project builds on achievements of previous projects to contain, or further reduce, the incidence of malaria to 0.5 cases per thousand population. The capacity of the federal, provincial and municipal health services to control malaria is being expanded to reduce morbidity and mortality from malaria. It is estimated that, without the project, there would be over 21 million malaria cases from 1982 to 1986. A majority of cases occur in the rural areas and the peak malaria season coincides with the culmination of agricultural activities. As a result, the income of poor farmers who contract the disease also suffers.

Assistance is being provided to strengthen the GOP's malaria program in the areas of management, epidemiology, operational research, evaluation, surveillance, urban malaria control, and the safe handling of insecticides. Training support is being provided to the National Malaria Control Center.

Rural Electrification

This $168.0 million project is providing assistance to Pakistan's Water and Power Development Authority (WAPDA) to expand reliable electric services. Project activities will result in an estimated 215,700 new connections plus improvement of services to 3.5 million users.

Major activities under the project include the construction of a 450 megawatt combined cycle generating plant in collaboration with the Asian Development Bank and other donors.

Another major activity of the project will be to minimize losses in the distribution system and improve the institutional capacity of the 65,000 employee distribution organization of WAPDA.

Primary Health Care

This $20.0 million project is designed to improve the quality and expand the coverage of primary health care services in rural areas of Pakistan. It builds on the experience gained in the earlier A.I.D.-supported Basic Health Services Project to expand the use of a three-tiered primary health care delivery system to move from a curative approach to providing health services to one which emphasizes preventive medicine and the use of para-medical personnel.

Support is being provided to improve management, conduct studies and carry out training and curriculum revision activities. Thirteen training schools for medical technicians will be constructed and health education materials and various commodities will be procured.

At the conclusion of the project there will be an additional 53 Integrated Rural Health Complexes established around the country (29 in Punjab, 12 in NWFP, 7 in Sind and 5 in Baluchistan), a revised medical technician schools constructed and equipped, and 1,359 medical technicians and 6,400 community health workers trained to carry out curative and preventive care. Pakistan's primary health management and supervision systems will be strengthened. Potentially, 3,250,000 rural people will benefit from activities financed through this project.

B. FY 1983 Activities

Irrigation Systems Management

This $90.0 million project is increasing the capabilities of institutions involved in irrigation planning, design, research, and operations and maintenance and encouraging the implementation of policies needed for effective water management. Two-thirds of the three-quarters of a million beneficiaries from this project will be farmers with land holdings of less than 12.5 acres.

Activities have been designed to take into account experiences gained in the On-Farm Water Management Project. In collaboration with the World Bank, approximately 14,000 kilometers of surface canals and 3,500 kilometers of surface drains will be rehabilitated.

Local level institutional and policy and planning improvements are a major emphases of AID's project. The control and management systems, design, planning and research capabilities of provincial irrigation departments are the major foci of AID's support.

In addition, in collaboration with the World Bank, studies are currently underway to develop a Command Water Management strategy whereby the irrigation problems and needs of priority areas can be addressed on a geographic basis.

Development Support Training

This $25.0 million project is designed to upgrade the managerial and technical expertise of Pakistanis from both the private and public sectors. Management and administration are the major emphases of the project which stresses in-country training in specially tailored programs. Particular attention is being given to the special training needs of women and the two least developed provinces of Pakistan, Baluchistan and the North West Frontier.

Approximately 1,620 individuals will receive training within Pakistan and 230 will be sent for training overseas. In addition, the technical assistance team contracted under this project will assist in the placement of the approximately 1,600 men and women who will be sent for overseas training under other projects in AID's portfolio.

Energy Planning and Development

This $30.0 million project is assisting the GOP to formulate and implement programs to assess, develop and use Pakistan's indigenous energy resources and increase the efficiency of energy use. The major components of the project are: energy analysis and manpower development; coal resource assessment and development, and, energy conservation and the development of renewable energy technologies.

The capacity of Pakistani institutions to collect and analyze data on energy resources and demand, and assess the financial implications of economic and social factors in the energy sector is being increased. Private sector and GOP efforts to develop coal as an alternative power source are being supported. This includes assistance in gauging the scale of national coal resources and preparing for Pakistan's first large scale coal-powered generating plant. A conservation program to increase the efficiency of industrial uses of energy will be undertaken. A comprehensive national renewable energy assessment and development program will promote appropriate technologies, such as solar heating and power and energy-efficient wood stoves, and coal briquetting to meet the household energy needs of rural families.

Forestry Planning and Development

This $25.0 million project is strengthening the ability of federal and provincial governments and local institutions to design, implement, and evaluate policies and programs for increasing fuelwood and timber production, primarily on small private farms. It is supporting the development of an effective plan to increase private sector production of wood. Women and children, who must walk great distances to collect fuelwood, will benefit especially from increased fuelwood availability.

North-West Frontier Area Development

This $30.0 million project is designed to complement and facilitate Pakistan's efforts to enforce its ban on opium poppy cultivation. It will transform Pakistan's principal areas of illicit opium poppy cultivation into an economy based on diversified agriculture with strong ties to the national economy.

This project is providing immediate benefits to the farmers of the area in the form of improved roads and electricity, seeds and fertilizers, and development schemes identified by the local councils of the area. The major development activities are agricultural development, infrastructure construction and off-farm employment. On-farm cropping demonstrations, the distribution of improved planting materials, and assistance in cropping practices, watershed management and marketing will promote increased production of existing food crops, new cash crops, improved livestock and trees. Support is being provided for infrastructure such as irrigation schemes, roads, trails and power lines. The marketable skills of the area's residents will be improved through participation in project activities, vocational training and basic education.

This project also is a major source of U.S. financing for Pakistan's Special Development and Enforcement Plan for the Opium Producing Areas of Pakistan (SDEP). The SDEP will finance activities to transform the economies of other poppy producing areas such as Dir and Chitral into economies which are based on diversified agriculture. The UN Agency for Drug Abuse Control (UNFDAC) is coordinating multilateral support for the SDEP.

C. FY 1984 Activities

Baluchistan Area Development

This $40.0 million project will accelerate development in Pakistan's least developed province by financing rural development activities and strengthening human and institutional resources. Local participation in the design and implementation of activities will be emphasized. Support will be provided for water management and conservation, improvement of rural road maintenance capability, increased planning to meet development needs, resource mapping, and human resources development. Funds will be programed for small self-help activities.

Social Marketing of Contraceptives

This $20.0 million project will draw upon the strengths of the private sector to dramatically extend the network of retail outlets for contraceptives, thereby significantly enhancing the availability and accessability of contraceptives. The project also supports management services and contraceptive promotion activities.

Energy Commodities and Equipment

This $100.0 million activity is designed to support Pakistan's balance of payments and policy initiatives to rationalize energy prices, to increase the participation of the private sector, and to decrease petroleum imports through energy conservation and increased use of indigenous energy resources. Financing will be provided: to establish a facility for the private sector to import energy sector commodities and equipment; and to import energy and fuel conservation, power sector, and coal mining and processing equipment.

Transformation and Integration of the NWFP's Provincial Agricultural Network (TIPAN)

This $35.5 million project will integrate agricultural research in the North West Frontier Province of Pakistan with agricultural education at the university level. TIPAN will improve the quality of education offered and research undertaken by the university, and strengthen linkages with agricultural extention through a problem-solving, farmer-oriented outreach program at the university. About 25% of the personnel and other resources of the university will be devoted to an outreach program. Approximately 140 individuals will be enrolled at U.S. universities and 65 short-term participants will be provided non-degree training in the U.S. and third countries.

Management of Agricultural Research and Technology

This $30.0 million project will strengthen the performance of the national agricultural research system to generate and disseminate quality and relevant agricultural technologies to the farmers of Pakistan. The project will contribute to increase agricultural production, farm income and rural development. The project consists of five components: (1) Research Management and Administration; (2) Information Transfer; (3) Training for the Agricultural Network; (4) Arid Zone Research; and, (5) Wheat and Maize Coordinated Programs.

Food Security Management

This $35.0 million project consists of three major sub-components: (a) Data Collection, which will improve the accuracy, timeliness and utility of primary and secondary agricultural data collected at the federal and provincial levels; (b) Economic and Policy Implementation Analysis which will strengthen analytical research into food security problems; and (c) Post-Harvest Management, which will address critical constraints in the post-harvest system including management of storage facilities.

D. FY 1985 Activities

Rural Roads

This $40.0 million project will improve the capacity of the federal and provincial governments to maintain roads and road building equipment and to carry out rural road research, planning and construction. Institutional improvement will be the major focus of AID assistance. Financing will be provided for the construction of low-cost roads in accordance with designs developed for the specific local soil and climatic conditions and the anticipated traffic type and intensity. This project will finance the upgrading and maintenance of approximately 3,000 miles of rural roads and generate significant off-farm employment opportunities.

Private Sector Mobilization

This $50.0 million project will expand the private sector's involvement in economic activities which directly support development or help expand the economic base for development. The project will emphasize expansion of services to small privately-owned firms. AID and the Government of Pakistan are discussing alternative approaches to financing private sector activities.

E. FY 1986 Activities

Lakhra Coal Power Generation

This $125.0 million project will be designed to fund the engineering and design costs of a major thermo energy generating facility at Jamshoro using Pakistani coal as an energy source. The feasibility of using domestic lignite coal to power such a plant is being tested by studies financed under the Energy Planning and Development Project described above.

PART B

A.I.D.,

THE HISTORY OF U.S. ECONOMIC ASSISTANCE TO PAKISTAN

RELATED BRIEFING MATERIALS

I. FY 1985 ASSISTANCE REQUESTS FOR SOUTH ASIA

Excerpts from a Statement before the Subcommittee on Asian and Pacific Affairs of the House Foreign Affairs Committee on February 6, 1984 by Mr. Howard B. Schaffer, Deputy Assistant Secretary for Near Eastern and South Asian Affairs.

Thank you very much for the privilege of testifying before the subcommittee regarding the Administrator's proposed foreign assistance program for South Asia in FY 1985. I will do my best to address your interests, as expressed by the Chairman, with particular emphasis on:

- The role of our aid program in supporting U.S. interests and objectives in the region;
- The levels, mix, and design of each country program; and
- The special considerations that must be taken into account with respect to our effort in Pakistan.

Political and Economic Overview

As a region, South Asia remains beset by difficult political, social, and economic problems. To the west, Afghanistan continues to suffer under the domination of Soviet, occupying forces whose efforts have, if anything, intensified over the past year.

The geographical position of Pakistan as a front-line state raises special problems of national security which complicate the movement toward political and economic development. Pakistan remains key to efforts to prevent the consolidation of Soviet power in Afghanistan and to bring about the withdrawal of Soviet forces as part of a negotiated political settlement.

U.S. Interests and Objectives

U.S. objectives in South Asia remain essentially unchanged from previous years. We want to encourage the growth of stable, strong, independent states which live in peace with one another free of outside interference. We support the development of sound political institutions, responsive to popular will. We seek to contribute to the efforts the governments of the South Asian countries are making to develop themselves economicallly and to bring about higher living standards for their people in a region which is among the world's poorest and most populous. We want to deter Soviet expansionism, especially in light of the strategic importance of the area.

These regional policy goals mesh with and reinforce wider U.S. objectives such as the prevention of the proliferation of nuclear weapons, the extension of human rights and democracy, the resolution of regional conflicts, the reduction of narcotics traffic, and the expansion of opportunities for American trade and investment. In order to pursue these goals with any effectiveness, it is important to maintain an atmosphere of trust and good will with all countries in the region, through cooperative interaction in the full range of economic, cultural, educational, and scientific activities.

Foreign Assistance and the Proposed Program

U.S. interests, as well as the interests of the recipient countries themselves, are well served by the carefully designed mix of our programs in South Asia. The Pakistan program, for example, responds to security challenges that must be met to preserve that country's territorial integrity and to protect U.S. interests in a strategically vital crossroads of south, west, and central Asia. In all cases, our programs not only serve broad political and development goals but also open up an avenue for wider dialogue, leading to a strengthening of our overall relations with the countries of the region.

Proposed Assistance Levels and Country Programs

Our proposed FY 1985 levels for South Asia have been set with the need for budget austerity very much in mind.

The Pakistan program involves certain special considerations, which I will cover in some detail later in this testimony. We are requesting $325 million in foreign military sales (FMS) credits and $300 million in a mix of economic assistance programs. These totals, which reflect an 8.5% increase over the FY 1984 multiyear estimates, are in accordance with the multiyear Pakistan assistance program agreed to with the Pakistan Government in late 1981 and involving, as you'll recall, close consultation with Congress. We are also requesting $1 million in IMET for Pakistan, compared with $800,000 for FY 1984.

Taking all South Asia programs together, including Pakistan, and factoring in security as well as economic assistance, our FY 1985 budget request for the region amounts to $1.1 billion. This represents 7% of the Administration's total request worldwide - about the same share going to South Asia in FY 1984.

Our economic assistance programs in South Asia account for about 4% of total capital spending in the region. Contributions from other sources are very roughly as follows:

Other bilateral donors - 11%
Multilteral Development Banks - 18%
Domestic Resources - 67%

Thus, our bilateral programs complement a much larger international effort undertaken by other bilateral donors as well as by the multilateral development banks, to which the United States is a major contributor. During the period 1978-82, the United States was the second largest bilateral donor of economic assistance to Bangladesh, Pakistan, India, and Sri Lanka and the fourth largest bilateral donor to Nepal. In most cases, Japan topped the list of foreign donors.

Mutlilateral development banks play a vital role in South Asia, matching the contribution of all bilateral aid donors as a group. The special value of multilateral organizations such as the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), and the Asian Development Bank (ADB) lies in their expertise in developing good projects and seeing them through to successful fruition. This year the Administration is requesting a total of $1.2 billion as our worldwide FY 1985 contribution to all multilateral development banks, including $750 million for the IDA-VII replenishment. In addition we are requesting about $320 million under the FY 1984 supplemental.

Let me now provide a more detailed review of individual country programs in the context of U.S. interests and significant political and economic developments.

Pakistan

Our rationale for our assistance program in Pakistan remains substantially unchanged from the time, in 1981, when we sought and received the support of Congress for the revitalization of our security and economic relationship with that front line state. We have warmly appreciated the backing we have received from you, Mr. Chairman, and from this committee in the ensuing years. That support has been vital in making it possible for us to implement, at very close to full funding, the initial 3 years of our 5-6 program of military and economic assistance. As a result of this consistent progress in moving forward with the multiyear program and other efforts we have undertaken, such as the provision of modern military equipment, the intensification of our dialogue with Pakistan's leaders and senior officials, and the recent establishment of a U.S.-Pakistan Joint Commission, we are well on our way to establishing the atmosphere of confidence and trust which we regard as key to a truly effective U.S.-Pakistan relationship.

The stability and security of Pakistan contribute significantly to the achievement of U.S. objectives in South and Southwest Asia. We continue to believe, as I testified before this committee last year, that a stable Pakistan, one of the world's largest Islamic states, can serve as an anchor for the entire region, lending its considerable weight and influence to the cause of regional peace and harmony. Conversely an unstable, insecure Pakistan adds to regional tensions and invites outside interference.

Pakistan's role is crucial with regard to the Soviet invasion of Afghanistan. The multiyear program for which we are again seeking your support was designed to bolster Pakistan as it confronted the challenges posed by this Soviet action. Four cruel years after the invasion, the continuing implementation of the program remains key to Pakistan's ability to pursue its courageous and principled opposition to Moscow's brutal efforts to subjugate the Afghan people. Without Pakistan's leadership on the Afghanistan issue in international forums, its willingness to offer hospitality and support to millions of Afghans who have fled their country, and its refusal to be cowed by Soviet bullying of bought by Soviet blandishments, Moscow would have been able to consolidate its hold. Afghanistan would have faded from the world's agenda, a forgotten victim of Soviet expansionism.

Pakistan's opposition to the Soviet occupation has had a high cost. Aside from the burden of 2-3 million refugees, aircraft and artillery from Afghanistan have bombarded Pakistani territory causing injuries and deaths and Soviet-supported terrorists, operating at times from Afghanistan, have carried out an aircraft hijacking, acts of sabotage, and assassinations. Pakistan has been subject to a relentless Soviet propoganda and disinformation campaign.

Soviet hostility toward Pakistan results largely from Moscow's frustration over its inability to suppress the increasingly effective Afghan resistance or to cow Pakistan into accepting the Soviet position. The military stalemate in Afghanistan continues: The Soviets control their military bases, major transportation routes and, at least during daylight, most parts of most major cities. The resistance operates virtually at will in the countryside and is capable of operating in the cities, as the recent increase of assassinations of communist officials in Kabul clearly indicates.

The freedom fighters did well during 1983, particularly against communist supply convoys last summer. Autumn campaigns in Paktia and Paktika and a December engagement with Soviet and regime forces near the town of Guldara also resulted in resistance successes. Unless the Soviets very substantially increase their effort in Afghanistan, they will not defeat the freedom fighters in the foreseeable future.

Both Pakistan and the United States remain fully committed to finding a political solution which will end the agony of the Afghan people and allow them to determine their own fate. As you know, Pakistan has energetically participated in the UN-sponsored indirect talks on Afghanistan. The United States also strongly supports the UN negotiating process, and we have clearly endorsed the concepts we understand form the basis of the current draft text, which would provide for a fully integrated settlement. We have stated that in our view such a settlement must include the basic elements spelled out in five UN General Assembly resolutions on Afghanistan - the withdrawal of Soviet troops, the independent and nonaligned status of Afghanistan, determination by the Afghan people of their own form of government, and the secure return of the refugees. We have welcomed the progress made to date and hope for further forward movement with the proposed resumption of consultations in the spring. The sticking point remains the unwillingness of the Soviet Union to seriously address the question of a withdrawal schedule, which is an essential ingredient of any solution.

The actions of the Soviets indicate that they have not given up on conquering Afghanistan. As long as Soviet behavior does not change, there seems little immediate prospect of resolving the crisis. Nevertheless, both we and the Pakistanis will continue to press for a peaceful political settlement.

Any such solutions must take into account the desires of the millions of Afghans forced to flee their homes by the communist coup and the subsequent Soviet invasion. The Afghans Pakistan hosts constitute the largest single body of refugees in the world. The Government and people of Pakistan deserve high praise for the warm and generous welcome they have given to the Afghan refugees. Despite the strain such a large number of refugees places upon the resources of a poor country like

Pakistan, trouble between the refugees and the local population has remained remarkably rare. The United States is proud to have contributed over $320 million in cash, food, transportation, and other relief supplies to Afghan refugee relief since the international relief program began in 1980. A number of other countries - such as Canada, Great Britain, Federal Republic of Germany, Japan, Australia, France, and Saudi Arabia - continue to make large donations to the relief effort. In addition to governments and international organizations, a number of private voluntary agencies have made notable contributions to the program. Despite the international community's generosity, however, Pakistan continues to bear the brunt of the refugee burden.

While the need to bolster Pakistan following the Afghanistan invasion was key to our decision to revitalize our assistance programs in Pakistan, these programs help in the achievement of several important U.S. objectives. Closely related to Pakistan's national security is its economic development and internal stability, key interconnected goals of our assistance programs.

Pakistan recorded its sixth consecutive year of rapid economic growth during 1982-83. Real GDP increased about 6%, and per capita income grew over 3%. Much of this growth is, however, the result of additions to capacity - added irrigated land in agriculture, and new public sector industries - rather than increased efficiency. In order to sustain this high rate of growth in the coming years, the Government of Pakistan intends to devote more attention to increasing agricultural yields and encouraging private sector investment. It is hoped that reforms aimed at deregulating the economy and other measures will stimulate mobilization of resources in the private sector. Although it has enjoyed a recent positive shift in its balance of payments, Pakistan remains dependent on worker remittances and vulnerable to even slight changes in exogenous factors, particularly swings in its trade accounts and shifts in world oil prices. Pakistan imports 90% of its petroleum requirements.

With these vulnerabilities in view, our economic assistance program provides Pakistan with short-term balance-of-payments support and helps stimulate long-term economic and social development. Our 23 ongoing and planned development projects are heavily concentrated in the agriculture, population, health, and energy sectors with a special initiative in private sector development.

We recognize that while economic progress is important in bolstering prospects for stability, the development and strengthening of representative institutions also plays a significant role. Such political actions also have an intrinsic value, as do the fostering of human and civil rights, and enhance the possibility of achieving warm relations with the United States. In this connection, we were encouraged by President Zia's August 12 announcement of his intention to return Pakistan to a more representative form of government. Recent disturbances in one part of Pakistan, which began soon afterward, have since subsided. We are also encouraged by the recent release of a number of political detainees. We hope that the Government and people of Pakistan will be able to manage the transition to more representative institutions peacefully and equitably.

Our economic assistance program also supports Pakistani efforts to suppress opium production and to interdict the traffic in illicit narcotics. Narcotics is a sensitive area in our relations with Pakistan. Over half of the heroin consumed in the United States comes from opium cultivated in Southwest Asia, much of it from Pakistan. Over the past 2 years, Pakistan has also become a major source of refined heroin.

Mindful of its obligations to the international community and deeply concerned about the alarming growth of heroin addiction in Pakistan, the Government of Pakistan is taking significant steps to control narcotics production and prevent trafficking in opium and heroin. A ban on opium growing is enforced in areas under central government control, and the government has agreed to enforce the ban in growing areas where it receives economic assistance from the United States and other donors. It has also agreed to destroy heroin labs immediately upon identification, and over 40 of these labs were closed last year. Interdiction efforts by Pakistani authorities have produced record narcotics seizures, although they recognize that progress is needed in prosecuting major traffickers and syndicates.

Most importantly, the Government of Pakistan has promulgated new legislation substantially toughening penalties for narcotics violations. These new laws are applicable in areas of the country heretofore not under central control. The government has submitted a special development and enforcement plan for multi-donor consideration and has thus signalled its desire to eradicate poppy cultivation throughout Pakistan, even in the tribal areas where central government control has hitherto been exercised indirectly.

We are particularly pleased that, as a measure of the increasing cooperation between our two governments in narcotics control, the Pakistanis have joined us in forming a special narcotics working group under our joint commission. While much more needs to be done, we are satisfied that the Government of Pakistan is firmly committed to controlling the production and trafficking of narcotics.

The assistance program also contributes to U.S. nuclear nonproliferation goals. We believe strongly that a program of support which enhances Pakistan's sense of security helps remove the principal underlying incentive for the acquisition of a nuclear weapons capability. The Government of Pakistan understands our deep concern over this issue. We have made clear that the relationship between our two countries, and the program of military and economic assistance on which it rests, are ultimately inconsistent with Pakistan's development of a nuclear explosives device. President Zia has stated publicly that Pakistan will not manufacture a nuclear explosives device.

We are aware, of course, of concerns about the impact upon Indo-U.S. and Indo-Pakistani ties of our defense supply relationship with Pakistan. The Indian Government at times has expressed apprehension about that relationship. Our supply of economic and military assistance to Pakistan is not aimed against India. Despite some misinformed public speculation, the moderate number of weapons we are providing Pakistan will not upset the current balance of military power in the region, which heavily favors India.

Regrettably, there has been some increase in tension between India and Pakistan in 1983. We do not believe that this can reasonably be associated with our security relationship with Pakistan, which was put into place well before. In any event, these tensions should not obscure the efforts made by both countries to better bilateral relations. In January inaugural meetings were held by elements of the new Indo-Pakistan Joint Commission. There have been continuing exchanges at the official and private level with a view to enhancing mutually beneficial cooperation in a range of fields. The two countries are also cooperating organization, a promising new development in the area. The United States continues to encourage India and Pakistan to draw closer. We will do whatever we realistically can to further the process of normalization between these two valued friends.

Conclusion

In summary, the Administration and the Congress can take satisfaction from the considerable progress that we have seen in South Asia and in our own contribution to that progress. We believe economic development in the region benefits the people of the United States as much as it does the people of South Asia. There was, of course, limits to the contribution we can make. Both to the extent possible, we should stand ready to assist this region - which contains about one-fourth of the world's population - in its search for peace, prosperity, and stability. It is important for both the Administration and the Congress to continue providing what support we can to this process.

II. GENERAL DESCRIPTION OF U.S. AID

The United States Agency for International Development (USAID) is the section of the executive branch of the U.S. Government charged with managing and implementing the bilateral economic assistance program of the United States. AID also acts as a principal advisor within the executive branch on all matters dealing with development assistance and policy. The U.S. Government is a principal contributor of funds for most international organizations active in economic development such as the United Nations, World Bank, International Development Association, International Monetary Fund, Asian Development Bank, etc., and AID advises the U.S. representatives to those organizations on development matters.

Types of United States Economic Assistance

AID-Direct and Managed

- Development Loans
- Development Grants
- Food Credits
- Food Donations
- Program Loans
- Program Grants
- Disaster Assistance
- Excess Property
- Housing Guaranties
- Local Currency Loans
- Local Currency Grants

Non-AID

Grants to Multilateral Institutions

World Bank:

IBRD - International Bank for Reconstruction and Development
IDA - International Development Association
IFC - International Finance Corporation

Asian Development Bank and Asia Development Foundation

United Nations Programs:

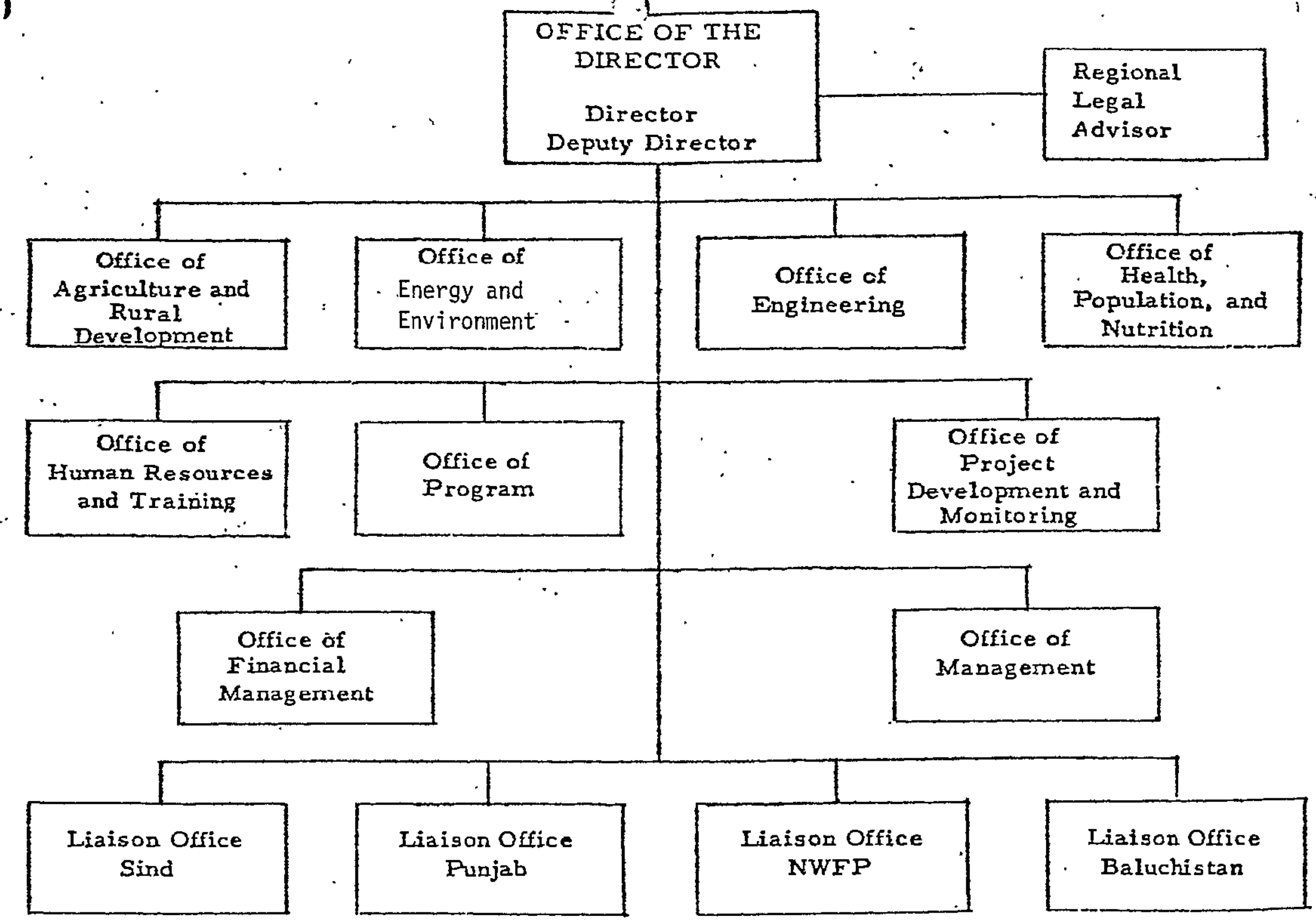
UNDP	ILO
FAO	UNHCR
WFP	WHO

Other U.S.

- Export-Import Bank
- Commodity Credit Corporation
- Overseas Private Investment Corporation

U.S. Assistance to Pakistan

Since the inception of United States economic assistance programs to September 30, 1982, the U.S. has provided directly to Pakistan $5,271.4 million in economic assistance. Thirty-seven percent, $1,967.0 million, of this assistance was on a grant basis. As of September 30, 1982, 34 percent, $1,136.5 million, of the loans were repaid. In addition, the U.S. provided directly $714.3 million in military assistance, $350.5 million in other assistance such as loans from the Export-Import Bank and Commodity Credit Corporation, and the equivalent of over a billion dollars from U.S.-owned rupees. The U.S. had also provided approximately $1,029.0 million indirectly through the IBRD, IDA, ADB and ADF.



Date Approved: November 28, 1983	ORGANIZATION - USAID / PAKISTAN	Approved: Donor M. Lion, Director

69

TABLE 7

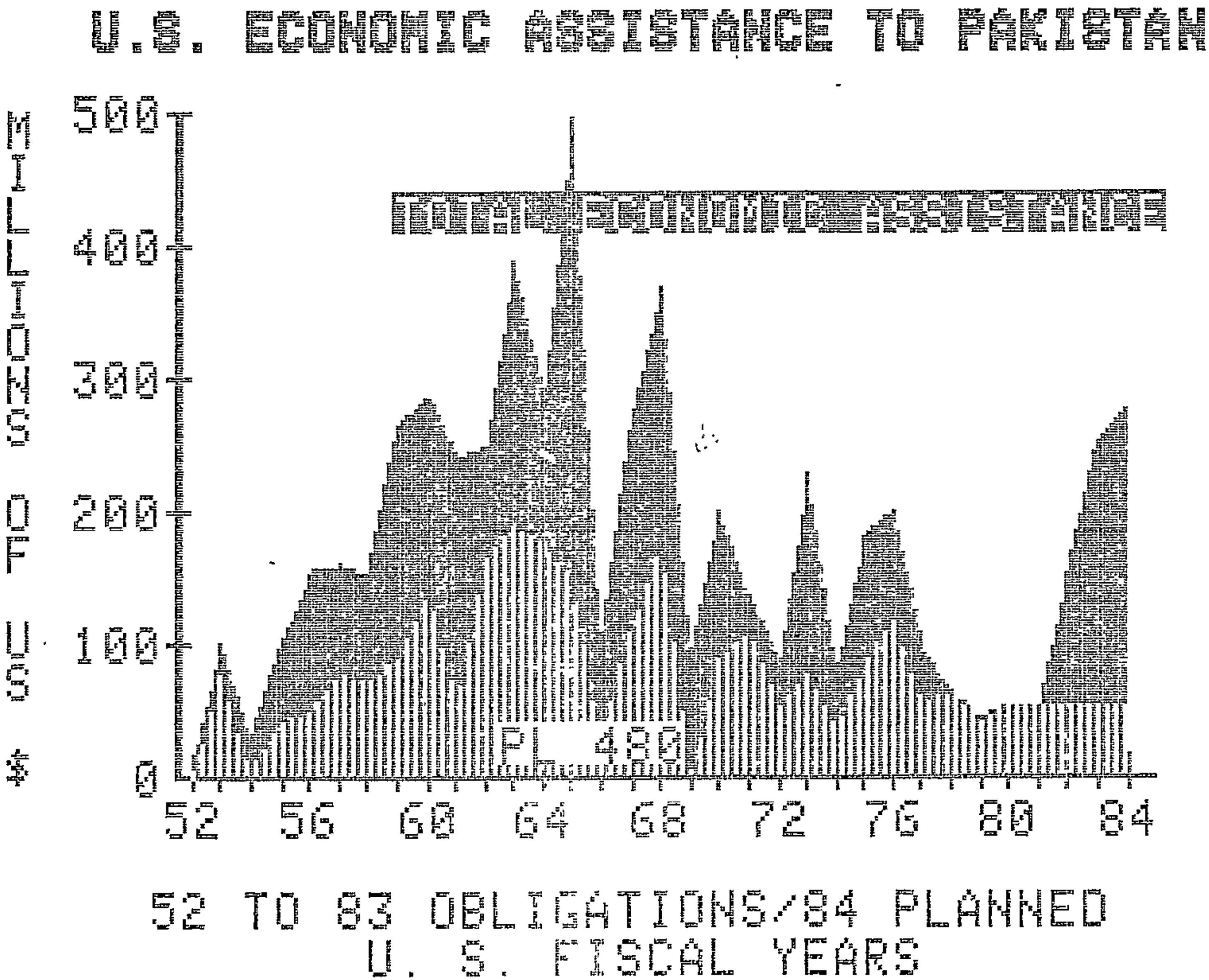

U.S. ECONOMIC ASSISTANCE TO PAKISTAN
$ MILLIONS OF US
500
400
300
200
100
0
TOTAL ECONOMIC ASSISTANCE
P.L. 480
52
56
60
64
68
72
76
80
84
52 TO 83 OBLIGATIONS/84 PLANNED
U. S. FISCAL YEARS

TABLE 8

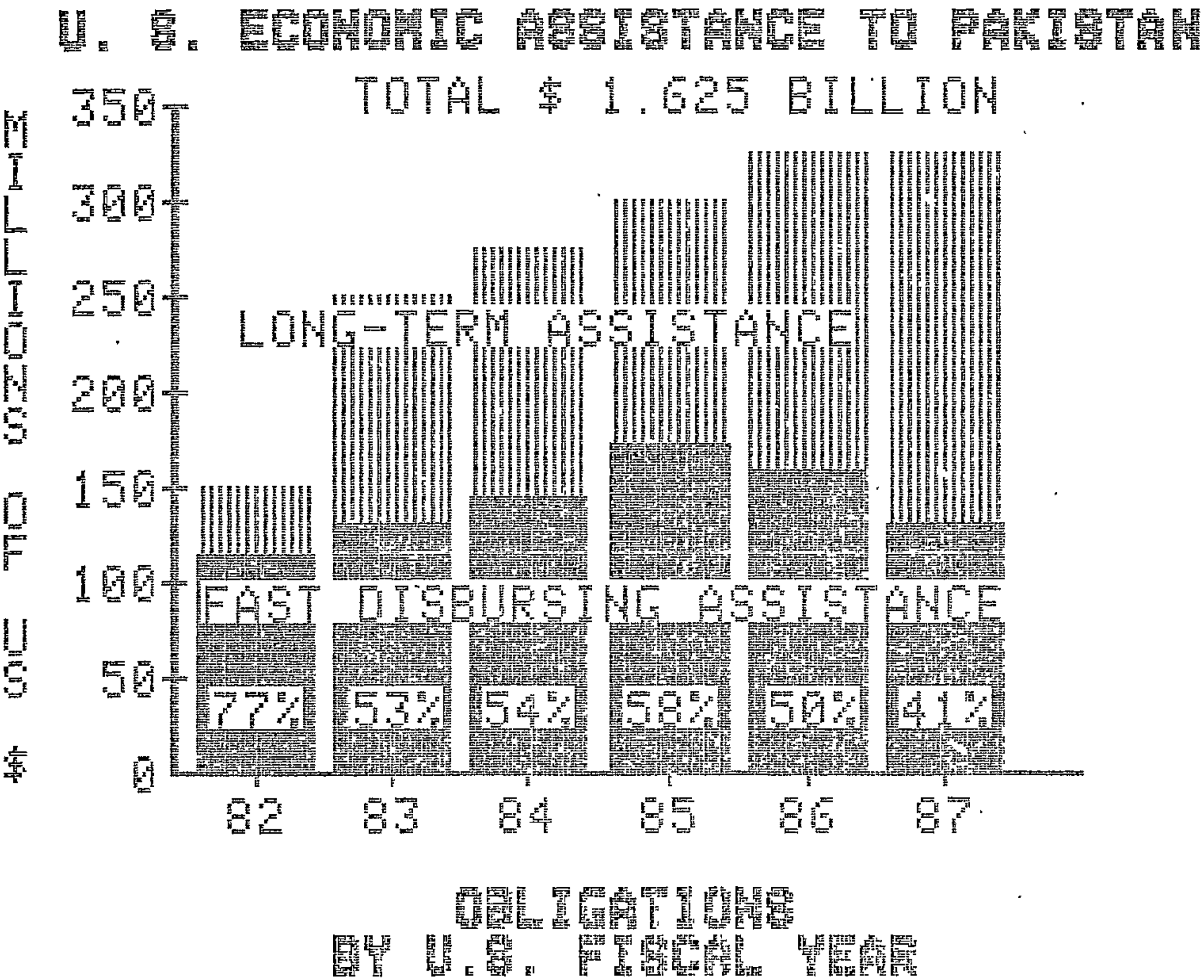
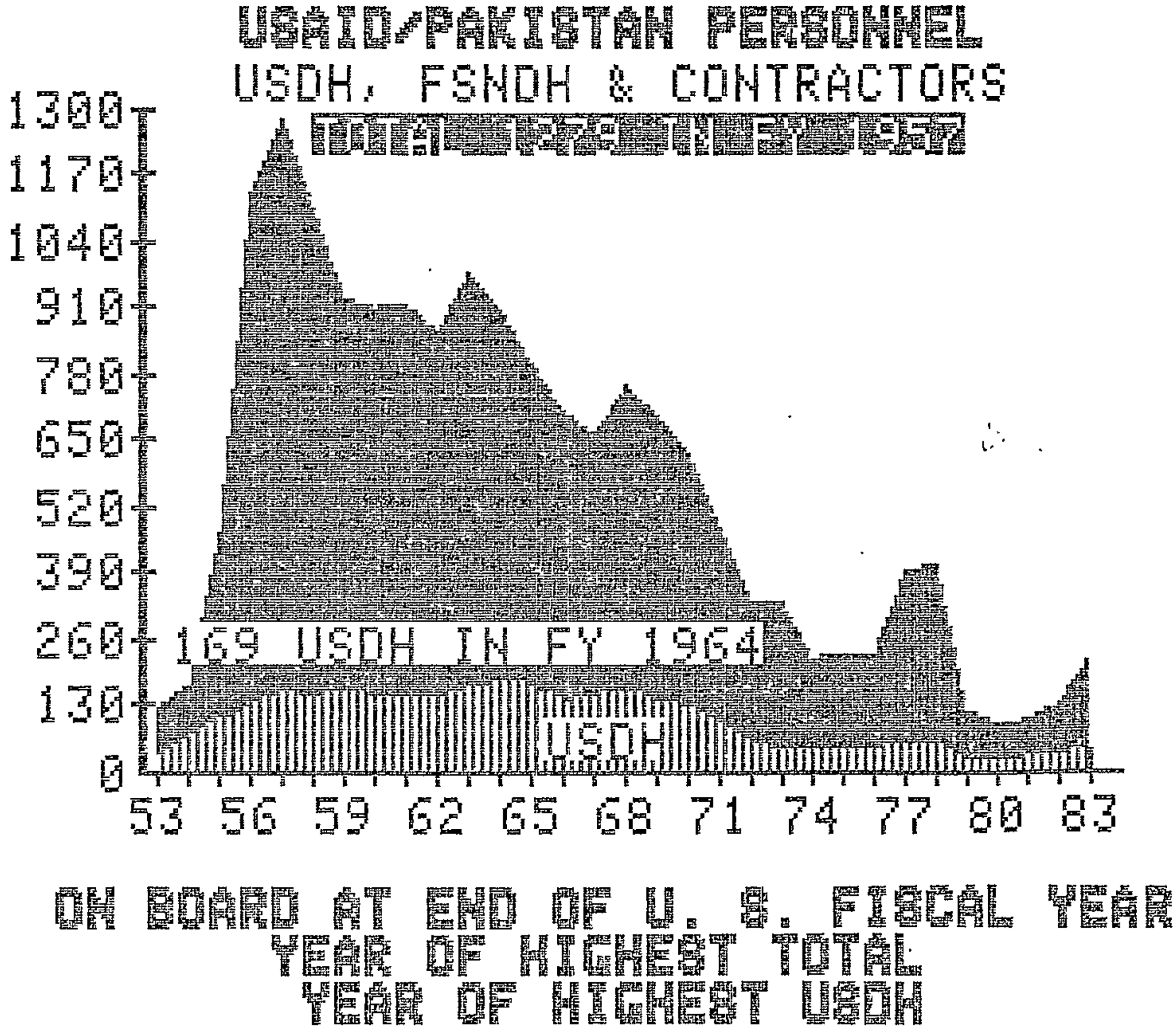
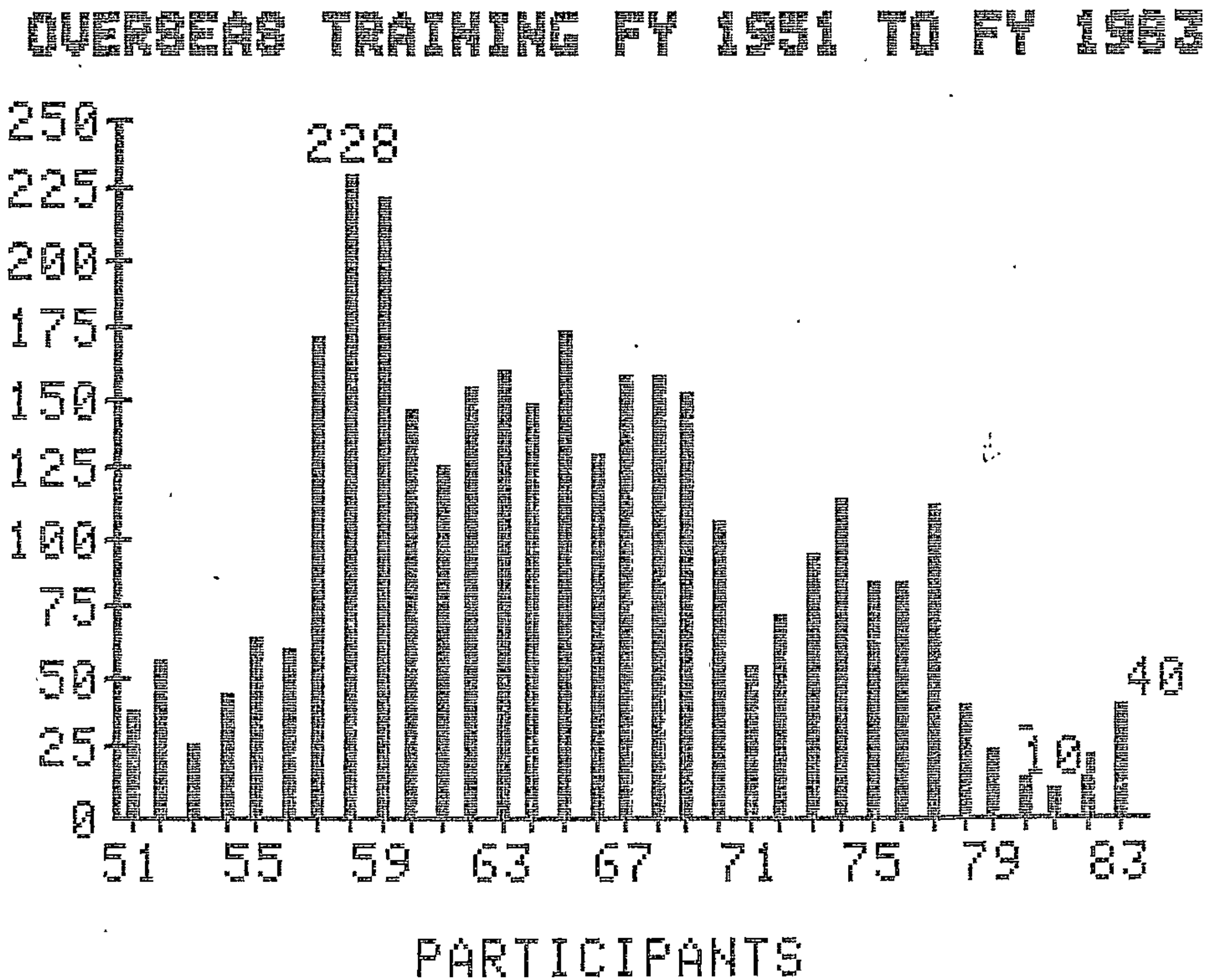

U. S. ECONOMIC ASSISTANCE TO PAKISTAN
TOTAL $ 1.625 BILLION
$ MILLIONS OF US
350
300
250
200
150
100
50
0
LONG-TERM ASSISTANCE
FAST DISBURSING ASSISTANCE
77%
53%
54%
58%
50%
41%
82
83
84
85
86
87
OBLIGATIONS
BY U.S. FISCAL YEAR

TABLE 9



USAID/PAKISTAN PERSONNEL
USDH, FSNDH & CONTRACTORS
1300
1170
1040
910
780
650
520
390
260
130
0
169 USDH IN FY 1964
USDH
53 56 59 62 65 68 71 74 77 80 83
ON BOARD AT END OF U. S. FISCAL YEAR
YEAR OF HIGHEST TOTAL
YEAR OF HIGHEST USDH

TABLE 10


OVERSEAS TRAINING FY 1951 TO FY 1983
250
225
200
175
150
125
100
75
50
25
0
228
40
10
51
55
59
63
67
71
75
79
83
PARTICIPANTS

III. A REVIEW OF U.S. DEVELOPMENT ASSISTANCE TO PAKISTAN 1952-1980

The following is an extract from the Summary Report of an independent review of the development assistance activities of the U.S. in Pakistan. The review was commissioned by AID and the Summary Report was prepared by Jeffalyn Johnson and Associates, Inc. It does not necessarily represent a statement of U.S. Government policies or views.

Development and U.S. Assistance

From a modest beginning in 1951, the U.S. bilateral assistance program to Pakistan grew to annual commitments approaching $400 million in the early 1960's and a cumulative commitment of approximately $5 billion through 1980. The early program focused on technical assistance and disaster relief, but increasingly shifted to capital assistance, particularly after 1958. Of total U.S. bilateral aid commitments, 19 percent was project aid, 37 percent was program aid, and the remainder, over $2 billion, consisted of PL 480 concessional sales whose macro impact was similar to that of program aid. Of the project aid, 38 percent was allocated to agriculture, 34 percent to infrastructure with the bulk of the remainder in health and sanitation (11 percent), public administration (4 percent), and education (2 percent). Except for some fertilizer and other agricultural input financing, the vast majority of the program aid was used to import raw materials, spare parts, and capital to run the industrial sector.

Although in this summary the US/Pakistan aid relationship is broken into several chronologically discrete periods, marked by identifiable changes in the nature of problems and policies, development and U.S. assistance overlapped considerably from one period to the next.

Early Program: 1951-1958

The early program focused on assisting the new Muslim nation of Pakistan to overcome the economic consequences of the 1947 partition of British India. Except for a rather well developed irrigation system in the Indus valley and a considerable railroad network, Pakistan possessed a meagre infrastructure and almost no industrial base. Much of the irrigation was threatened by cutoffs of water from eastern rivers. The road and rails were oriented to former greater India trade and not to the trade needs of the new nation. To make matters worse, the emigration of Hindu professionals and the immigration of unskilled Muslims deprived Pakistan of a skilled labor force on which to found development while leaving it with a difficult refugee problem. Thus, it is not surprising that much of the early U.S. assistance effort focused on disaster relief, infrastructure rehabilitation and expansion, and technical assistance, including programs to modernize the public service. Following a foreign exchange crisis in 1952 and the breakdown of trade with India, the new government undertook a massive effort at rapid industrialization through import substitution. U.S. support for this effort consisted of expanded capital assistance for infrastructure development, increased technical aid to ease the "skills-shortage", and PL 480 concessional sales, which generated local currency for public investment and made it easier for Pakistan to finance industrialization by keeping agricultural prices low and thereby extracting an investable surplus from agriculture.

The results of these efforts were predictable, but in degrees surprising. The industrial sector, dominated by textiles and large-scale industry, grew at annual rates approaching 24 percent while agriculture stagnated, barely keeping pace with population growth. It may be argued that U.S. assistance played an important role in these developments, but it would be a mistake to attribute too much to U.S. efforts, as a variety of circumstances worked to minimize the immediate impact of U.S. aid on development. The size of the program, its administrative instability, the paucity of U.S. knowledge about Pakistan and about the role of foreign aid in development, the equivocating and uncertain commitment within the U.S. to foreign aid program, in combination with political instability and the lack of an orderly approach to development within Pakistan, all worked to minimize the effectiveness of aid utilization. Furthermore, except for disaster relief, food aid and the financing of fertilizer imports designed to bring about quick increase in agricultural output, assistance was aimed at creating the conditions for future agricultural and industrial growth. The experience gained during this period made it possible for future AID Missions to design a more effective assistance program in the next decade.

Pakistan's "Take-Off" Years: 1959-1964

By 1959 the Pakistan economy appeared to be emerging from a rehabilitative stage and entering a "take-off". Prior investments, particularly in human resource development, began to pay off. A Ford Foundation project to train Pakistanis for planning development led to the publication of the nation's first systematic development plan. In addition, earlier investments in physical infrastructure — roads, railways, power, and communication — began to come on stream to provide needed inputs for further industrial and agricultural development. But most importantly, the Ayub Khan government provided the country with a needed degree of stability and a commitment to development. In 1958 the Planning Commission was upgraded to the status of Advisory Committee to the President, and charged the newly trained planners and their foreign advisors to focus attention on the country's pressing economic problems. In quick order attention focused on two issues: the stimulation of agricultural growth and reform of the newly created industrial system. With respect to the former, the government abandoned compulsory procurement of grain at low fixed prices, lowered export taxes on raw cotton and jute, and increased agriculture's share in public development expenditures. In industry, the government established an export subsidy scheme, liberalized import licensing, and gradually replaced import quotas with tariffs. By adopting modernizing policies that the U.S. and the rest of the donor community advocated, the Pakistanis gained donor community financial support. Thus, it is not surprising that the U.S. bilateral program reached a zenith during this decade. The U.S. committed just under $3 billion, nearly 60 percent of its total commitments to Pakistan. Within the Second Five Year Plan period (1960-1965) the U.S. provided 55 percent of all aid received by Pakistan, covering 35 percent of the government's development budget, and 45 percent of its import bill.

In addition to the GOP's adoption of policies which made it easier for the U.S. to increase assistance, an understanding of Pakistan's economic problems and of how foreign aid could be used to ameliorate them led the U.S. to assist in implementing a series of strategies for dealing with flagging industrial and agricultural growth and for assisting a large scale effort aimed at infrastructure development. By 1962, planned AID investments were embodied in a series of "goal plans".

AID's Goal Plans for Pakistan during Take-Off

In industry, the AID "goal plan" was to enhance productivity by alleviating Pakistan's structural balance of payment problem. In addition to financing imported capital goods, raw materials, and spare parts to increase capacity utilization rates, the U.S. funded a series of projects designed to increase the managerial and technical capacity of Pakistan's industrial firms. In agriculture, the AID "goal plan" was to increase low yields by concentrating resources on the development of a series of one million acre areas in the Indus Plain. By arguing that low productivity was the result of a multitude problems, "... any one of which if left unattended could frustrate in large measure activities taken in others", AID came to support an intensive rather than an extensive agricultural strategy. The AID Mission recognizing that growth in industry and agriculture was dependent on rehabilitation and expansion of Pakistan's water, power, transportation and communications networks, now provided additional support to these areas.

The results of these policy changes and increased resource availability were highly rewarding. GNP at constant prices grew annually at a little over five percent while major crop output was growing at 4.1 percent and industry at 6.3 percent.d Both the domestic savings rate and the gross investment rate jumped while income per capita was growing at an annual rate of 2.3 percent.

Both the size of the U.S. aid program and the increased sophistication of AID programmers suggest that U.S. assistance generally played an important role in the healthy performance of the economy during this period. In industry, available evidence suggests that the U.S.-supported commodity assistance program was generating significant returns. Surveys demonstrated that the largely U.S.-financed industrial imports were bringing about higher capacity utilization rates. Furthermore, there is some evidence that the program was fostering higher growth rates in capital goods and intermediate goods industries. But an unfortunate turn in political events brought a rather abrupt halt to the import liberalization program, thus at least partially unravelling these positive developments.

U.S. concern over the 1965 Indo-Pakistan war led to a cessation of new commitments and to the cancellation of the sixth and seventh meetings of the Pakistan Aid Consortium. Although U.S. bilateral aid was quickly resumed, it never reached pre-war levels. The rapid reduction in foreign aid in combination with a growth in defense expenditures made it difficult for the GOP to finance the imports associated with the liberalization program. Not surprisingly, Pakistan resurrected elements of its old trade regime and with predictable consequences. By the GOP denying the industrial sector the inputs to run plants at full capacity and resorting to import quotas, capacity utilization rates fell while the inefficiencies associated with the old protective system reappeared. Furthermore, the reduction in capacity utilization rates undoubtedly led to increases in unit profits. Given the high reinvestment rates out of profits, this must have had a negative effect on both savings and investment rates.

The Revelle Report -- A Strategy Unfulfilled

To make matters worse, there was never full agreement between Pakistan and the U.S. on the area development strategy for agriculture, formalized as a joint White House, Department of Interior study (more commonly known as the Revelle Report) of waterlogging and salinity in West Pakistan. The study was the outgrowth of high level discussions between the Presidents of the U.S. and Pakistan.

Officials in the Pakistan Government took issue with the report's conceptual structure, technical analysis, and organizational logic. While subsequent research suggests that the critique was overdrawn, it is also clear that the Revelle Committee's recommendations ran into heavy political and bureaucratic opposition. First, the Pakistanis felt that it was politically impossible to divert scarce inputs, the scope, as the plan was visualized. Second, the report proposed a reorganization of the Pakistan Government along area as opposed to functional lines, a proposal which found little favor with the generalist-oriented senior bureaucrats. Given the opposition in Pakistan on both counts, it is not surprising that after financing three area development projects (known as SCARPs), AID obligated and then de-obligated the fourth in 1968. The SCARP projects did, however, help to mobilize the government to deal more effectively with lagging agricultural productivity, and they continue today, though at reduced levels.

GOP Policies, U.S. Assistance -- Second Plan

On a more positive note, U.S. assistance efforts seem to have produced encouraging results in three areas. First, the timing of increased PL 480 wheat sales and of Pakistan's increased support prices for its agricultural products in 1959 suggests that those sales may have encouraged the GOP to adopt more favorable price policies. There is a sound argument to be made that favorable price policies played a highly important role in the break-through in agriculture which occurred during the Second Plan period. Second, a number of AID-supported technical assistance projects, including assistance to the Pakistan Industrial Credit and Investment Corporation (PICIC), the Industrial Advisory Center (IAC), the West Pakistan Water and Power Development Authority (WAPDA) and the Agricultural University at Faisalabad, appear to have produced lasting effects, as each of these institutions has attained a degree of self-sustaining prominence in Pakistan. GOP officials praised AID's training programs, which by all accounts were successful. (The vast majority of AID trainees have remained in Pakistan, but many highly qualified professional technicians were unable to find a meaningful role in the generalist-dominated public service and have quit Pakistan for opportunities abroad.) Third, U.S. investments in infrastructure rehabilitation and expansion, especially in air, water, power, and rail development continue to generate positive benefits. One cannot travel in Pakistan today without being aware of the extensive nature of infrastructure development. Further study is needed to analyze the full impact of these developments.

Period of Political Unrest: 1965-1972

The 1965 war with India was followed by the emergence of sharply critical attacks on the decade's economic accomplishments. Some argued that West Pakistan was "exploiting" East Pakistan by diverting foreign exchange earned in the East to finance industrial development in the West, while others argued that the benefits of growth even in West Pakistan had failed to a select few. These attacks seemed to shake the confidence of those responsible for managing development, and provided an additional political weapon with which to challenge the status quo, including the fragile East-West linkage. Economic disillusionment, following the euphoria at the first half of the decade, undoubtedly contributed to the political unrest which ultimately led to the break-up of Pakistan into two separate nations and the rise of power of Z.A. Bhutto. His efforts to broaden, rapidly and drastically, the base of social, political and economic participation in development, in what remained of Pakistan, foundered on the shoals of his excessive zeal. In retrospect, it seems clear that the lack of concern, or, at least, the lack of attention by Pakistani leaders to the growing social, political and economic inequities was a key factor in the political disintegration which took place from 1965 to 1972. Some studies seem to indicate that the rapid growth of the 1960's did result in a major improvement in levels of real income of laborers and other low income groups. However, the extent of awareness among such groups and their subsequent disillusionment, which occurred in the latter part of the decade, is not known and probably cannot be assessed at this time.

What is especially interesting about these developments is that AID program analysts were keenly aware of the potentially explosive nature of Pakistani society as early as 1962, but made little adjustment in program focus to cope with this problem. Between 1965 and 1968, the AID Mission continued to support the macro growth strategy developed in 1962-63. After 1968, the Mission attempted to redress the imbalance in aid allocation between East and West by establishing a larger effort in East Pakistan, and it prepared a series of papers aimed at reforming the industrial system to bring about greater participation. The latter effort never got off the ground and the Mission subsequently let the aid program in West Pakistan wind down. The outbreak of civil war in 1971 finally led to a sharp curtailment of new aid, as non PL 480 commitments dropped to $7 million. In light of this pattern, it is difficult to argue that AID played a productive role in assisting Pakistan during this transition period. Compared to the large U.S. aid flows of the early 1960's, which averaged $375 million annually, average annual commitments fell to a low $150 million. Considering that foreign aid fell from 6.6 percent of the GNP in 1965-1966 to less than one percent in 1971-1972, and that at the same time Pakistan increased its defense expenditures, it is little wonder that the rate of growth decline.

The Bhutto Period

In December, 1971, the new government turned its attention to restructuring a fractured economy and to fulfilling its promise to curb the excesses of the previous pattern of development. To meet the latter, the government committed itself to revising the health care system, expanding educational opportunities, enhancing the productivity of small farmers, and using the power of the state to establish greater control over private sector activities to restrain the amassing of wealth by a few. One aspect of the program was reform of the administrative structure, which the government sought to achieve by weakening the position of the influential elite leadership of the civil service. Initially, the government's efforts were constrained by severe resource shortfalls. A world recession, the consequences of OPEC's oil price policies, and low foreign aid commitments made it difficult for the new regime to meet its goals. Pressed by the need to satisfy his constituency and by resource scarcity, the government adopted a series of policies toward industry and agricultural which only encouraged capital flight, depressed the savings rate, and reduced incentive prices for farmers. Not surprisingly, the gross domestic product at constant factor cost barely kept pace with a three percent population growth rate. After 1973-74, the government recognized the importance of increasing incentive prices in agriculture, and it adopted policies which improved the benefit cost ratios associated with increased fertilizer use and increased growth rates of major crops.

Beginning in 1971 the AID Mission prepared a series of sector papers which formed the basis for a resumption of the bilateral program in FY 1973. Uncertainties surrounding the new government's priorities led the Mission to support the GOP's 1973 requests for debt relief, commodity loans, and an expanded PL 480 program, but the Mission viewed this program in "transitional" terms. In the interim, pressed by the passage of the Foreign Assistance Act of 1973 which stressed the pursuit of <u>growth with equity</u> to meet basic human needs, the Mission set about devising a new assistance strategy. Lack of interest in AID/Washington in the industrial sector, in combination with the nationalization of 31 firms in ten basic industries, including the vegetable ghee industry, and GOP support for the publicly owned Russian-assisted steel mill in Karachi, led the Mission to drop discussion of the industrial sector in its FY 1974 statement.

Recent Program: 1973-1979

Agricultural Emphasis Renewed

The Mission seized on the new government's concern for the small farmer and for the poor to propose a series of investments in agriculture and the social sector. In agriculture, the Mission focused on water and fertilizer, while its investments in the social sector included support for family planning, nutrition research, malaria control, and rural health. With respect to the former, AID funded a research project on water management and a follow-on demonstration project, and sought to get the GOP to develop a fertilizer strategy. In support of that strategy, AID agreed to finance research to identify the constraints to increased fertilizer use, provide foreign exchange to cover fertilizer use, provide foreign exchange to cover fertilizer imports, and assist the GOP to increase domestic fertilizer production capabilities.

The efforts in agriculture have been on a much greater scale than those in the social sector. The research project on water management demonstrated, much to the surprise of everyone involved, that as much as 40 percent of Pakistan's irrigation water was being lost in her water courses. As a result, the Mission funded a demonstration project to improve the water courses, and, although that effort has proved to be too costly to replicate nationally it has galvanized both the GOP and the donor community to search for more effective ways to reduce water losses. AID financial support for the GOP's fertilizer strategy has focused attention in this direction and played an important role in gaining donor community support for a larger effort. As a result, fertilizer consumption has grown rapidly and has been the single most important cause of the recent rapid growth in agriculture production and particularly wheat production after 1974.

Social Sector Development

On the other hand, the GOP has shown ambivalence toward social sector investments. Three major social programs, population and family planning, health and nutrition have been examined by the review team. Between 1952 and 1980, AID expenditures in Pakistan for these programs amounted to $78,152,000, with the breakdown as follows: population and family planning -- $24,806,000, health promotion -- $52,070,000, (over 80 percent devoted to malaria control), and nutrition promotion -- $276,000.

Population and Family Planning assistance accounts for .5 percent of total U.S. assistance to Pakistan and over 70 percent of this was expended in the period 1973-78. There has been no assistance since April, 1979. The GOP population programs began in the mid-1950's on a modest scale and increased in size and momentum through the 1960's, reaching a zenith in the 1970's. Much foreign support, principally from AID, UNFPA, Germany and Sweden, bolstered the government's efforts until the late 1970's. Currently the program receives limited foreign assistance, only from UNFPA. The principal reason for the withdrawal of support was the absence of positive results in use of contraceptive methods and in the spread of knowledge about these methods. More important, total fertility rates had not dropped. The effort seems to have failed because of: internal organizational problems; the necessity of training large numbers of people when the program did not have the capability; problems in distribution logistics, inadequate research and evaluation efforts, different program expectations of AID officials and Pakistanis; and program interruptions caused by changes in the priorities of both governments. Although the statistical base is inadequate, recent estimates indicate a 1980 population of 82 million and an annual growth rate of three percent. At the current rate, Pakistan, already the 9th most populous country, will come close to doubling in population by 2,000 A.D. GOP officials express alarm at the population growth rate but until recently few have seemed to appreciate the dimensions of the problem and/or accord it a high priority.

Health promotion assistance by the U.S. accounts for only about one percent of total U.S. aid, but it has had positive results. Pakistan's problems in this area are enormous, and despite the GOP's increasingly effective efforts to expand the health care system, health services are by and large inadequate, except in the larger urban communities. U.S. assistance to various anti-malaria projects has helped achieve results, but on a more modest scale than anticipated. AID is also providing major funding for a pilot Basic Health Services Project, intended to establish basic health units in the rural areas.

On nutrition, available records indicate that GOP activities have been largely limited to working with international relief agencies. For the most part, these agencies are less than satisfied with the Government of Pakistan's participation and support. AID's contribution was totally expended on a Nutrition Planning and Research Project which ran from 1974 to 1977 and for which records could not be located. Other projects were considered, scheduled and eventually dropped. The AID-funded rural health project is beset by difficulties, among them the opposition of physicians to having trained paramedics diagnose and treat minor health problems, and inability to attract enough physicians and trained women paramedics to staff the basic health units in rural areas, where social customs prohibit treatment of women by men.

AID Impact from 1973

While it is too early to assess the ultimate impact of AID's investments on development after 1973, several aspects deserve mention. First, the size of the U.S. program between 1973 and 1977 was small by historical standards. Annual commitments averaged only $8 million more than investments made between 1969 and 1973. Furthermore, U.S. assistance remained relatively small in comparison to standard macro-economic indicators (i.e., GNP, *per capita* income, etc.), and Pakistan's growing development needs. Despite this, the efforts in fertilizer and water seem to be producing results out of proportion to the size of the financial flow. By contrast, efforts in the social sector are producing meagre results. Although a variety of factors probably contribute to the differences in the results from these two sectors, the most significant factor could be the degree of difference in GOP commitment to them. For example, AID's extensive strategy for increasing the supply of agricultural inputs is consistent with the GOP's conception of the most effective way to increase agricultural productivity. At least since the early 1960's, GOP officials have been arguing that low productivity is due to the lack of and/or inadequate supply of inputs. The inputs strategy has the further advantage of directly increasing the growth rate, which is consistent with the expressed sentiment that the quickest way to improve basic human needs of the poor is through the "trickle-down" effects of rapid growth. On the other hand, there is ample evidence to support the conclusion that Government (by and large) has lacked interest in social sector investments. AID's assessment of Pakistan's commitment and performance in the social sector demonstrates that Pakistan fares poorly in comparison with other countries at a similar stage of development. Similarly, at least on analyst has argued that policy-makers have not yet

> "...been convinced that a healthy nation is one of the most valuable capital assets a country can have."

Finally, a number of GOP officials interviewed during October and November, 1980 were quite frank in expressing their disenchantment with the pressure they were receiving from the donor community to increase resource allocations to what they referred to as non-income producing social investments.

This emphasis on macro-growth at the expense of a commitment to greater equity has been heightened since the overthrow of the 1977 government. The new government was quick to realize that the previous government's downfall was largely a result of its inability to deal effectively with pressing economic problems. Thus, the present government undertook a number of corrective measures, such as offering increased incentives to farmers, dismantling public control of the industrial sector, and restoring the position of the elitist leadership of the bureaucracy, designed to revitalize the economy and to rebuild confidence.

These changes seem to have produced encouraging results, but difficult problems remain. Productivity in agriculture and industry continues to be low despite the policy changes and the balance of payments remains in a precarious position. Foreign exchange needs are acute, burdened by heavy debt-service obligations. A large part of these needs (60 percent of Pakistan's import bill and eight percent of its GNP) today is met by worker remittances, mainly from the Middle East, but remittance growth rates are levelling off. Furthermore, the continuing debate over denationalization and the pace of Islamization seems to reflect a tension between those who espouse a return to macro-growth and those who argue for broadening the base of participation in social, political and economic life. Some officials see this debate as a search for national identity, and several commented that Islamization could be the vehicle by which Pakistan finally integrates growth with equity.

Since 1978, assistance has been limited to drawdowns on existing projects, PL 480 sales and support for debt rescheduling. Pakistan's disappointment with this curtailment of aid reflects concern not only over the need for assistance, but also over the disturbing implications for the US/Pakistan relationship as a whole

Recently the GOP signed a three-year EFF agreement with the International Monetary Fund (IMF). In recognition of Pakistan's precarious balance of payments position, the IMF has extended credit up to $1.7 billion over the three years in conjunction with the adoption by the GOP of a series of macro policy changes designed to increase the growth rate. While the Western donor agencies have not, as yet, offered additional financial support, the IMF package is based on the assumption that the major donors will come forth with some combination of structural adjustment, lending and debt relief. Although it is apparent that the IMF is concerned about international financial stability and that Pakistan is strongly motivated to increase its aggregate growth rates, the framework of the current dialogue is likely to continue to detract attention from pressing needs in the social sector. AID's current emphasis on growth with equity places it in a potential position of leadership and influence within the donor community. The continued delay in resumption of the bilateral program may be depriving both Pakistan and the donor community of a much needed opportunity to provide a better balance between growth emphasized in the IMF agreement, and increased equity which is an important end it itself. This may be critical in avoiding a repeat of the political disturbance of the late 1960's and early 1970's.

Lessons Learned

A number of important lessons about the relationship between aid and development can be gleaned from the United States/Pakistan bilateral assistance experience.

The Cost of Aid Interruptions

The bilateral program was interrupted for political reasons at least three times during the period 1965 to 1978. Furthermore, the rapid growth in assistance between 1960 and 1965 was followed by an equally rapid decline after 1965. In each instance, this lack of stability in U.S. aid commitments worked to wholly or partially negate the developmental impact of the resource transfer. The cessation of new commodity commitments following the 1965 War and the breakdown of the Pakistan Consortium made it difficult for Pakistan to continue the import liberalization program that donors and recipient had worked to hard to establish. While subsequent internal political developments may have made it impossible for Pakistan to carry out the program, there is little doubt that the rapid reduction in aid commitments hastened the resurrection of elements of the old trade regime, thus largely negating the positive impact of the commodity assistance program on capacity utilization rates and industrial structure. Similarly, the cessation of new commitments in 1978 can be expected to severly limit the impact of the resource transfers associated with the U.S. program between 1973 and 1978. The current curtailment is less likely to affect the productivity of investments in water programs, which have proven their value, than to affect investments in fertilizer and the social sector. Severe resource shortages will make it more for the government to maintain the disciplined scheduling of required level of imports for the fertilizer programs, and the GOP may be compelled to terminate the social sector programs in the absence of significant U.S. or other foreign assistance.

The Importance of Stable Commitments

Additionally, erratic fluctuations in aid commitments make it difficult for the managers of development to plan successfully. The reductions in aid which followed difficult political times, especially between 1969 and 1973, exacerbated the economic decline, making it more difficult for the government to resolve tensions in a productive way. To the observer it seems that ways could have been found to alleviate the tensions within Pakistan other than those ultimately adopted by the Bhutto government. There was warning as early as 1968 that pressures for nationalization would grow unless mechanisms were created for broadening the base of participation in the industrial system. In addition, AID personnel had developed a series of proposals for alleviating those tensions. The U.S. not only did not support those measures, it systematically reduced new commitments to Pakistan (the former West Pakistan) between 1969 and 1973, depriving it of both the strategy and the resources needed to resolve its difficulties in the most productive manner possible.

The Limits of Leverage

Aid practitioners as well as critics have been enamored of the concept of policy leverage. Those who favor macro approaches to aid allocations are fond of arguing that nothing is more important than the adoption of correct macroeconomic policies, while the critics contend that the donor "conditioning system" represents an unwarranted intrusion in the domestic decision-making processes. There is little doubt that policy changes, particularly those adopted prior to and during the Second Plan period, played an important role in Pakistan's "take-off" during the

Second Plan period. The results of changes in support prices for agriculture and in liberalization of the import system offer powerful support for those who favor this approach to aid giving. But the Pakistan experience suggests that much of the argument has been overdrawn on both sides. For one thing, the success of the efforts in the 1960's as well as the increasing fertilizer activity is attributable more to donors' acquiescence and support for policy changes that Pakistan wished to make, than to donor "conditioning" of Pakistan. Those who favor leverage give too much credit to donor agencies' capacity to influence governments to adopt the "right" policies. Second, in the case of the large-scale commodity assistance programs, foreign aid broadens the base of participation in the import system, thereby helping to reduce the potential political costs of a program designed to enhance efficiency. This does not fit the picture of "unacceptable interference in domestic policies" that critics portray in discussion when the U.S. has tried to leverage the GOP in the manner portrayed by critics, the attempt has not been successful. The governmental reorganization proposed in the Revelle Report was never fully implemented and the lack of support within the GOP for an integrated area development strategy played a large role in the failure of the SCARP program. Also, the changes advocated by the U.S. in the structure and operational style of the public service never took, partly because of traditional attitudes, partly because of an overly aggressive promotion of change.

Finally, the lack of interest within the GOP in social sector investments helps to explain the poor performance of recently funded AID projects in health. These examples demonstrate all too clearly how difficult it is to get governments to do something with which they do not agree.

Pakistan's Urgent Needs

Pakistan's problems are both urgent and acute. The country in weighed down by a heavy import bill and a crushing debt service burden, much of it deriving from U.S. development loans. Recent short-term borrowing from the IMF and commercial banks offers only a temporary and potentially costly solution. Moreover, foreign exchange needs will grow as the cost of petroleum imports rises and remittances from abroad, which now meet 60 percent of Pakistan's import bill, level off. Further pressures on the balance of payments are likely to result from import liberalization policies, induced by the recent agreement with the IMF, and the continuing and substantial imports of vegetable oils, for which demand is increasing by 15 percent annually. Maneuverability in allocating domestic fiscal resources is almost equally constricted. For one thing, 85 percent of Pakistan's development budget is committed to local currency financing of on-going donor-assisted projects. For another, action in the areas in which savings seem possible -- reduction of food and fertilizer subsidies, closure of unprofitable and inefficient nationalized industries, cuts in defense expenditures -- is likely to be minimal at best because of the political and social risks involved and the situation on Pakistan's borders. Assistance to Pakistan, if resumed, must somehow address these immediate needs.

In addition, the population problem is becoming increasingly urgent. Pakistan, conscious of past failures to cope with the population problem, and with growing alarm, at least at the top level government, over the implications of an unchecked population growth rate of 3 percent, has devised a new three-year plan, integrating population planning with broad social sector objectives. This depends, in part, for its successful implementation on a heavy input of foreign assistance possibly including financing of local currency costs. It is a program consistent with the current development priorities of Pakistan and the U.S. and one for which U.S. aid could be considered.

IV. FOOD FOR PEACE: PUBLIC LAW 480

Expanded agricultural production in the developing countries is the only feasible long-run solution to the world food program. Consequently, U.S. development assistance assigns a high priority to helping Less Developed Countries achieve this goal. In the interim, however, to meet the continuing need for U.S. food aid, AID believes that the PL 480 program should have as its priorities: (1) assuring an adequate U.S. response capability in emergency situations; (2) assuring program continuity for high priority Title II projects; (3) the allocation of most Title I food aid to those needy nations facing the greatest food deficits; and (4) providing other Title I programs on the basis of U.S. national interest after establishing the intended recipient's import requirements for PL 480 commodities. It is AID policy, in interagency discussions on the total amounts of food to be made available and the choice of recipients, to emphasize LDC development and humanitarian requirements.

It is AID's goal to utilize all non-AID resources, and particularly U.S. food available under PL 480, as efficiently and carefully as funds are made available for AID use. These resources must therefore be integrated as fully as possible with all resources in support of Country and Mission overall or sector goals, with particular care taken to avoid production disincentives in agriculture and other sectors. Thus, Title I food sales, which are essentially similar to program or sector loans, are justified by Missions and Bureaus on the basis of either a limited resource gap (i.e., balance of payments) analysis or the impact the food sales will have on the agriculture sector directly and on that and any other sectors indirectly through the local currency thus made available to the LDS government for development purposes. Title II grants (other than emergency assistance) are justified in terms of maternal-child nutritional and health needs, labor-intensive community development projects, and elementary school lunch programs, with maximum feasible use of U.S. private voluntary agencies.

A) U.S. Food Credits to Pakistan

Through September 30, 1982, the United States had provided a total of $2,006.9 million for food imports to Pakistan under concessionary terms. Between 1972 and 1982, 3 million metric tons of wheat and 580,000 metric tons of edible oil were imported. As of September, 30, 1982, Pakistan had repaid 18 percent ($367.9 million) of these credits.

During FY 1983 and 1984, the U.S. provided an additional $100.0 million credit, $50.0 million each year, for the importation of 170,000 metric tons of edible oil.

B) U.S. Food Grants to Pakistan

Through September 30, 1982, the United States had provided $327.7 million in food donations for Pakistan. Most of this assistance, 84 percent, was provided for Emergency Relief and Economic Development through the World Food Program. The balance, $62.3 million, was provided through voluntary relief agencies.

Since 1979, the emergency relief needs of Afghan refugees have become especially important. The U.S. has provided $230 million in food through WFP to help feed the Afghan refugees.

V. GOVERNMENT OF PAKISTAN

I. Federal Level

Under the 1973 Constitution, which is still operative with the suspension of certain Articles under the present Martial Law regime, Pakistan has adopted a federal form of Government.

It consists of four provinces, namely the Punjab, Sind, Northwest Frontier and Baluchistan. The central government as well as each province has a separate civil service system. The government at the federal level is termed the Government of Pakistan (GOP) and the government at each province level the Provincial Government. They each independently deal with matters falling within their jurisdiction in accordance with their respective legislative list contained in the 1973 Constitution.

The GOP functions in tiers and separates policy making and administrative functions. The two basic tiers are Federal Level and Provincial Level which each follow parallel lines. The Federal Government is made up of Ministries, whose Secretariates handle policy matters, and Field Departments, Attached Departments and Autonomous Public Corporations that are charged with implementation matters.

A) Civil Service Administration

The Civil Service of Pakistan is composed of the Federal Civil Service and the Provincial Civil Service, each monitored by the respective government. In addition, local governments also have their own civil service.

The civil service has a dual structure of General Administrators who form the career service and a specialized cadre for those with special technical qualifications.

Secretary: Each Ministry in the Federation as well as the Province is headed by a Secretary. He is the highest executive from the the civil service. He is in charge of his Ministry and is empowered to commit the Government in matters relating to his subject. His decisions in the administration of functions relating to his Ministry are final. Although the Secretary of the Ministry plays an important role in the formulation of Government policies, final decisions are taken by the Minister of by the Cabinet. Most of the Ministers concern themselves very little with day-to-day business of their Ministry with certain notable exceptions. Under the Government of Pakistan rules of business, the President and certain Secretaries of the Government of Pakistan (not any Secretary of the Provincial Government) are, pursuant to the authority delegated to them, empowered to commit on behalf of Pakistan.

Additional Secretary: Next in the hierarchy of the Executive system (both at the Government of Pakistan and the Provincial Government levels) is the Additional Secretary who generally has a distinct and discrete part of a division (a wing). In turn, each will have a number of joint Secretaries. The Additional Secretary has independent assigned responsibilities under the Rules of Business of the Government under the general supervision of the Secretary. In the absence of the Secretary, the Additional Secretary assumes full charge and the responsibilities of the Secretary.

Joint Secretary: Under the Additional Secretary, there are a number of Joint Secretaries who either deal with assigned work or are made responsible for certain jobs in the Ministry. They are empowered to make limited decisions at their level, subject to review and approval by the Additional Secretary or the Secretary. Unless especially empowered by the Secretary of his Ministry, they cannot officiate as Additional Secretary even if the Additional Secretary is on leave or out of the country.

Deputy Secretary and Section Officers: Beneath the Joint Secretary, there are a number of Deputy Secretaries and the Section Officers. The initial note on any matter under consideration by the Ministry is generally prepared by the Section Officer. This note is submitted to the Joint Secretary throught the Deputy Secretary. Although the Deputy Secretary normally has no personal authority to decide any matter at his level, he either recommends or disagrees with the note of the Section Officer and in turn submits the note to the Joint Secretary.

Parallel to this structure, and at times overlapping, are other professional titles used in government according to various organizational arrangements. These include the following:

Director General: Roughly equivalent to Joint Secretary. Apart from the normal decision-making powers enjoyed by him under Rules of Business of the Government, he is assigned specific powers and responsibilities which relate to the specific job assignments. He enjoys more freedom and authority in dealing with day-to-day work of specific projects under the general supervision, control and authority of the Additional Secretary or Secretary.

Chiefs: Roughly equivalent to Joint Secretaries. They are placed in charge of a specific project. The American bureaucracy would consider these officers as Division or Section Chiefs.

Directors: Directors are equivalent to Deputy Secretaries or in some cases slightly less. They are usually concerned with specialized functions or arrangements, and are normally specialists rather than generalists.

Grade Structure: Pakistan's civil service is composed of 22 grades. Federal Secretaries are grade 22, Additional Secretaries 21, Joint Secretaries 20, Deputy Secretaries 19 and Section Officers grade 17 or 18. The lower grades (1 to 16) are assigned to clerical staff. Except for Department Chief Secretaries, who could be a grade 22, Provincial Secretaries are grade 20. Provincial Additional Secretaries are grade 19, Deputy Secretaries 18 and Section Officers grade 17.

B) Ministry of Finance and Planning

1. Economic Affairs Division

The Economic Affairs Division (EAD) is the major focal point for all AID business with the Government of Pakistan. All development ideas are initially officially discussed with EAD; all agreements are negotiated with EAD and signed by its Secretary for the Government of Pakistan. AID (D, DD and Program Officer) usually meets with EAD once a month or more often if necessary. The senior staff with whom AID deals include: Secretary (Ejaz A. Naik), Joint Secretary (Nisar Ali Shah) and Deputy Secretary (Agha Ghazanfar).

2. Federal Planning Division

All projects with which AID assists the Government of Pakistan proceed on the Government's side by preparation of a Planning Commission Document (PC-1 for all operational projects and PC-2 for all research projects) which eventually must be approved by the Central Development Working Committee of the National Economic Council. The Planning Division is responsible for this process.

AID meets with the Secretary to get ideas on development programs as appropriate. AID staff members meet with the Economists and other Section Chiefs relative to specific programs.

Once a project idea has been vetted with EAD, and a "go ahead" is given, formal discussions may proceed with the concerned Federal and Provincial authorities.

3. Line Ministries

Each AID Office Chief has regular contact with the Government of Pakistan Secretary of the Ministry in which projects assisted by AID are located.

Provincial Government project documents are reviewed and approved by Federal Ministries after which they go to the Federal Planning Division.

4. Project Review

Decision making on projects is all highly centralized with approval authority vested at various levels in accordance with the monetary value of a proposal. Director Generals and certain top provincial officials can approve projects within their Annual Development Plan Budgets of up to Rs 5 million. All projects above Rs 20 million must be forwarded through the Federal Planning Commission.

The Federal Planning Commission is a permanent agency carried by the President or Prime Minister. The Deputy Chairman, operational head, is a Federal Minister. The Planning Commission carries out short-term and long-term economic planning for the entire country. It also assesses resources and priorities and carries out relevant research. All federal government projects are reviewed by the Planning Commission.

The National Economic Council (NEC) reviews all five year plans and annual development plans as well as all other major projects, i.e. projects over Rs 20 million. Its chief executive is the Prime Minister or President and includes Ministers and representatives from the provincial governments. The Executive Committee of the National Economic Council (ECNEC) is chaired by the Minister of Finance and composed of other federal and provincial officials. Ad hoc Development Working Parties are established for each major project.

II. Provincial Level

Each Provincial Governments has an Additional Chief Secretary for Planning and Development, in some instances termed Development Commissioner. This officer plays a role at the provincial level similar to that of the Federal Planning Division. Historically, the AID Director, Deputy Director and Chief of Program Office have assumed responsibility for maintaining contact at this level in the province.

All AID Office Chiefs have regular contact with Provincial Secretaries of Departments through which project implementation takes place. Increasingly, AID projects are implemented at the provincial level.

The following organization chart is typical of a provincial government under normal conditions. Under the present Marshall Law Authority, there are no Provincial Ministers but occasionally a Governor may appoint special advisors who, in effect, perform ministerial functions.

BIO-DATA

General Mohammad Zia-ul-Haq, President of Pakistan

General Mohammad Zia-ul-Haq came from East Punjab, which is now part of India. He was born on August 12, 1924. At the time of creation of Pakistan, in 1947 he was in the Indian Army and opted to serve Pakistan.

On March 1, 1976 he was promoted to Army Chief of Staff. On July 5, 1977 he replaced Prime Minister Zulfiqar Ali Bhutto as Chief Martial Law Administrator.

At that time there was a lot of chaos and all opposition parties agitated against Bhutto's regime. The take over was not opposed by the opposition political parties. It was, however, challenged in the Supreme Court of Pakistan by Begum Nusrat Bhutto, wife of the ex-Prime Minister, under the provisions of the 1973 Constitution. The Supreme Court validated the act of General Zia and allowed his continuance in office under the "Principle of Necessity". The Supreme Court discussed the law and order situation in the country in detail and quoted innumerable instances in which Bhutto and his party had planned a large scale elimination of the opposition and had brought the country to the verge of break-up. The Supreme Court concluded that the timely intervention of the army saved the very existence of Pakistan. The Supreme Court also concluded that the continuance of President Zia in office is temporary until the situation becomes normal for holding elections in the country.

With the mandate so given by the Supreme Court, General Zia continues to function as the President and Chief Martial Law Administrator.

CHAPTER VI: PAKISTAN: KEY SOCIAL AND ECONOMIC INDICATORS

AREA	POPULATION*	DENSITY
803,943 Km^2	94.1 (Mid-1983)	117 Per Km^2

POPULATION CHARACTERISTICS

Population Growth Rate	2.6%	(1983)
Population in Urban Areas	29.0%	(1982)
Live Births per 1,000 Population	47	(1983)
Married women aged 15-44 years using contraceptives	64.0%	(1980)

Population (1980)
In Age Group (0-14 yrs) 46.5% (15-64 yrs) 50.7%
(65 yrs) 2.8%
Infant Deaths in first year of life per 1000 live births (1983) 126

HEALTH

People per physician (1977) 3,775
Major cause of
Disease - (1981) Amoebiasis, tuberculosis, typhoid fever
Death - (1974) Malaria, parasitic diseases, infectious diseases

Per capita calorie supply as a % of requirements (1977)99%
Population with reasonable access to safe water supply (1976) 29%

EDUCATION

Total School Enrollment as % of Population in Age Group:

Primary	(1978)	Total 56.0%	Male 81.0%	Female 31.0%
Secondary	(1978)	Total 16.0%	Male 24.0%	Female 8.0%
Post-Secondary	(1976)	Total 1.6%	Male 2.3%	Female 0.8%

LITERACY

	(1979)
Total	24%
Male	36%
Female	14%

AGRICULTURE

Annual per capita Agricultural Production Growth Rate (1973-1982) 1.1%

Agricultural Production as % of GDP (1981) 27%
Population Density/Sq Mi of Agricultural Land (1979) 821

Major Crop(s)	Arable Land	Year
Subsistence: Wheat, corn	47%	(1982)
Cash : Rice, cotton	31%	(1982)

Major Agricultural Exports (1983)
Rice, cotton
Major Agricultural Imports (1983)
Vegetable oils
Proportion of Labor force in Agriculture (1982) 57%

* Population estimates according to C.P. data sheet

FOREIGN TRADE

Major Exports (1982) rice, cotton, cotton fabrics

Exports to U.S. ($ million US FOB) (1982)	168
As % of Total Exports (1981)	7%

Major Imports (1983) Petroleum

Imports from U.S. ($ million US CIF) (1982)	555
As % of Total Imports (1981)	8%

Major Trading Partners: United States, Japan, Saudi Arabia

GNP PER CAPITA (1983) $350

PUBLIC FINANCE (Rs Million) (1983)

Revenues	58,928
Surplus of autonomous bodies	2,286
Expenditure	86,774
- current	(59,718)
- development	(27,056)
Overall Deficit	-25,560
Financing:	
External (net)	5,068
Domestic Non-bank	14,368
Banking system	6,124

BALANCE OF PAYMENTS ($ Million) (1983)

Trade Balance	-2,906
Exports f.o.b.	2,628
Imports f.o.b.	-5,534
Invisibles (net)	2,471
of which: remittances	(2,885)
Current Account Balance	- 435
Gross Aid Disbursements	1,224
Overall Balance	723
Change in Reserves	1,147
Total Reserves (end June)	1,956
(in weeks of imports)	16.9
Debt Service Ratio	13.2

ANNUAL REAL GROWTH RATES (Percent) (1983)

PFY 1959-60 factor cost	
- Gross National Product	7.7
- Gross Domestic Product	5.8
- Agriculture	4.8
- Manufacturing	7.4

TABLE 11

VII. U.S. HUMANITARIAN ASSISTANCE FOR AFGHAN REFUGEES

United States Humanitarian Assistance for Afghan Refugees
(Millions of United States Dollars)

	1980	1981	1982	1983	1984	TOTAL
UNHCR	8.80	32.60	27.20	26.50	20.00	115.10
WFP	31.80	39.20	65.90	49.30	44.00	230.20
ICRC & Vol. Ags	1.30	4.10	3.00	3.60	5.60	17.60
GOP		8.00				8.00
World Bank					.80	.80
TOTAL	41.90	83.90	96.10	79.40	70.40	371.70