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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/180

5:45 p.m., December 21, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	T. Ramtoolah, Temporary
	L. E. J. M. Coene, Temporary
	X. Blandin
	J. Delgadillo, Temporary
R. D. Erb	
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	
	L. Leonard
	J. R. N. Almeida, Temporary
	G. Grosche
	G. Gomel, Temporary
R. N. Malhotra	
	J. E. Suraisry
	A. A. Scholten, Temporary
	M. J. Kooymans, Temporary
G. Salehkhou	
	M. Camara, Temporary
M. A. Senior	J. L. Feito
J. Tvedt	
	T. A. Clark
	Wang E.

A. Wright, Acting Secretary
R. S. Franklin, Assistant

Also Present

Asian Department: U. Baumgartner, P. Chabrier, J.-P. C. Golle. European Department: M. Z. Khan. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; S. Mookerjee, Deputy Director; C. F. J. Boonekamp, M. R. Kelly. Legal Department: J. K. Oh. Middle Eastern Department: A. S. Shaalan, Director; A. K. El Selehdar, Deputy Director; S. H. Hitti, H. E. Jakubiak, M. Shadman. Treasurer's Department: M. N. Bhuiyan. Western Hemisphere Department: S. T. Beza, Associate Director. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, K. A. Hansen, W. Moerke, Y. Okubo, M. Z. M. Qureshi, D. I. S. Shaw. Assistants to Executive Directors: M. B. Chatah, C. Flamant, I. Fridriksson, V. Govindarajan, C. M. Hull, A. K. Juusela, H. Kobayashi.

1. PAKISTAN - 1983 ARTICLE IV CONSULTATION AND REVIEW OF EXTENDED ARRANGEMENT

The Executive Directors considered the staff report for the 1983 Article IV consultation with Pakistan, together with a review of performance during the third program year under an extended arrangement in an amount of SDR 1,268 million (EBS/83/249, 11/23/83; and Sup. 1, 12/20/83). They also had before them a report on recent economic developments in Pakistan (SM/83/246, 12/5/83).

Mr. Finaish made the following statement:

The past five years have witnessed an impressive turnaround in Pakistan's economy. Over this period, the authorities have steadily pursued a policy of economic reform aimed at sustained improvement in domestic economic performance and attainment of a viable external position. Measures taken under this policy have been wide ranging, seeking to combine tighter demand management with important structural adjustments. For the past three years, this policy has been carried out within the framework of an extended arrangement with the Fund. The record of implementation under the arrangement shows that success has been achieved in attaining most of its financial and structural reform objectives. What makes this achievement even more creditable is that it was realized in spite of several adverse exogenous developments, including a prolonged international recession, a continued terms of trade deterioration, and the presence in the country of over three million Afghan refugees.

Economic developments and policies over the period of the extended arrangement as well as the outlook for the medium term are set out in detail in the staff documents. In this statement, therefore, I shall focus on some salient features of the economic situation.

Real growth averaged about 6 percent during the three years of the arrangement, a rate which has now been sustained for six years. The forward movement in the economy was well spread. The growth of agricultural output averaged over 4 percent during the arrangement, maintaining the buoyancy of the previous three years, and thereby making possible not only the achievement of self-sufficiency in major foodgrains in 1980/81 but also the initiation of wheat exports. Manufacturing output also continued to grow rapidly, averaging about 10 percent. At the same time, as a result of restrained demand management policies, the financial performance of the economy improved appreciably. Despite sizable shortfalls in external financing, the ratios of the budget deficit and bank budgetary financing to GDP were broadly in line with program targets. Monetary growth was contained well below the expansion in nominal GDP in the first two years of the arrangement. Although the growth in domestic liquidity was much larger in

1982/83, causing an overshooting of the monetary growth target, this development resulted mainly from a large and unanticipated balance of payments surplus. The improvements in demand management and supply availabilities helped to bring down the rate of inflation to about 6 percent by the end of 1982/83, compared with a target of 10 percent.

In the external sector, as a result of the restrained financial policies and structural changes in the sector, the balance of payments outcome for the three program years taken together turned out to be much better than projected. The average current account deficit was much below that forecast, and the overall balance of payments was in surplus in aggregate terms, compared with a sizable projected deficit. The improvement in the balance of payments was particularly striking during 1982/83, resulting in a more than doubling of reserves. While the continued large inflow of workers' remittances has been a factor in the improved external financial performance, a generally healthy growth trend in exports has also been an important contributory factor, with the outcome particularly encouraging in respect of nontraditional manufactured exports. Despite weakening world demand, exports have increased at an average rate of 9.2 percent in real terms over the past five years. The recovery of exports in 1982/83, after an absolute decline in the previous year, appears to have been facilitated by the introduction of a flexible exchange system in early 1982, under which the rupee was allowed to depreciate sufficiently to restore external competitiveness.

The aforesaid improvements in growth and financial performance were accompanied--and assisted--by substantial progress in many of the areas targeted for structural reform. The public sector investment program was significantly reoriented toward agricultural and rural development, basic infrastructure, energy, and social services, leaving industrial development increasingly to the private sector. Measures that have been taken, and are being taken, to promote private investment include the simplification of regulatory procedures, easier access to imported inputs, improved availability of credit and infrastructural facilities, and assistance toward the financial restructuring of ailing industrial units. Progress has also been made in improving the efficiency of public enterprises, both through special measures in respect of a number of public manufacturing units and through the introduction in stages of a general performance evaluation and incentive system designed in collaboration with the World Bank. In cost-price rationalization, substantial increases were made in the consumer and producer prices of oil and gas as well as in agricultural output and input prices. Expenditure on subsidies as a proportion of total public expenditure has been about halved since 1979/80.

Besides the change in the exchange system already noted, several important structural reforms were introduced in the external sector. Licensing restrictions on imports were virtually eliminated. Despite the difficult international situation and increasing protectionism elsewhere, the target for the removal of protective bans or equivalent restrictions was significantly exceeded, including the greater liberalization of capital and intermediate goods. Restrictions were also removed from a large number of items not produced domestically. A change was made from a positive to a negative list import system; some further refinements of the new system, including the complete deletion of the temporarily retained positive list, are proposed to be announced in the import policy order of 1984/85. There was also a significant reduction of export subsidization.

While the progress already made in restructuring the economy has been good, the authorities recognize that there remain areas where they would need to continue their structural reform efforts in order to sustain the recent improvement in economic performance over the medium term. Thus, one of the objectives of the recently launched Sixth Five-Year Plan--from 1983/84 to 1987/88--is to continue the process of cost-price rationalization and reform of the import system, and some further measures to these ends have been taken in the current fiscal year. The reorientation of public investment priorities is being carried forward in a substantial way under the Plan. Special emphasis has been placed on promoting saving and investment, an essential requirement for sustaining satisfactory growth rates over time but one where progress in recent years has been limited. The ratios of gross domestic fixed capital formation and national savings to GNP are targeted to increase to 17.4 percent and 16.6 percent, respectively, by the end of the Plan period from their average levels of 13.5 percent and 12.3 percent during the past three years. The role assigned to the private sector has been greatly enhanced, with private investment projected to grow twice as fast as public sector investment. Among measures to promote private sector investment, the Plan calls for further deregulation of the economy, expansion in the sector's role not only in industry, agriculture, and construction but also in the development of physical and social infrastructure, and a strengthened policy to attract foreign private investment. Improvement in the investment climate and generation of larger surpluses by the Government and public enterprises are envisaged as the main factors contributing to the projected increase in the savings rate. The objectives and strategy of the Sixth Plan have received strong endorsement from the World Bank and members of the Pakistan consortium.

As noted in the staff appraisal, given the breadth of the program under the extended arrangement, it was inevitable that some of the reforms would be delayed. In certain cases, delays occurred for administrative or technical reasons. The authorities, however, remain determined to effect the necessary adjustments in all such cases, including the reform of the indirect tax system--to make it rely more on domestic production and consumption and less on foreign trade--and of the tariff structure.

The conduct of financial policies in the period ahead will continue to be geared to realizing the country's growth objectives while maintaining domestic and external financial stability. The financial program for 1983/84 reflects this policy perspective, as attainment of a growth target of over 6 percent--close to the target average growth rate of the Sixth Plan--is to be combined with a strengthening of demand management following some weakening during the past year. The rise in the fiscal deficit as a proportion of GDP that took place in 1982/83 is to be reversed. Total government recourse to the banking system is targeted to fall below 0.5 percent of GDP. The use of private savings collected through small savings schemes for budgetary financing is also projected to decline. The authorities recognize that continued reliance on the latter source of financing as a substitute for revenue would not be advisable, but they are of the view that it is helpful in the short run in achieving demand management goals and, in the present circumstances, is not in competition with the mobilization of savings for investment in the private sector. With respect to the financing of commodity operations, the primary cause of the breaches of credit ceilings that occurred, an important step that has been taken is the decontrol and derationing of sugar. A similar change in respect of wheat flour has also been under consideration.

With respect to monetary policy, the rate of liquidity expansion, which rose to 26.3 percent in 1982/83 as a result of the substantial external surplus, is to be brought down to about 12 percent in 1983/84. The authorities do not share certain reservations expressed in the staff appraisal regarding the stance of monetary management in the current year. First, they consider that a significantly larger correction for the overshooting of the monetary growth target of 1982/83 in a single year is not feasible. They are also of the view that, given the reduction in the velocity of money as reflected in the continued rapid growth of time deposits, monetary expansion in 1983/84 at a rate of about 12 percent does not appear to pose a serious threat to price stability or the external position. Second, they believe that, coupled with the large increase in private liquidity last year, the 21 percent targeted increase in credit to the private sector in 1983/84--similar to the actual rate of increase of the past two years--would be sufficient to enable the sector to carry out the role allotted to it in the macroeconomic framework for the year.

Projections for the balance of payments for 1983/84 show that the current account deficit may rise to 2.7 percent of GNP from 1.4 percent in the previous year, owing mainly to a projected large increase in imports and a slowdown in workers' remittances. The overall balance, however, is forecast to remain in surplus, albeit at a lower level. Projections prepared in connection with the Sixth Five-Year Plan point to a sustained improvement in the external position for the rest of the Plan period. The projected trends would permit a reduction in the debt service ratio to 12.2 percent by 1987/88 and the repurchases to the Fund to be made without straining the reserve position. While the tentative nature of these projections needs to be borne in mind, they do broadly indicate significant progress having been made toward the goal of balance of payments viability. Another noteworthy point about the projections is that the aforesaid improvement in the balance of payments is forecast to materialize notwithstanding the assumption of a considerable slowdown in the growth of remittances, which suggests an increasing resilience in the external position. The projections also assume continuation of a flexible exchange rate policy.

Data available for the first four to five months of 1983/84 show that, despite certain divergences, developments in most cases are broadly in line with targets for the year. The authorities, however, are monitoring the situation carefully, and would consider further measures should the divergences grow larger.

In summary, the success achieved during the extended arrangement in improving the economy's domestic and external financial performance as well as in reforming its structure was substantial. The record of implementation under the arrangement was good, in spite of an adverse external environment, which bears testimony to the authorities' firm commitment to the task of financial and structural reform and to their willingness to take difficult but necessary decisions. Some departures from targets that occurred were more or less inevitable in a program of such breadth, and were largely attributable either to developments outside their control or to delays resulting from administrative or technical reasons. The authorities recognize that in order to consolidate the progress made in recent years, and to build upon it, they would need to continue their reform efforts over the medium term.

Mr. Hirao said that he was in general agreement with the staff appraisal and could support the proposed decision. Pakistan had made substantial progress in restructuring its economy under the extended arrangement; it was encouraging to note, for example, that growth performance had been strong over the three-year period of the program, owing to a continued expansion in production. However, overall investment had fallen short of targets in the recent past, and sustained economic growth in future would require an enhancement of investment activity in the private sector. He had noted with interest in that regard that private investment was expected to accelerate in the current fiscal year because of the import liberalization measures adopted by the authorities and the decision to allocate central bank foreign exchange to facilitate capital goods imports. Still, some additional measures might be necessary, such as a broad deregulation of the economy and adjustments in the labor law, actions that had been postponed during the program period. He welcomed the authorities' efforts to correct cost-price distortions in agriculture and energy; he agreed with the staff that, in order to lessen the impact of energy shortages on private investment, further increases in some energy prices might be needed to accelerate domestic production.

With regard to public finances, Mr. Hirao observed that the fiscal outcome for 1982/83 had been off target, with the overall deficit rising to 6.9 percent of GDP, which was well above the level registered during the previous two years. The increase in the deficit had resulted mainly from revenue performance, which had fallen 10 percent below forecast for two consecutive years. The authorities were estimating the tax revenue elasticity for the 1983/84 budget to be about 1.25, which was well above the 0.7 figure registered in recent years. He shared the staff's concern that revenue estimates for 1983/84 might be on the optimistic side, and he agreed that the authorities might be well advised to institute structural reforms in the tax system to overcome the heavy reliance on foreign trade taxes and to broaden the tax base through progressively reducing exemptions from taxes on domestic consumption and production.

In recent years, the authorities had largely compensated for weak revenue performance by enhanced domestic nonbank financing, such as through government small saving schemes, Mr. Hirao said. If that trend were to continue, and if budget financing were to become even more dependent on private savings, private investment could be adversely affected. In that regard, current expenditures had risen more rapidly than forecast, reflecting the increased burden of interest payments, while development spending had fallen short of the target.

The authorities were to be commended for having taken steps to decontrol sugar marketing, steps that had substantially reduced the burden of commodity financing, Mr. Hirao commented. However, the privatization of commodity operations would increase private sector demand for bank credit, and there was thus a need for fiscal measures to reduce government use of bank credit so that more could be released for the private sector.

Monetary developments during 1983 had been quite different from what had been expected, Mr. Hirao continued; in particular, an unanticipated large external surplus had been mainly responsible for the excess monetary expansion that had resulted in a breach of the program ceiling on net domestic assets. He took note of the authorities' intention to tighten demand management policy so as to absorb excess liquidity in the coming years. Perhaps due attention should be paid to the movement of prices and to the external position as well as to the reduction in velocity that had been suggested by Mr. Finaish; if necessary, the authorities should also adjust the pace of correction.

Balance of payments developments during the program period had been considerably better than projected, Mr. Hirao commented. The authorities should be commended for having maintained a flexible exchange rate policy, which had contributed significantly to the favorable export performance. Given the present external position and the level of reserves, the authorities' intention to facilitate imports of capital goods was clearly appropriate, as were the steps taken to liberalize the import system. Some further action could however be taken to simplify the new negative restricted import list system. Finally, noting that reform of the tariff structure had been delayed somewhat, he welcomed the intention of the authorities to initiate reforms at an early date.

Mr. Suraisry considered that various factors had contributed to the success of the extended arrangement with Pakistan, despite highly adverse external circumstances. First, the authorities had approached the Fund at an early stage of their balance of payments difficulties, a move that had allowed them to formulate a program and adopt policies in an unpressured atmosphere. Second, the authorities had shown a strong commitment to adjust, by implementing most of the corrective measures envisaged under the arrangement. On the demand side, for example, monetary and fiscal policies had been conducted prudently, and quantitative performance criteria had for the most part been met. Moreover, domestic bank borrowing by the Government and overall credit expansion had remained within the envisaged limits. On the supply side, considerable progress had been made in improving the cost-price structure in the economy, with price and cost adjustments covering a wide range of essential goods and services. Other structural adjustment measures included the implementation of a revised program of development expenditures, the application of a performance incentive system in the public enterprise sector, the adoption of a flexible exchange rate policy, and a gradual liberalization of the import regime. Third, the growth, inflation, and balance of payments targets of the program under the extended arrangement had all been met or exceeded, and the authorities had been able to increase their gross official reserves during the period of the arrangement.

Having achieved a measure of success, the authorities should look toward consolidating the gains that had been made, Mr. Suraisry continued. Three areas of policy required particular attention. First, the authorities would need to continue the process of allowing greater private sector participation in the economy. Second, additional fiscal reforms would be needed to broaden the revenue base and channel expenditures into more productive areas. Third, there was considerable scope for liberalization of imports and reform of the tariff structure, particularly given the emerging recovery of the world economy. Progress in all three areas would be important if the authorities were to achieve the objectives of the Sixth Five-Year Development Plan, which had only recently been endorsed by the Pakistan consortium. The balance of payments projections underlying the Plan gave good grounds for optimism, although persistent adjustment efforts would be required over the medium term, and he had noted Mr. Finaish's indication of the authorities' commitment toward that end.

Mr. Clark observed that the authorities in Pakistan had achieved some notable successes, in particular by maintaining a real growth rate significantly in excess of population growth through a difficult period for the world economy. The country had also secured self-sufficiency in major foodgrains and had become a potential wheat exporter, while the external position had turned around significantly, despite a fall in projected aid inflows. Nonetheless, he continued to feel that the situation in Pakistan was fragile and that the progress of the past six years could easily be undone. The balance of payments projections in Table 9 of EBS/83/249 did not show sustained improvement, and the downside risk appeared considerable. A closer look showed that much of the progress on the current account had been due to workers' remittances, which had surpassed Pakistan's export earnings in 1983. Given the origin of those remittances and the possibility of slower growth in some of the countries involved, he would take a cautious view about the extent to which the external situation had been stabilized.

In the February 1983 discussion on Pakistan, several Directors had questioned the advisability of delaying some of the major elements of the extended arrangement until the last year of the three-year period, Mr. Clark recalled. Now that the program was ended, Pakistan had drawn 85 percent of the amount originally envisaged, but significant structural problems remained. For example, despite some improvements, the trade regime was still highly restrictive; and, on the fiscal front, the deficit in 1982/83 had been nearly twice as large a proportion of GDP as had been programmed. Moreover, in the area of tax reform, the authorities had not yet succeeded in adequately tapping domestic revenues.

Pakistan's continuing economic vulnerability reinforced the importance of pressing on with structural reform--along the lines indicated by the staff in its appraisal--and with the investment plans, Mr. Clark remarked. He hoped that the Fund could continue to play a useful advisory role in that regard. Unfortunately, neither the structural reform nor the investment plans could be sustained if the authorities maintained the sort of fiscal and monetary policies that the staff regarded as inappropriate and that risked, inter alia, accelerating inflation.

Turning to more specific points, Mr. Clark considered that a strengthening and broadening of the tax base was essential if the buoyancy of the domestic tax system were to be increased and the vulnerability of fiscal and monetary policy to the external sector were to be reduced. A commensurate reduction in the extent to which the Government resorted to nonbank domestic financing of the deficit would also help to avoid the risk of crowding out private sector investment. One important way to reduce the fiscal deficit would be to continue with actions to cut subsidies; in that regard, he had been pleased to learn from SM/83/246 that domestic oil product prices were being maintained at international levels. Moreover, raising domestic gas prices only to two thirds of international prices by 1988 was unlikely to have the desired impact on conservation or the exploitation of domestic resources. On the exchange rate, it was important that the external value of the rupee should maintain Pakistan's competitiveness and that adjustments should continue to be made promptly whenever necessary. In conclusion, the Pakistan economy seemed to remain vulnerable in a number of areas, and he urged the authorities to continue with the reforms initiated under the program. The growth in workers' remittances had provided some breathing space and, although the authorities had done well in the short term by building up reserves rather than import levels, their efforts needed to be supported by more positive measures in the longer run.

Mr. Leonard commented that the Pakistan authorities had been remarkably successful in bringing about sustained progress in the economy over the past several years. Moreover, it was clear from the staff papers that that progress had been achieved primarily through carefully devised adjustment measures persistently applied over the period. There were several areas in which progress had been particularly noteworthy: the more flexible exchange rate policy adopted in early 1982 had contributed to a strengthening of exports and an improvement in the balance of payments; important reforms in the income tax system had led to a substantial growth in revenue; increased emphasis on public development spending in the agricultural, energy, and social sectors had produced good results; the goal of foodgrain self-sufficiency had been achieved; price distortions in agriculture and, to some extent, in the energy sector had been reduced; the import regime had been liberalized and reformed. However, that progress needed to be safeguarded, and it was important that the ambitious growth targets set for the next few years should be realized without the emergence of new imbalances in the economy. Hence, continued emphasis should be placed on the pursuit of structural readjustment, particularly in trade liberalization, price reform, the promotion of private investment, and fiscal policy. Some significant slippages had occurred during 1983 in demand management. If not corrected, they could seriously threaten future plans.

In many respects, the key area for adjustment was the management of the public finances, Mr. Leonard continued. Unless expenditures were kept under firm control and further tax reforms effected, overall demand pressures could again increase, and a disproportionate amount of credit could flow to the public sector, crowding out private sector investment. He noted that current fiscal plans depended on rather optimistic forecasts for government revenues and that government domestic bank borrowing for budgetary support was already at PRs 5.7 billion, higher than had been projected for 1983/84 as a whole. It was to be hoped that the expectation of a reduction in budgetary support over the coming months would be borne out.

He shared the staff's concerns that no specific policy changes had been made to ensure that private sector savings would be adequate to meet the demands arising out of plans for private investment and the projected level of capital goods imports, Mr. Leonard commented. Furthermore, adequate domestic credit provisions did not seem to have been made in the credit plan to facilitate purchase of foreign exchange out of the $200 million allocation by the State Bank of Pakistan for private sector imports or to finance the domestic component of investment. The authorities apparently felt that private savings would be sufficient for that sector to carry out the tasks assigned to it; he would appreciate a fuller account of their reasoning on that point.

The authorities had addressed themselves to the problems of the excess liquidity within the domestic economy occasioned by the external surplus, and they had taken measures to sterilize some of the inflows, Mr. Leonard noted. According to the staff paper, however, the measures being taken would absorb only 12 percent of the previous year's excess liquidity; the staff had indicated that a more reasonable level of absorption was at least 50 percent. In view of that significant divergence, he would appreciate some elaboration from the staff on the impact that the excess was likely to have on projected economic developments for 1983/84. In particular, would it be possible to keep the rate of inflation within limits compatible with stable growth?

Good progress had been made by the authorities in structural adjustment, Mr. Leonard considered. However, the momentum of that progress should be continued over the coming years so that the current high rate of economic growth could be sustained in the medium term. As part of the effort, emphasis should be placed on further measures to simplify and reduce provisions to limit imports and to reduce reliance on export subsidies. The authorities might also usefully re-examine measures to deregulate the economy and reform the labor law, actions that had been postponed during the program period. He noted, too, that energy prices remained well below international levels, despite some adjustments, and that potential bottlenecks as a result of the re-emergence of power shortages could have adverse consequences for production. The measures being taken by the authorities to ease the situation were therefore to be welcomed and, as advocated by the staff, might be enlarged upon. Finally, he hoped that his remarks would not be seen as critical or as showing a lack of appreciation of the striking progress that had been made in Pakistan's economy. The commitment of the authorities to a high rate of growth was particularly encouraging, and his concerns stemmed solely from a desire to ensure sustainable and balanced progress in future.

Mr. Grosche remarked that, by comparison with the situation in Pakistan at the end of 1980, the economy had moved a long way toward a viable balance of payments position, and the authorities had been reasonably successful in restructuring the economy and in embarking on a remarkable growth path. Nonetheless, as others had noted, sizable slippages in the implementation of adjustment measures had occurred, especially with respect to the conduct of fiscal and monetary policies. If the departure of those policies from the path agreed upon under the extended program were to continue, the progress achieved thus far would be severely undermined.

He hoped that the authorities would again make an effort to reduce the public sector budget deficit, Mr. Grosche remarked. The attempt to limit the deficit to 5.4 percent of GDP in 1982/83 had not been successful, mainly because of the increase in current expenditures and the authorities' hesitancy to introduce market-oriented pricing policies. A rapid elimination of subsidies on consumer items, energy, and fees for irrigation would alleviate the burden on the public budget and would improve the efficiency of the economy as a whole. He shared the staff's pessimism with regard to the future development of budget revenues and noted that the underlying assumptions used to evaluate the future tax yield might prove to be optimistic. He also observed with regret that capital expenditures had not increased as planned; in 1983/84, they might even decrease in real terms.

In monetary policy, it was to be hoped that the most recent figures indicated a reversal of the expansionary trend observed thus far, Mr. Grosche commented; otherwise, it was certain that the success achieved on the price front would be endangered. He encouraged the authorities to implement measures that would contribute to sustainable noninflationary growth rates of monetary aggregates while preserving the private sector's access to credit. A more cautious monetary policy stance was also indicated for balance of payments reasons. Too expansionary an approach might induce too great a demand for imported goods and offset the favorable developments in the external account. In addition to making an effort to preserve the present trend of those developments, the authorities should look toward a further smooth adjustment of the exchange rate in order to maintain competitiveness and provide a cushion against the projected increase in the debt service.

Mr. Malhotra said that he too was in broad agreement with the staff assessment and wished to congratulate the Pakistan authorities for having achieved an annual rate of growth in the economy of 6 percent over an extended period, a relatively stable price situation, a moderation of inflation, and a positive evolution of the external sector. It was also heartening to note that the rate of export growth had been maintained on average at about 9.2 percent, a remarkable achievement considering the unfavorable international trading environment. Moreover, Pakistan had kept its exchange rate policy on a reasonable path; a flexible application of that policy had, by and large, maintained the competitiveness of the rupee. In the circumstances, he could endorse Mr. Finaish's statement that "the success achieved during the extended arrangement in improving the economy's domestic and external financial performance as well as in reforming its structure was substantial."

The staff had nonetheless voiced some concerns with regard to the period ahead, Mr. Malhotra recalled. Monetary growth had been on the high side during 1982, mainly because the balance of payments had improved beyond expectations. There was apparently some difference of opinion, however, about whether the further growth envisaged for 1983 was excessive. Whatever view prevailed, it was clearly appropriate for the authorities to keep the monetary aggregates under review, and, in the medium term, they should perhaps make a greater effort to increase the rate of savings in the economy. They should also keep a close watch on fiscal policy.

He agreed with Mr. Suraisry's reasoning about why the Pakistan program had been so successful, Mr. Malhotra commented. Pakistan had come to the Fund at an early stage of its difficulties, the authorities had shown great commitment to the adjustment process, and the program had been appropriately conducted within a framework of a well-conceived national plan. When a member country had a reasonably good framework, appropriately underpinned by efforts on the fiscal and financial sides, there was a reasonable likelihood that an extended program would succeed.

Mr. Wang remarked that, during the Executive Board discussion on Pakistan in February 1983, his chair had noted that, as a result of the successful implementation of a comprehensive program of economic reform, a high rate of growth had been achieved and maintained. That development was clearly reflected in the staff paper, which reported that Pakistan had made substantial progress toward the most important financial and structural reform objectives envisaged under the three-year program. Indeed, economic performance during 1982/83 had been impressive, with real GDP continuing to grow at about 6 percent as a result of a 10 percent increase in manufacturing and a 4 percent increase in agricultural production. Demand management policies had generally been implemented successfully, and there had been a significant reduction in inflationary pressures.

On the external side, Mr. Wang continued, the volume of exports had increased considerably, despite the world recession, mainly because of the strong performance of nontraditional exports. Combined with a sharp rise in workers' remittances and a fall in imports, the result had been a large reduction in the current account deficit by comparison with the deficit registered in 1981/82. Still, some developments in the budgetary and financial areas had fallen short of expectations, and there were instances in other sectors of the economy in which policy measures had not brought about the intended benefits. Of course, the Fund program had been interrupted, but it was important to note that the authorities had achieved success in most of the program's financial and structural reform objectives.

The significance of Pakistan's achievements during 1982/83 should be evaluated in the context of the Fifth Five-Year Plan, which had ended in 1982/83, Mr. Wang said. As a result of the implementation of comprehensive adjustment and growth measures, basic changes had occurred in many important aspects of the economy. The successful attainment of the overall growth target had resulted in an average increase in GDP of about 6 percent during the past five years, and the continuing expansion in agricultural production was particularly noteworthy because it had contributed to the easing of chronic food shortages. The Pakistan authorities themselves regarded those developments as an indication of the complete turnabout of the economy and felt that the stage was set for the economy to take off during the Sixth Five-Year Plan, beginning in 1983/84. Recognizing the inadequacies in some aspects of the structural changes attempted under the previous Plan, the authorities intended to broaden their policies so as to consolidate the gains achieved in the economic sphere and to meet the unsatisfied infrastructural needs under the current Plan in the areas of human resources development and regional development. In conclusion, he could support the proposed decision.

Mr. Ismael indicated his agreement with the staff's assessment of Pakistan's economy and noted with satisfaction the substantial progress that had been made through the implementation of wide-ranging and structural reform measures under the extended arrangement. Not surprisingly, there remained some problem areas toward which the authorities would need to redirect their attention. He joined the staff and others in urging the authorities to seize the opportunity provided by recent successes to adopt policy measures that would lead to further improvements in the economy over the medium term.

Mr. Salehkhou noted that the overall performance of Pakistan's economy under the Fund-supported program had been based on the determination of the authorities to pursue the program's objectives to a successful conclusion. In that respect, the results had been encouraging: appropriate demand management and credit policies had contained the growth of liquidity and had helped to reduce the rate of inflation. However, the strong 1982/83 surplus in the balance of payments had generated an increase in liquidity and some additional use of credit, in the circumstances, continued monitoring of the liquidity situation would be necessary. On the fiscal side, the budget deficit and the Government's use of the banking system for budgetary purposes had been close to the program targets, although there was a need to strengthen the revenue base and to continue with tax reform. Further constraints in investment and development outlays might adversely affect the growth potential of the economy, although that possibility did not pose a serious obstacle at present.

Structural reform had gained widespread momentum under the program, and there had been progress toward reducing cost-price distortions, Mr. Salehkhou noted. In the energy sector, efforts had been made to achieve realistic pricing, and institutional improvements had been recorded in energy production and use. Still, there was a need to continue with structural reforms in the public enterprises and to speed up the pace of improvements with respect to the efficiency and management of both the public and private sector enterprises.

While favorable climatic conditions and a good harvest had helped to produce quite satisfactory economic growth in the real sector, there was a need to strengthen investment programs further and broaden and strengthen the infrastructure and the real base of the economy, Mr. Salehkhou said. The economy should be structured in such a way as to withstand any adverse exogenous shocks that might affect the country in future. The external sector had also performed well under the program, and the current account deficit had turned out to be less than forecast, with the overall balance of payments in surplus. Imports, both private and public, had fallen, which reflected lower than projected investment outlays. While manufactured exports had done well, commodity and other major exports had not kept pace.

The outlook for 1984 and 1985 was promising, but the authorities would be well advised to lean toward the side of caution and to pursue demand management policies with an eye on liquidity, Mr. Salehkhou remarked.

It was encouraging to note that, in 1983/84, total government recourse to the banking system would fall below 0.5 percent of GDP and that the rate of liquidity expansion would be reduced to 12 percent. Although the indication that exports and workers' remittances had increased in the first five months of 1983/84 was certainly welcome, the authorities should monitor both items closely for a considerable period. He was somewhat concerned that the unit prices of Pakistan's major export items had continued to decline, despite the modest recovery in the international economy. Cotton exports, in particular, seemed to call for special attention.

On another matter, he welcomed the efforts toward Islamization of the financial system in Pakistan, Mr. Salehkhou commented. He hoped that those efforts would not be temporary or piecemeal and that all the intended measures would be implemented in their totality. In that regard, it was disappointing that only three pages of SM/83/246 had been devoted to describing and assessing developments toward Islamization of the financial system. Nearly 10 percent of the total money supply in Pakistan consisted of profit-and-losssharing deposits, and, given the scale of institutional changes that had occurred in conformity with Islamic concepts, the staff had perhaps paid insufficient attention to that matter in the staff papers A more detailed assessment of developments toward the Islamization of the financial system in Pakistan would be of interest to many Fund members.

Mr. Camara stated that he was in broad agreement with the staff appraisal and had no difficulty supporting the proposed decision. Pakistan's economic performance had been satisfactory: the authorities had indeed surmounted enormous difficulties, including adverse exogenous developments such as the prolonged international recession, continued deterioration in the terms of trade, and the influx of refugees from neighboring countries. At the same time, they had experienced difficulty in fully implementing the extended arrangement, some targets of which had not been met; for example, an inappropriate budgetary forecast had led to the suspension of the arrangement for some time. Fortunately, the authorities had continued to persevere with the program, the terms of which had been successfully renewed.

Developments in agriculture in Pakistan should inspire a number of developing countries in their efforts to reach a viable economic situation, Mr. Camara continued. A shift from capital-intensive investment had been particularly helpful in Pakistan, providing the country with the opportunity to rely on its own resources. As Mr. Finaish had noted, "the growth of agricultural output averaged over 4 percent during the arrangement, maintaining the buoyancy of the previous three years, thereby making possible not only the achievement of self-sufficiency in major foodgrains in 1980-81, but also the initiation of wheat exports." Special efforts worthy of recognition had also been made on the demand side, as the authorities had observed restrained demand management policies. The upgrading of financial policies had been characterized by the implementation of structured reforms and increased resource mobilization, and the introduction of new taxes had facilitated the achievement of the objectives of the program in limiting the overall fiscal deficit to 5 percent of GDP and government domestic borrowing to 2 percent of GDP. However, he was somewhat puzzled about why the expected degree of restraint on current outlays had not materialized. Was there a need for further tax reforms, or was the lack of restraint linked to the structure of imports, which seemed to be a source of concern in its present form? He noted that the Pakistan authorities had taken some steps to reassert their definition of the structure of imports by making changes in the list of restrictions.

Performance in the external sector had been generally good, with the current account deficit turning out to be less than expected, Mr. Camara concluded. For 1983/84, however, a slight increase was projected for the deficit because of the weak position of exports and a possible reduction in workers' remittances. The authorities would be advised to exercise caution in relying too strongly on such receipts. With regard to the exchange rate, the authorities were aware of the negative effects of an appreciation of the rupee, and he commended their exchange rate actions. In sum, while it was certain that a great effort had been made to keep the economy on an even keel, more needed to be done in future.

Mr. Coene considered that the authorities should be commended for having achieved impressive results under the extended arrangement during the previous two years, despite adverse external circumstances. However, full implementation of some of the recommended reforms had proved difficult, and it was important not to delay them much longer if the favorable results achieved thus far were to be preserved. It was particularly important not to allow any slippages in economic performance, since the medium-term scenario showed that Pakistan remained vulnerable to adverse external circumstances. The balance of payments outlook through 1987 rested on a continued favorable development of exports and private transfers, and he fully shared the staff's concerns on those matters. He generally endorsed the staff appraisal, particularly with respect to the need to increase domestic savings and to ensure the provision of adequate credit to the private sector so that it could take up a higher share of investment activity. Finally, he could support the proposed decision.

Mr. Erb remarked that the staff papers gave a comprehensive background on economic policies and developments in Pakistan over several years, and, as such, they represented a good basis from which to examine the current situation and prospects. The Fund had provided Pakistan with considerable financial resources and advice, and the question was whether the economy had met the expectations of the Fund and the authorities, whether the foundation had been laid for a high rate of growth and a sustainable balance of payments position in the near term. His own views on that question were mixed.

Despite significant progress in a number of areas, including a favorable growth rate and some adjustments on the external account, much remained to be done on the monetary and fiscal side and in the area of structural adjustment, Mr. Erb continued. The staff papers seemed to suggest that the fiscal and monetary areas had not been the object of primary emphasis under the program, although there had been an expectation of continued progress during the three-year period in improving both the revenue base and control of expenditures. As a percentage of GDP at the end of 1982/83, total revenue was slightly lower than it had been in 1979/80, and of total expenditures were somewhat higher. As a result, the the actual deficit for 1982/83 of 6.9 percent of GDP was higher, and he joined those Directors who had expressed concerns about that matter and had indicated the need for greater adjustment efforts by the Government.

Like others, he had noted that progress in the domestic savings rate as a percentage of GDP had been disappointing, Mr. Erb said. If Pakistan were to generate enough domestic savings to support a high rate of investment, further progress would be needed. The efforts of the staff and the authorities over the past few years to reach agreement on the exchange rate regime had led to a system that it was to be hoped would maintain the competitive position of Pakistan's exports over time, although continued monitoring of the situation would be necessary. Policy adjustments had resulted in some important improvements in the economy, including a very high rate of growth in industrial exports, and he was certain that the exchange rate adjustments that had been made over the past year or two had contributed to the decision of Pakistanis working abroad to send their earnings home. Pakistan was a clear example of a country in which the exchange rate worked as a policy tool. Of course, it was important for the authorities to maintain a favorable rate of domestic inflation; otherwise, what had been gained on the exchange rate front might be overcome by a deterioration in the domestic fiscal and credit situation.

Import liberalization had been the major focus in the program, and he was on balance disappointed at the outcome, Mr. Erb remarked. Although it was difficult to judge the degree of liberalization that had taken place, it was clear that measures were being implemented along the lines of those recommended in the study that had been completed earlier in 1983, and the system had certainly become more efficient in the sense that there had been a shift away from quantitative restrictions and licensing toward a reliance on pricing mechanisms through the tariff structure. Nonetheless, Pakistan remained a highly protectionist economy, and the authorities had a long way to go before the economy was sufficiently open to enable it to generate the benefits that the exchange rate liberalization had permitted.

As shown in the data presented by the staff, Pakistan's debt service ratio was relatively low; however, experience showed that, even with a very low debt service ratio, Pakistan could periodically encounter difficulties in refinancing its debt coming due, Mr. Erb said. The area was one that left little room for mistakes or major fluctuations in the external accounts. Moreover, while gross reserves at end-September had equaled $1.9 billion, liabilities to the Fund alone at the time had been $1.4 billion, which suggested that the net reserve position was not as strong as it should be, especially given the better than expected developments in repatriated earnings and export growth. In the circumstances, the authorities should perhaps be placing greater emphasis on the buildup of net reserves.

In conclusion, while considerable progress had been made toward improving the structure of Pakistan's economy, much remained to be done to improve its internal structure, to open up the trading regime, and to reverse the recent deterioration in the fiscal and monetary areas, Mr. Erb considered. He agreed with the proposal to hold Article IV consultations with Pakistan on the normal 12-month cycle; however, in the light of the outstanding use of Fund resources, and given the deterioration in some of the fiscal and monetary indicators over the past year, the Fund should continue its dialogue with the authorities to keep abreast of developments and to provide advice about where further adjustments might be necessary. If there were a sharp deterioration in the economy in the coming year, the Executive Board should be informed, and the Article IV discussion should perhaps be accelerated. Alternatively, a preliminary discussion of developments might be held in the Executive Board.

The Director of the Middle Eastern Department, commenting briefly on points raised by two Directors, said that the staff would attempt to include in future Article IV consultation reports more information on the Islamization process in Pakistan. He could also accept Mr. Erb's proposal that the staff should pursue developments in a country after the conclusion of an extended arrangement with the Fund and should report on those matters to the Executive Board if circumstances warranted so doing. A brief visit to Pakistan was already planned for February.

The staff representative from the Middle Eastern Department, responding to questions raised by Mr. Leonard on the demand management stance in 1983/84, noted that the authorities were assuming a rate of inflation of 6.5 percent. The staff had made the point that, at such a rate of growth of nominal GDP, the absorption of liquidity would be relatively low. Implicitly, the staff was suggesting that, unless additional measures were taken, the rate of inflation would be higher than the assumed rate of 6.5 percent in 1983/84; and that expectation appeared to have been borne out thus far by the data that had been received for the first four months of the financial year, showing a rate of inflation at 8.6 percent.

With regard to the use of liquid assets, the authorities believed that, with an appropriate policy framework, the private sector would be induced to turn liquid assets into savings and investments in the economy, the staff representative continued. An appropriate policy framework for Pakistan should have several parts, only one of which--the provision of foreign exchange for the importation of capital goods--was in place at present. Also being contemplated was a new industrial policy under which the private sector would be encouraged to invest in certain areas that it had been restricted from investing in earlier and under which sanctions for private investments would be eased.

On the weakness of the revenue effort in Pakistan, the staff representative said that the ratio of tax revenue to GDP had fallen to 13.3 percent but was expected to increase to 14.4 percent in 1983/84 on the basis of various underlying assumptions. Apart from the optimism regarding the tax elasticity that was implicit in the revenue estimates for 1983/84, improved collections were expected by the authorities to generate a significant increase in tax yields. While discretionary tax measures had been implemented to increase revenues, other measures--such as increases in personal exemptions and provisions to reduce or eliminate the surcharge on income taxes--would result in reduced revenues.

Finally, with respect to the liberalization of the import system, the staff representative from the Middle Eastern Department agreed that the primary emphasis thus far had been on quantitative restrictions; the tariff reform effort had not proceeded, because the effective protection study had not been in place. As a result, the authorities had been placing tariffs on items that had been free from quantitative restrictions with the idea that there would be a further step toward liberalizing the entire tariff structure.

Mr. Finaish observed that Pakistan's overall record under the extended arrangement was a good one. Growth had been maintained at a high rate, the rate of inflation had been considerably reduced, and the balance of payments and reserve positions had been appreciably strengthened. In addition to the pursuit of a restrained demand management policy, important and wide-ranging structural adjustments had been effected, both in the domestic and external sectors. Those achievements were all the more creditable for having been realized in the face of several adverse exogenous developments and at a time when a number of other programs with the Fund had been encountering serious difficulties.

It was true that there remained areas where further improvements were needed, Mr. Finaish commented. The authorities were fully cognizant of that need and were determined to continue their reform efforts over the medium term so as to consolidate, and extend, the considerable progress that had already been made. In passing, he observed that the existence of a need for further improvements in certain areas at the conclusion of a Fund arrangement did not, by itself, imply that implementation under the arrangement had been deficient. The record of implementation under an arrangement ought to be assessed in relation to the targets and goals set forth in it, and that record was good in the case of the arrangement with Pakistan. Rather than being a reflection of the degree of success under an arrangement, the need for continuation of the reform efforts could be a reflection of the generally long-term nature of the task of attaining sustained growth with domestic and external financial stability. There would normally remain a need for further adjustment and reform even with a 100 percent implementation of an arrangement. What was important was that the arrangement should produce evidence of a substantial move toward those goals and toward the laying of a sound and sustainable basis for continuation of the additional reform efforts that might be needed. The Pakistan authorities considered that the Fund's arrangement with the country had been successful in achieving that objective.

While some delays had occurred in the introduction of a few measures, Mr. Finaish continued, such an outcome was more or less inevitable considering the breadth of the adjustment program. Besides, most of the delays had resulted from administrative or technical causes, as in the envisaged reform of the tax and tariff structures. However, an overall assessment of the arrangement should be based on overall performance. The performance had been particularly good in the external sector, where substantial progress had been made toward a viable balance of payments position, a central objective of Fund programs. In that regard, he had some difficulty with Mr. Clark's argument that the country's medium-term balance of payments picture did not show a sustained improving trend. The medium-term balance of payments projections given in Table 9 in Appendix III of EBS/83/249 showed the current account deficit falling steadily to 1.7 percent of GNP by 1987/88, compared with an average of close to 5 percent of GNP prior to the extended arrangment. Furthermore, the projections in Table 9 showed an overall balance of payments surplus over the next five years that would be large enough to permit repurchases falling due to the Fund to be made without placing a strain on Pakistan's reserves position.

The fact that the extended arrangement had become inoperative in the last few months, despite a good overall record, called for some comment, Mr. Finaish considered. First, the lapsing of an arrangement ahead of its scheduled expiration date, even if for only a short period, could create the impression that the arrangement itself had not been successful. In Pakistan's case, that impression was incorrect. Second, according to the staff paper, the arrangement had become inoperative at the end of June 1983 because of the nonobservance of certain monetary ceilings and because of staff reservations about some elements of the authorities' financial program for 1983/84. It should be noted that 90 percent of the overshooting of the overall monetary growth target for 1982/83 had taken place because of a large and unanticipated balance of payments surplus. The program had envisaged a contraction of about PRs 3.2 billion in foreign assets, but the actual outturn had been an expansion of almost PRs 11 billion, most of which had taken place in the second half of the year. It has not been possible for the authorities to correct such a large and unanticipated growth in liquidity on short notice; it would be an error either to interpret that expansion as a failure of demand management in 1982/83 or to build a case for a very deflationary monetary policy in 1983/84.

Moreover, the balance of payments projection for 1982/83--the departure from which had been the primary reason for the excess in monetary growth during the year--had been arrived at as a compromise between the authorities' own projections and those of the staff, Mr. Finaish noted. The staff had projected a much less favorable outcome for the balance of payments than the authorities had; in the event, the balance of payments had turned out to be even more favorable than the authorities' original expectations.

The subceiling on credit to the Government had been breached because of the financing of commodity operations only, Mr. Finaish continued; the subceiling on bank financing for budgetary purposes had been observed. The excess on account of commodity financing had occurred partly because of increases in the stocks of wheat and rice and partly because of certain special factors in respect of sugar stocks. A correction for the excess was being made, and the overall monetary impact of government commodity operations was projected to be contractionary in 1983/84. Total government recourse to the banking system was also targeted to fall considerably. The decontrol and derationing of sugar--which the authorities had been unable to effect in 1982/83 for certain administrative reasons--had since been implemented, providing a longer-term solution to the problem of sugar financing. Generally speaking, it would be interesting to consider whether a ceiling on such a volatile element as the financing of commodity operations--which was dependent, inter alia, on weather conditions--should even be included in the performance criteria of a program. He could envisage a situation in which a welcome development, such as a bumper harvest, could lead to the suspension of a Fund program because of a breach of a credit ceiling. There were some Fund programs in which there were no ceilings on commodity financing.

Turning to the staff's reservations about the financial program for 1983/84, Mr. Finaish remarked that a full correction for the overshooting of the monetary growth target of 1982/83 in 1983/84 alone was not feasible, since it would have required an overrestrictive monetary stance. Monetary growth was to be reduced to about 12 percent in 1983/84, compared with a projected increase of 14 percent in nominal GDP during the year and an actual monetary growth of over 26 percent in 1982/83. The authorities considered the projected reduction during 1983/84 to be both adequate and appropriate and were of the view that the projected monetary growth rate of 12 percent--given the reduction in the velocity of money--did not pose a serious threat to price stability. The authorities had been far more successful in reducing inflation than had been envisaged in the arrangement, and they had no intention of frittering away their hard-won success. In passing, he noted that the difference between the 12 percent growth rate and the 10 percent rate that the staff had indicated during the negotiations would be acceptable, was not large.

As to the financing available to support the level of private sector activity assumed in the financial program for 1983/84, Mr. Finaish observed that credit to the private sector was projected to increase by 21 percent during the year, which was slightly above the trend of recent years and far higher than the allowed rate of increase for the Government and public enterprises. The authorities considered that the projected increase in credit to the private sector, in conjunction with the large increase in private liquidity that had taken place in the previous year because of the balance of payments outcome, would be sufficient to enable the private sector to perform its assigned role in the macroeconomic framework for the year. In that respect, they considered the financial program for 1983/84 to be internally consistent.

Questions had been raised on the budgetary use of private savings collected through small savings schemes, Mr. Finaish recalled. The authorities agreed that it would not be desirable to continue to use that source of financing as a substitute for ordinary revenue-raising measures. However, in the short term--particularly in the context of the present liquidity situation--the authorities did not feel that the use of such savings by the Government would leave inadequate resources for private investments by putting the Government in competition with the private sector in the market for investment funds. It was relevant to note that all recent capital issues by the private sector had been heavily oversubscribed. Moreover, the authorities considered that the small savings schemes--to which a substantial part of the increase in remittances was finding its way--also served demand management purposes in the present liquidity situation by mopping up excess liquidity in the private sector. Finally, the proposed 12-month cycle for Article IV consultations was acceptable to the authorities; on a related matter, however, while informal staff visits to Pakistan and other countries could be useful, the reporting of changes to the Executive Board outside the normal framework of Article IV consultations--unless the events were truly alarming--seemed unnecessary.

Mr. Clark, responding to comments by Mr. Finaish on improvements in the balance of payments, observed that it was questionable whether a movement of 1.2 percentage points represented sustained improvement. The trade balance showed the picture to be far less bright than the one that had been painted by Mr. Finaish, and the likelihood that the current balance would remain broadly flat hinged to a great extent on the outcome of private transfers, which might turn out to be less than expected.

The Chairman made the following summing up:

Executive Directors generally complimented Pakistan on the successes achieved under the extended arrangement despite adverse circumstances; indeed, several of them considered the results to be an example of what a well-devised extended arrangement could achieve. The growth performance of Pakistan had been most impressive: the economy had expanded at an average rate of about 6 percent, while inflation had been kept under control. At the same time, there had been a considerable improvement in the balance of payments by the end of the program period. The three-year current account deficit had turned out well below forecast, and the overall position was in surplus, although a deficit had been projected. International reserves had also moved into a more comfortable position--although one Director remarked that the net reserve position was not as strong as might have been expected--and debt servicing had been carried out on schedule. Nevertheless, there remained several areas where there had been some slippages or delays and where further action was necessary. The economy remained vulnerable, and noninflationary growth would not be easily sustained without a number of additional measures.

Directors commended the authorities for the reform of the exchange rate system and for the effective use of exchange rate policy to restore external competitiveness. Those actions had strongly contributed to the positive outcome in the external sector. Particular note was taken of the rapid expansion in nontraditional manufactured exports, which was a promising development. Executive Directors also welcomed the substantial progress made in import liberalization and trade reform during the program period and endorsed the reduced reliance on export subsidies.

Directors observed that considerable progress toward structural reform had also been made in a number of other important areas; in that regard, the framework provided by successive national development plans was considered by several Directors to have been of particular importance to the achievement of growth targets. Moreover, price rationalization had been advanced in the agricultural and energy sectors, development spending had been reoriented, and corrective programs had been introduced in the public enterprise sector. To reap full benefits from all those initiatives in the long run, the authorities would need to complete the reforms already initiated and strengthen their efforts in various areas. For example, deregulation and the reform of the tariff system had yet to be achieved, and a meaningful start in those fields would be most desirable. The new import system would also benefit from simplification at an early date; and a number of Directors urged the authorities to continue their programs of import liberalization and price rationalization, particularly in the energy sector.

Turning to the financial sphere, Directors stated that the implementation of tight demand and credit management policies during the first two program years had been a major policy success and had contributed to the improved balance of payments performance and to the declining rates of inflation. That demand management outcome had been assisted by the authorities' success in achieving the broad quantitative fiscal targets set out in the program. However, the structure of public finances had not been strengthened as envisaged. Revenue performance had been weak, partly owing to delays in reforming the tax system. Current expenditures had grown more rapidly than expected, and to contain the budget deficit it had been necessary to restrain development spending. Aggregate investment had fallen short of targets; there had also been a heavy reliance on private savings to finance the fiscal deficit.

Since a continuation of the aforementioned trends could impair implementation of the new development plan, Directors urged that the authorities strengthen their fiscal reform effort, a move that was seen as the key to continued success of the adjustment process. In taxation, for example, a broadening of the domestic sales tax would be helpful. Also, Directors agreed with the authorities' decision to deregulate sugar marketing, but some noted that, as the financing of the Government's commodity operations had presented problems for demand management during the program, further measures and better policy coordination would be needed. Concern was also expressed over the apparent weakening of demand management in 1982/83. While recognizing that rapid money growth was in large part due to the positive balance of payments outcome, Directors observed that a weakening of domestic credit management had also played a role.

Directors endorsed the authorities' commitment to a strengthening of demand management in 1983/84. While welcoming the assignment of greater responsibilities to the private sector, they expressed the view that such action would need to be complemented by measures to reduce public sector credit needs and the use of private savings to finance the fiscal deficit. The generation of private savings had not come up to expectations, and greater efforts would be needed in that very important area. Moreover, a tighter monetary stance would be necessary in 1983/84 to effect a greater degree of absorption than currently targeted by the authorities of the excess in domestic liquidity expansion that had occurred in 1982/83. The view was expressed that, without additional measures, a resurgence of demand pressures could occur, leading to a weakening of the external position and higher rates of inflation.

In sum, Directors noted the many successes under the extended arrangement. They encouraged the authorities to strengthen demand management, to make further progress with import liberalization, and to continue their structural reform program in order to underpin the positive results of the past three years and enhance Pakistan's favorable economic prospects.

It is expected that the next Article IV consultation with Pakistan will be held on a 12-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision relating to Pakistan's exchange measures subject to Article VIII, Section 2, and in concluding the 1983 Article XIV consultation with Pakistan, in the light of the 1983 Article IV consultation with Pakistan conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund hopes that Pakistan will continue to pursue policies that will facilitate a relaxation of restrictions on payments and transfers for current international transactions. The Fund notes that Pakistan has eliminated a bilateral payments agreement with one Fund member and hopes that further progress will be made toward eliminating the bilateral payments agreements with two Fund members.

Decision No. 7588-(83/180), adopted
December 21, 1983

APPROVED: May 3, 1984

LEO VAN HOUTVEN
Secretary