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Planning for Education

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Asian countries have achieved quantitative expansion of educational facilities at all levels of education—elementary, secondary, technical,vocational higher education and teacher training during the last decade. The share of education in the Gross National Product has increased. Governments are committed to community education programmes designed to help young students to understand and develop their local environment by indentifying and solving their social and economic problems. Programmes have been launched for converting ordinary secondary schools into comprehensive schools, revision of curriculum, stepping up adult and non-formal education, expansion of technical and vocational education and speeding the development of agricultural education. These improvements in education are desirable in themselves but they do not add up to an educational plan nor do they represent an integrated programme of social and economic development. It is expected that steps will be taken in the years to come to formulate comprehensive educational plans to achieve the desirable goal of integrated development.

The experience of countries in the ECAFE region in integrated development planning has shown that there are a number of difficulties involved in translating the concept into reality. The main difficulty is the absence of a general theory of development. Reference has already been made to the difficulty of quantifying benefits of educational investments. Inevitably, there is a vast amount of uncertainty and subjectivity involved in the whole process of planning. The relationship between education and the economy has been proved by studies and researches done by economists in advanced countries. The work done by Mr. Denison in the United States has demonstrated that the human factor—knowledge, skills, organization—and in particular education, has been responsible to a large degree for economic growth in the United States. These studies and reaction to them led to a lively debate which is summed up in the book, "The Residual Factor and Economic Growth".[1] It has been argued that "Growth

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1. O.E.C.D. *The Residual Factor and Economic Growth :* Study Group on the *Economics of Education*, Paris. 1964.

rates derived from the experience of the United States cannot be used to calculate the returns on education in the entirely different setting of under-developed countries".[2] Nevertheless, the impaet of these studies has led to the growth of the new branch of knowledge called, 'Economics of Education'. There is a new vocabulary where education is referred to as "investment" rather than as a social service. Planning agencies in Asian countries have also been affected by the new discipline. They have now been converted to the point of view that education is a sector like other sectors such as agriculture, communications and power. This is a welcome change in thinking which augurs well for educational planning.

It is time now to consider some practical problems which remain to be solved in the process of integration of educational planning with development planning. Firstly, developing countries of Asia are not yet equipped to mount big programmes in the sector of education. Quite apart from the scarcity of resources and the competing demands on them, the difficulty of preparing soundly-conceived programmes covering an entire field of activity cannot be easily surmounted. They do not have enough professional people who are needed for this purpose. Secondly, many Asian countries have formulated development programmes within the framework of short-term and medium term plans ranging between 3 to 5 years. The time horizon required for planning education is longer, say, 10 to 15 years. Thirdly, the existing administrative structure for running the systems of education is simply not equipped to handle complex problems which must arise when a big development effort is launched to introduce radical changes which require innovation both in the structure of education as well as in the content and methods of education. The initiative in this direction must come from the administrators of education. They are helping to make the old system work but are not trained in the techniques of modern management. The existing system of education which they serve, with all its rules and procedures, its organization arrangements and staff-

2. T. Balogh and P.P. Streeten, "The Coefficient of Ignorance" *Bulletin of the Oxford University Institute of Economics and Statistics*, Vol. 25 No. 2 (1963), pp. 99—107.

1. See Annex 1

ing, is ill-adapted to the requirements of a modernizing society. It is imperative to reform the administrative organization and bring some order into its activities to ensure that suitable personnel are placed in charge of educational development. All these problems remain to be solved before educational planning is integrated with development planning.

The problem facing the developing nations in the sector of education are many and complex. The state of educational administration is generally unsatisfactory, little coordinated planning takes place, rates of wastage and drop-outs are high and many imbalances exist in the educational structure. These problems are compounded by rising costs, poor quality of teaching, student unrest, irrelevant content of education and lack of innovation and adaptation in the curriculum. The existing systems of education need to be reformed and future expansion needs to be planned so that waste is eliminated and output is produced which meets the requirements of their economies and societies, Governments in developing countries are busy doing an agonizing reappraisal of their development experience and are expected to devote more attention to this politically sensitive sector in the decade 1970-1980. It would be wrong to expect miracles. All that one can ask for is a steady improvement in the internal efficiency of the educational systems by introducing educational planning. There is a long way to go and each country has to decide its particular strategy for meeting the challenge of the future. The obstacles are many. The factors which impede progress are :

(a) Basic intertia and conservatism of the educational systems ;

(b) Weak educational administration ;

(c) Scarcity of resources and uncertainty about their availability ;

(d) Lack of reliable and up-to-date statistics.[1]

FORMULATION OF AN EDUCATION PLAN

An educational plan is a statement about the future. It is not merely a technical document containing facts, trend estimates or a statement of future policies. It is

1. See Annex II

an instrument of action which is designed to influence what will actually happen, what schools will be opened or expanded, at what location and at what time. A plan is usually a formal document approved by government at the highest level which lays down a set of goals and policies for the future development of the educational system. It is subject to constant revision so that the content of plan keeps changing as information about previous planning efforts are received and evaluated. It provides guidelines for all those who are involved in the process of educational planning.

The preparation of an educational plan requires a great deal of participation by a variety of professionals : economists, statisticians, demographers, curriculum, experts, engineers, educational administrators, teachers, sociologists, psychologists and others. They look at the system of education from the economic, demographic, sociological and man power points of view. They are not merely looking at the cultural value of education or education for education's sake.

We shall sketch briefly the steps in the formulation of an educational plan. The preliminary stages of planning include :

(i) The identification of constraints.

(ii) The preparation of overall national economic and social targets.

(iii) The preparation of budgetary and manpower targets.

After this preliminary work has been done, the active preparation of the plan is taken in hand. At this stage, the planning organizations get down to the formation of committees whose role is defined by giving them their terms of reference. This is followed by an in-depth study of alternatives and basic policy decisions. All this hard work is then translated into programmes for all levels of education : elementary, secondary, higher, professional and technical education. The programmes are usually formulated in macro-terms by setting global targets. These macro targets are than broken down into school by school targets of enrolments, teachers, operational costs and capital costs. From this, the planners go on to the preparation of projects. A draft educational plan is born after all this elaborate exercise which identifies objectives, sets out priorities, lays down specific targets to

be met within specific time limits. It is discussed at all levels and, if formally approved by government, becomes a programme of action which is to be implemented by appropriate agencies. The story does not end here. In fact, the stage is now set for the preparation of school operational plans. It involves fixing school enrolment targets for each school, calculating the number of teachers needed by qualifications, and from this estimating operational costs for each school. As far as capital costs are concerned, it is first necessary to study the existing facilities, their need for maintenance or replacement and their level of utilization. The capital expenditures needed for maintenance or replacement can then be calculated. This makes it easy to work out the capital requirements for new buildings and equipment.

Educational planning is a new field of activity in Asian countries. Governments are devoting a great deal of attention to education and efforts are being made to plan the development of education in a systematic manner. Educational planners are busy working on alternatives and possibilities open to governments and the range of consequences arising from their adoption. They are working out guidelines for the policy-makers to enable them to adapt the organization of content of their educational systems to their economic needs and social conditions.

We shall now take up some of the key policy issues for discussion.

A. Multiple objectives

The process of preparing and educational plan is bedeviled by multiple objectives. These objectives are both cultural and economic and include :

(1) Preservation of national culture ;

(2) Equality of opportunity ;

(3) Forging of national unity ; and

(4) Economic development.

Conflicts arise because the modernizing elements want a radical break with the traditional system of education. To them, the modernization of the curriculum, methods and content of teaching is an essential pre-requisite for improving the efficiency of the educational sys-

tems. They are critical of the over-academic curriculum and irrelevance of courses at all levels of education. Economists are usually the allies of these elements and insist that scarce resources available for education be used efficiently. They like to ensure that education for development takes precedence over other goals of education On the other hand, conservative educationists accuse the economists of a narrow vision and emphasize the broader aims of education which include the development of total human personality. They regard themselves as 'keepers of tradition and tutors of the elite'.

The conflict between cultural and economic goals can be resolved by adjusting the scale and structure of the desirable educational pyramid or by surrendering the achievement of one or more of the objectives. The need to introduce education for development, therefore, involves a delicate marriage of the old and the new, not necessarily replacing the one with the other. The modernization ideal demands that something must be given up to accommodate the demands of new culture based on science and technology. In any case, the formulation of an educational plan requires team work and cannot be entrusted to economists alone who merely point out the economic costs of choosing one alternative rather than the other. The cooperation of a variety of experts, viz ; engineers, statisticians, administrators, sociologists, psychologists, curriculum experts, and others has to be enlisted to ensure that an educational plan is drawn up which meets the requirements of the society and the economy.

B. Determination of the share of investment in the total investment.

We have already referred to the problem of inadequate allocation to the education sector in a preceding seminar. How much should a country spend on education ? UNESCO recommends to governments in developing countries the figure of 5 per cent of GNP for achieving minimum targets of expansion as well as for improving quality. The share of education in national budgets has been growing. The annual rate of growth of educational expenditures between 1960-1965 has been 13 per cent in Asia, 16 per cent in Africa and over 20 per cent in Latin America. This expansion has helped these countries to register quantitative improvements on

an unplanned basis and created problems of dilution of quality, indiscriminate expansion of inappropriate institutions and construction of expensive buildings. In most cases the linear expansion of the existing system of education has aggravated the imbalances in the educational systems and accentuated the problem of educated unemployment. What these countries need is planned expansion of education of educational facilities in the light of projected ecomic and social requirements ten or fifteen years from now. Only a firm commitment to invest a definite percentage of Gross National Product in the development of education and training can provide a basis for sound educational planning. Educational programmes covering an entire field of activity can then be drawn up. Heretofore, this commitment has been lacking in most of the plans of developing countries with the result that educational prgrammes are drawn up which lack coherence and substance. These programmes are neither properly coordinated with the economic development of the country nor can be justified in terms of certain widely accepted social goals.

C. Setting educational priorities

A strict order of priorities among different branches of education is necessary because developing countries lack resources to support the cost of simultaneous and equalized development at all levels. Decisions have to be taken on the distribution of total investment among the different levels and tiers of the educational system. Further, at any particular level, how should the total be divided among vocational and academic education, among expansion of numbers and improvement of quality, among formal education and informal training, and so on ? Questions which arise are : Should universal primary education be given priority ? Should technical education get percedence ? How should quantitative expansion at various levels be reconciled with qualitative improvements ? What can be done to strike a balance between general education and specialized training ? These and many more issues need to be resolved before an educational plan can be formulated to satisfy the tests of efficiency and consistency. Poor countries faced with these compelling alternatives and with ill-equipped analytical and statistical bases need pragmatic guidelines for choosing between these alternatives.

D. Reform of the Educational Systems

We have already referred to the serious imbalances in the system of education in developing countries which have created the twin problems of unemployment of the educated and the shortage of persons with intermediate skills that correspond to the needs of industry, agriculture and other developing sectors of economies. We shall examine some of the features of the system of education in Asian countries which have contributed to the structural maladjustment in the supply and demand for the educated.

There has been a rapid expansion in the number of schools and colleges, particularly for non-professional studies, without a corresponding expansion of physical and other teaching facilities. In discriminate admission to colleges and universities without using a suitable criteria for selection has led to low standards and mass failures in examinations. An element of waste is inherent in a system based on poorly qualified and untrained teachers. A considerable proportion of schools and colleges lack the basic minimum requirements in respect of laboratories, equipment, suitable textbooks and handbooks. There is a limited range of elective courses and virtual absence of educational and vocational guidance. Overcrowding in non-professional courses is threatening to convert these institutions into glorified coaching establishments.

In colleges and universities, teaching is geared to the sole purpose of passing the examination and securing a diploma or a degree. There is a deep-seated conviction in everybody's mind that the whole purpose of teaching is to go through a prescribed course and finish it. The 'course' is specified by a list of items set down in the syllabus which is to be expounded by the lecturer to the students. No time must be wasted on items which are not in the course. Presently the student will be faced with an examination in which he will be asked stock questions on the stock material; it is, therefore, necessary that he be primed with the required information. In this process, the student is neither required nor expected to display any intitative. Completed passitivity in the classroom is considered a virtue. The information offered to him must not be questioned; it is simply to be memorized. Every device that helps to eliminate

the necessity of thinking is used to the full—notes to be copied and memorized, ready-made answers, bazaar notes and 'made-easies' are the stock-in-trade of the professional crammer. Memory is at a premium and intelligence at a discount. The system is designed to iron out independence of mind, originality and native curiosity; to turn young men and women into automata. It is almost a Pavlovian process of conditioned reflexes; the perfect examinee is one for whom the stock question evokes the conditioned, the memorized answer. The examination is the measure and mould of everything else. It dominates the educational process and is highly inefficient as a method of producing properly educated graduates. A radically new approach is needed if we are to improve the quality of the end product of the educational system.

The system is not designed to produce the types of persons for whom the demand has grown during the last 20 years. It produces a large number of school and university graduates who cannot be absorbed in the type of jobs and at the rates of pay which they expect. The system lacks balance. It is heavily weighted in favour of general studies and humanities. This pattern attaches less importance to science education at all levels; primary, secondary and higher education. Finding few alternative outlets, and products of secondary school gravitate to colleges and universities and aggravate unemployment. There is no point in clinging to the so-called liberal concept of education which suggests that everyone is entitled to higher education of any sort. Such a concept is an intellectual luxury which low-income countries simply cannot afford. What is needed is to adopt a radically new approach and plan the output of educational institutions in the light of national requirements. The preferences of the individual may have to be made to conform to the needs of society.

This is not to deny the importance of general education. Education is important because it increased knowledge; it alters the outlook of the population, changes their perspective and in general leads to a widespread acceptance of the scientific spirit in matters economic or otherwise. But these are mere tautologies about the significance of education in the modern world

of science and technology. These have been substituted for vague generalizations of an earlier age about the aims of education. To say that education is a social force integrating the individual into society or that it is a means for adapting the human personality to meet the challenge of environment tells us precious little about the practical issues in education. The planner is interested in examining the systems of education with a view to finding out if investment in education is related to the social and economic needs of the country and to determine the priorities of such investment. Indiscriminate investment in education lead to human and material waste : optimum returns are obtained through a careful analysis of trends in the economy and the allocation of resources to key educational sectors so that education fits harmoniously into the pattern of economic and social change.

Conclusions :

(a) Theoretical models of educational planning have limited value for practical programming in the sector of education.

(b) The formulation of educational plans and programmes is a laborious and time-consuming process. It requires participation by a large number of specialists.

(c) Planning and implementation cannot be separated. A plan that is not implemented is not even worth the paper it is written on.

(d) It is necessary to convince people who run educational institutions that planning is good for them.

ANNEX I

Some definitions .

1. A plan is a rational method of attaining a goal. A national educational plan is a sketch which identifies objectives, sets out priorities, lays down specific targets to be met within specific time limits. It provides basis for action but it does not in itself produce action.

2. An Educational Programme is an entirefield of activity that is either justified in terms of economic development plan of the country and/or in terms of certain widely accepted social goals, say, expansion of the secondary school system.

3. An Educational Project is a separable activity fitting into a larger programme-say, the construction of teacher training colleges whose graduates are designed to take up teaching in secondary schools.

4. Internal efficiency of an educational system refers to the relationship between the resources it is using and the educational results it is getting, looked at from the inside.

5. Productivity of an educational system refers to the relationship between the resources invested in education and all the resulting benefit accruing later on to the students and to society as a whole.

ANNEX II

STATISTICT NEEDED FOR EDUCATIONAL PLANNING 1

A. Demographic statistics

(a) Basic Data

A:1 Total population, by sex and age

A:2 Population projections

(b) Supplementary Data

A:3 Population 15 years old and over, by sex, age and educational attainment (or literacy)

A:4 Natality, mortality and migration

B. Labour force statistics

(a) Basic Data

B:1 Economically active population, by industry and educational attainment

B:2 Projections of the labour force

(b) Supplementary Data

B:3 Economically active population by occupation, sex and age

C. Economic and financial statistics

(a) Basic Data

C:1 Gross national product, indices of economic growth

C:2 Total public expenditure, by authority and purpose

D. Statistics on educational institutions

(a) Basic Data

D:1 Institutions by level and type of education

(b) Supplementary Data

D:2 Institutions by regions

D:3 Number of schools of the first and second levels of education by number af grades, number of teachers and number of pupils enrolled.

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1 Extracted from document of same title by K.G. Brolin, Director, Office of Statistics, UNESCO, Paris and reproduced by the UNESCO Regional Office for Education in Asia as No. A-6 Reproduction Series (Bangkok 1970).

E. Teachers and other educational personnel

(a) Basic Data

E:1 Number of teachers by sex and age

E:2 Teachers by qualification and length of service

E:3 Number of teachers lost to the educational system each year, for various reasons

(b) Supplementary Data

E:4 Teachers by subjects (or group of subjects)

E:5 Full-time and part-time teachers, hours of teaching

E:6 Number of non-teaching staff, inspectors, administrative, health and other auxiliary personnel

F. Classes

(a) Basic Data

F:1 Number of classes by grade

(b) Supplementary Data

F:2 Number of classes by size

G. Pupils (students)

(a) Basic Data

G:1 Number of pupils by sex, age and grade

G:2 Pupils at the first and second levels of education leaving school each year

G:3 Pupils entering school each year

G:4 Pupils repeating grades each year

G:5 Pupils at the second level of education by branch of study.

G:6 Students at the third level of education, by field of study, level and type of degree or diploma

G:8 First-time students at the third level of education, by field of study

(b) Supplemcntary Data

G:9 Number of pupils by regions

G:10 Pupils in non-co-educational school

G:11 Fulltime and part-time pupils

G:12 Pupils by Socio-economic origin

G:13 Pupils by domicile

G:14 Future occupation of pupils

G.15 Average daily attendance of pupils at first and second levels of education

G:16 Students abroad, by country, field and duration of study

H. School building and equipment

(a) Basic Data

H:1 School buildings by type of construction, qualitative standards, and size

H:2 Classrooms and special rooms

H:3 School buildings, classrooms and special rooms completed each year, and their capital costs.

I. Educational testing and vocational guidance

(a) Basic Data

I:1 Evaluation of pupils achievement

(b) Supplementary Data

I:2 Mental measurements of pupils

I:3 Measurements of pupils' aptitudes and interests

J. Health, feeding, transportation and lodging of pupils

(a) Basic Data

J:1 School health services

J:2 School feeding programmes

(b) Supplementary Data

J:3 School transportation services

J:4 School lodging facilities

K. Scholarships and fellowships, school fees

(a) Basic Data

K:1 Scholarships, fellowships, etc.

(b) Supplementary Data

K:2 School fees

Out-of school education

(a) Basic Data

L:1 Facilities for out-of-school education, by type of organization

L:2 Staff enagaged in out-of-school education, by sex and qualification

L:3 Persons availing themselves of facilities for out-of-school education, by sex, age and level of educational attainment

Costs of education

(a) Basic Data

M:1 Recurring expenditure on education by public authorities

M:2 Capital expenditure on education

M:3 Loan, repayment and interest charges, related to educational expenditure

(b) Supplementary Data

M:4 Private expenditure for education

Some Welfare Implications of Shadow Pricing

SHAHEEN AKATAR*

Introduction

The last decade has seen a constant stream of articles and books on cost- benefit analysis and project evaluation appearing in print. All these writings incorporate the analysis of shadow prices on a high level of economic sophistication. One may well wonder at the audacity of a beginer in economics to pick such a field for exploration. But the effort may be justified by, in G. C. Harcourt's phrase, the need of a poet to expian to other poets what is going on, and also by the fact that most of these writings have very little to say about the welfare implications of project selection.

Shadow prices are used to reflect the intrinsic values of the inputs involved in the process of production. It is a device intended to restrict the use of under-priced factors and stimulate the use of overpriced factors, In most of the mixed economies of today, in which public and private enterprise competes with each other for the available resources, public planners find that there is a significant degree of divergence between social costs and market prices. This divergence is even more marked in the case of underdeveloped countries and results in misallocation of resources. It has been pointed out that there are some fundamental characteristics of the underdeveloped economies which lead to this sort of misallocation (19). The market and intrinsic values of goods and services would be the same under competitive conditions, But the price system is distorted because of obstacles in the freeworking of the laws of supply and demand. The very basis of

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optimum efficiency, called the Paretotoptimum in economic jargon, namely, perfect competition in all product and labour markets, perfect information about present and future prices, given consusumer tastes, profit motive, divisibility of capital, no externalities and what not, is lacking. (6, p. 22). The rationale for using shadow prices is based on this failure of the market system. They are assumed to be essential to correct the cousequences of market failure.

Other than the above efficiency basis for corrective action, there is another type of market failure which is not related to a breakown in the technical operation of the market system. This originates in society's rejection of the way in which the market system distributes income. It is based on ethical judgement rather than on market failure. Shadow prices calculated by planners with a limited purpose of removing the divergence between social and private costs and achieve technical optimality may or may not be the prices needed to bridge the gap between incomes of different sections of society. Given perfect competition, unregulated price system should work as an ideal allocator of economic resources. But the dictum holds only for technical efficiency, not for welfare maximisation. The recent debate in Pakistan on choosing between the maximisation of gross national product and maximisation of employment involves one such problem.

The way shadow prices are set in situations described above and the direction in which the price structure is bent by deliberate public policy is important for overall development effort. (3).

Part I and II of this paper give an eclectic overview of current opinion on shadow prices in the literature. Part I deals very briefly with the problem of shadow prices in developed countries under the assumption of near full employment. Part II deals with underdeveloped countries where, as pointed out above, due to some fundamental disequilibria, market prices fail to clear the factor market.

Despite the different employment assumptions, shadow pricing, in the last resort, is nothing but a calculation

of the opportunity cost of factor inputs for current and future use. The question of inter-generational allocation of resources is avoided so as not to get involved in the problem of social discount rate or social rate of time preference. This concept, which tries to explain the relative valuation which society puts on a marginal amount of consumption in different time periods, is sometimes used in place of the private sector marginal productivity of capital for public project evaluation. The interested reader is left on his own to clarify this concept by "exploring the dark jungles of the second-best." (1)

Part III focuses on the normative side of the issue. It tries to relate shadow pricing to the aims of Pakistan's economic planners. The paper ends-with a caveat for calculating these prices in Pakistan under different side-conditions than those assumed in the recent Western literature.

Throughout the paper, the type of economy under discussion is the mixed-economy, where private and public sectors overlap and somehow tend to do each other in.

I

With an increasing role of governments in economic affairs of the developed as well as the under-developed countries of the so-called capitalist world, social and private costs have assumed great importance in the context of project evaluation. In the developed economies because of near full employment, resources have to be withdrawn from the private sector to be made available to the public sector. Long-run projections of costs and benefits are a common feature of planning for public projects. The measurement of social cost, in keeping with the principle of efficient allocation, should be done by the standard opportunity cost, wherever there are supply restrictions or multiple prices. The opportunity cost of using a resource is best measured by the principle of equal marginal valuation to the user, whether private or public. If, for instance, the marginal productivity of capital is lower in the public relative to the private sector, the national planners should attach a price to the use of capital in the public sector. This can be done by attach-

ing to each year a discount rate that corresponds to the expected marginal productivity of capital in that year.

S. Marglin has derived an objective function for each public project for measuring the opportunity cost of public investment when the social rate of discount is below the marginal productivity of capital in the private sector. (16).

$$\int_0^{\infty} B(x, t)\, e\, dt^{-rt} - aK(x)$$

where

x	size of the project
t	time
B(x, t	benefit rate of the project, a function of the scale of the project and time.
r	marginal social rate of discount
K	capital cost
a	opportunity cost per unit of money of public investment.

"a" here represents the shadow price, attached to the capital cost which is a function of the scale of the project The shadow price is higher than the expected future price if investible funds are relatively scarce, and lower if funds are relatively abundant.

The same reasoning has been followed by Harberger in calculating the opportunity cost of capital. Marglin's "a" becomes "w" in Harberger and serves the purpose of a shadow price in project evaluation. But Harberger parts company with Marglin when the question of an appropriate social rate of time preference arises. According to Marglin this rate, which lies below the current opportunity cost of capital, should be used without any reference to the capital market to reach decisions on the allocation of resources between present and future gene-

rations. With a lower rate more projects for the future will become worthwhile. Harberger differs with this. We can quote from his paper, (8, p. 30).

> "Let us suppose that the opportunity cost of capital (our w) is currently equal to 10 per cent, while the social rate of time preference is only 4 per cent. This does not mean that public sector projects should be evaluated at a 4 per cent rate, since marginal increments of public funds could be put into the private capital market where they would have a social yield of 10 per cent. The appropriate policy is for public projects to be continuously evaluated at "w", and for fiscal authorities to design their policies so as to gradually bring "w" down to 4 per cent . . . . in the process "w" would continue to guide investment decisions. If the social rate of time preference is a guide for anyone, it is for fiscal authorities and overall planners, not for project evaluators".

II

In some of the economic studies carried out about West Pakistan, empirical backing is provided for the contention that there are discrepencies between private and social profitability of investment. (2,12). Two of the sources of these discrepancies have a special significance.

1. Market wage rates for farm labour overstate the opportunity cost of labour.

2. Capital is underpriced as a result of overpricing of the exchange rate.

These two factors are usually advanced as the basis for using shadow pricing in underdeveloped countries. It is contended that a higher market valuation of labour relatively to capital not only fails to clear the labour market but also leads to a wrong choice of technology. A shadow wage rate and a shadow rate of foreign exchange, it is believed, can remove the above distortion.

As defined by V. Joshi (11, p. 6),

> "——the shadow wage rate is an estimate of the social cost of labour which takes into account both

the differential productivity of labour in agriculture and industry and the effect of extra employment on total saving. The accounting rate of interest is an estimate of the social opportunity cost of capital."

SHADOW WAGE RATE :—

The differences in skills and immobility of labour from one region to another region and from one sector to another sector make the calculation of the shadow wage rate (SWR) very difficult (9). If SWR is the opportunity cost of labour, then which opportunity cost is to be estimated ? The correct method would probably be to estimate the skill-mix of different industries and look at the average or marginal product of labour of a specific skill, irrespective of the industry in which this labour is being used. The US National Bureau of Economic Research has derived a methodology for that and cross-section studies based on that methodology have been made.

However, the problem is circumvented in the literature by assuming that all labour is drawn from the agricultural sector and, therefore, it is uniformly unskilled for the purpose of absorption in the industrial sector. Since this labour is in excess of the needs of the agricultural sector, its marginal productivity is extremely low. It naturally follows that the SWR should be very low also (10).

It may not be advisable, however, to take the agricultural productivity as the shadow price of labour when moving it to the industrial sector. Firstly, the marginal product of labour in the agricultural sector may be lower than its earnings in that sector and secondly, due to the costs involved in diverting labour from rural to urban employment, labour will be available only at a higher price in urban areas. (9). These factors, if taken into consideration, will give an upward bias to the SWR and consequently provide a lower level of employment to surplus labour.

Labour market biases are thus assumed to be important in economies where employment decisions in all sectors are not based on wages. Employment in a non-

market sector is carried to the point of full cooperative use of all labour, and individual incomes are not limited to the marginal contribution of individul workers. Under these circumstances, the absorption of labour in the market sector is less than optimum.

In addition to the above strictly labour-market price influences on employment, industrial policy, intended to encourage the use of machinery, further reduces the the capacity of the market sector of the economy to absorb the available supply of labour. (14).

The distortion created in the social allocation of labour by the above forces can be somewhat controlled by introducing the SWR in evaluating new projects. But this sort of reasoning implicitly assumes that augmenting employment is the sole objective of the planning authority. This is not only not true but the real position in most of the cases is its opposite.

SWR, SAVINGS AND INVESTMENT :—

So far we have been talking of the possibility that the wage rate in industry overstates the opportunity cost of labour. There is, however, another problem facing the labour surplus underdeveloped economies. The aggregate saving and investment in the economies is less than is socially desirable. In these absence of adequate fiscal measures and iustitutional arrangements to increase savings, settiug a very low SWR will further reduce their relative size. This conclusion is based on the classical premise that all wages are consumed and all profits saved. A low SWR, besides cutting income inequality, will reduce the volume of aggregate saving.

If, on the other hand, the SWR is set at a high level, more savings can be generatcd but only at the expense of the employment level which will tend to be lower. The simple problem of providing employment to surplus labour by using shadow pricing gets mixed, in this context, with an inter-generational equity problem. The choice is between more employment and consumption now and more savings, and hence investment, now and more employment and consumption in the future. This takes us to the border line of the controversial question

of choice of technology, which, in underdeveloped countries, is constrained by the supply of capital as an input. In these countries, supply of capital more or less means the availability of foreign exchange.

SHADOW PRICE OF FOREIGN EXCHANGE:-

Foreign exchange is assumed to be the key factor in evaluating a project. (17, 18). Because of the need for building an industrial infra-structure, the capital co-efficient is relatively high in backward economies, especially in early stages of their development. Sometimes there is even a redundancy of ex ante domestic savings imposed by limited availability of foreign exchange. Deepak Lall (13) has pointed out in a recent article that these countries suffer from foreign exchange bottlenecks as well as foreign exchange shortage. The former arises if an overvalued exchange rate is maintained and the latter reflects a disequilibrium in the foreign exchange market.

While different shadow prices may be needed for labour due to its heterogeneity, no such problem exists for foreign exchange which is basically homogeneous. The problems which do arise are related to the different uses to which foreign exchange can be put. This can be explained with an example from Harberger. (9).

Suppose the exchange rate has somehow settled at ten rupees to one dollar and we have one extra dollar to allocate over three importable goods where Good One is not taxed at all, Good Two is taxed at the rate of 20 per cent and Good Three at 50 per eent. At these tax rates Goods One, Two and Three will have internal values of Rs. 10/-, 12/- and 15/- respectively. For estimating the shadow price of foreign exchange we will have to know the amount spent on each good from this extra dollar. If 50 per cent is spent on Good One, 30 per cent on Good Two and 20 per cent on Good Three, then the shadow price of a marginal doilar would be :-

$$(\cdot 5)\ (10)+(\cdot 3)\ (12)+(\cdot 2)\ (15)=(11\cdot 6)$$

This example does not tell how one dollar came to be equal to ten rupees. But we have lived for far too

long under systems of fixed exchange rates and we all know the answer. The pertinent question, however, is whether this arbitrarily fixed rate reflects the intrinsic value of the rupee. If it does not, then we need a shadow price here too.

One way of defining industrialization is to say that it is the substitution of domestic production for imported mannfactured goods. The choice between domestie production aud imports is based on the availability and opportunity cost of resources required by each alternative. Chenery and others (4) have shown that we can build a linear programming model, in which the solution is based on the shadow price of foreign exchagce which is determined by the opportunity cost of domestic production in the margiual importing and exporting sectors. In equilibrium the price of foreign exchange becomes the reciprocal of the marginal productivity of investment in these sectors.

The ECLA Manual on project evaluation (7) suggests calculating the shadow price of foreign exchange on the basis of a purchasing power parity formula. And the Little-Mirrlees guide to such evaluation (15) recommends the use of world prices of traded goods as shadow prices for purposes of resouree allocation.

The basic point to note in the above discussion is that a country should not be led to import or export goods for which its resource endowment is inappropriate by the use of inappropriate prices in project evaluation.

III

Economic planning in Pakistan, at least upto Third Five Year Plan, was based on the princlple that the maximum rate of saving and the highest rate of growth of the gross national product are the fundamental aims to be pursued. Pakistan's Chief Planner dismissed the questions of distributional justice with contempt (10a). Recently, there has been a shift in this policy and more emphasis is being put on the provision of employment.

In development planning, on strict theoretical grounds, SWR, if not equal to the marginal productivity of labour

in agriculture, should be kept very near it. This is a necessary condition if the goal of maximum employment is to be followed unambiquously. The current position in Pakistan presents us with a half-way house where neither employment nor maximum saving goals are followed very rigorously. For the practitioners of political economy this is not an uncommon situation. Lacking sufficient eccnomic or political daring, practical economists have always tried to tread the middle path. Thus, an economist suggests that,

> "It would be wrong to set the SWR equal to labour's opportunity cost (measured ln terms of the shadow price of the agricultural production foregone) because labour consumes all its wages, and aggregate savings are judged to fall short of the optimum. It would also be wrong te set the SWR equal to the actual wage rate since labour's increase in consumption is not wholly bad. Consequently, the SWR lies somewhere in between. The SWR depends on labour's opportunity cost, the industrial wage rate and the shadow rate of investment," (5, p. 40).

This is the approach advocated by Little-Mirrbees in the OECD Manual on project evaluation. This approach, that the SWR should lie above the opportunity cost of labour, assumes that the surplus created by restricting employment and diverting resources to savings would automatically result in more investment. This additional investment is then supposed to provide employment and the resultant benefits in future.

One view about this sort of approach is that since the future generations will be better off than the present one, robbing this generation to provide for the next is like standing Robin Hood on its head. The subsidisation of future generations is not bad per se. But making this provision by restricting the consumption of poor sections of the society, i.e., the wage-earners, is not only unethical but also against the principles of welfare maximisation. It is an elementary principle of economics that the total welfare would be greater higher the number of poor people for whom additional consumption is made available making them slightly better off, than if it is spread over a

smaller number of poor people making them much better off. (11).

Another objection against the OECD type guide for shadow pricing is that the deliberate restrictions put on the growth of labour's share in national income may well be worth the sacrifice if the other half goes towards augmenting the so-called "economic possibilities for our grand-children." What actually happens is that a significant part of the surplus generated at the expense of wage-earners is transformed into conspicuous consumption and foreign accounts, thus delaying the absorption of surplus labour in gainful employment.

CONCLUSION :—

In poor and backward countries the governments grant tax holidays. trade licences, cheaper foreign exchange, expense accounts and what not to the capitalist sector and levy excise taxes on necessities to be borne by the wage and salary earners. One is amazed at the degree of regressive taxation carried on in these countries in the name of long-term economic growth. The break in the chain is inevitable and it does occur, always in the form of social and political unrest. The cost of this unrest to society is always greater than it would be if proper economic policies are adopted in time.

By shadow rates of discount governments should not always allocate capital resources among the sectors of the economy to equalize net returns. A government can always favour one sector over the other by using an appropriate rate of discount. Similarly, the objective of using a shadow wage for labour need not be limited to increasing the efficiency with which resources are employed, low shadow wage may also be designed to equalize the distribution of income by increasing the volume of emloyment in the cconomy. This may be the most practical means of improving the distribution of income in the absence of appropriate fiscal measures.

It is suggested that the economic planners in Pakistan should set the SWR as low as possible, even lower in backward regions within the country relative to other regions. Foreign exchange should be shadow priced not

as a key factor, but purely as a complementary inp with labour.

The gap between the SWR and the market wage ra should not be filled by taxing the wage goods. Fis measures should be devised to curtail conspicuous co sumption. And whatever the improvement made labour's welfare, it should not be siphoned off throu the expedient channels of the printing press and t rising prices. But that is another story.

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Rising Prices and Social Change

(With reference to Pakistan)

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Prices play a key role in guiding and organizing economic activity of a free-enterprise economy. Prices determine consumers' choices, ensure efficient allocation of resources in production and indicate the efficiency of working of the economy. The pricing process of a free-market economy presents itself as a series of reciprocal price relationships which have the tendency of bringing the economy to a state of equilibrium. Furthermore, price variations predict the probable nature and direction of changes in economic organisation and economic activity of the economy. As price changes have vast repercussions on the economy, economists, in most cases, use prices as a basis for prescribing policy measures to mould or modify economic activity along the lines they think are desirable.

CONSEQUENCES OF PRICE FLUCTUATIONS

Rising prices, in early stages, stimulate real investment in the economy. Because investors think that investment made now will cost them less than that made at any future time. Wages and salaries lag behind prices during inflation but overhead expenses such as property taxes, depreciation charges, maintenance costs and interest payments do not generally vary in proportion to changes in the general price level. Profit margins, therefore, increase The larger realised profits motivate firms to exapand.

Rising prices also stimulate investment in public sector. Because when business profits increase during inflation, government tax revenues also go up. The Governments, therefore, are tempted to implement vigor-

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ously their construction programmes thereby bidding up the general price level further.

As firms start working in full capacity, jobs become plentiful, wages and salaries rates go up, profit margins increase and businessmen start building up inventories to very high levels, therefore the general demand for output increases which further propagates price rises.

Money balances start losing their purchasing power constantly during inflation. The general public is therefore, tempted to convert their hard cash balances into goods and property rights thereby increasing their prices. Speculative activities take hold, people buy goods and other kinds of property, hold them for sometime and then sell them at higher prices thereby making wind-fall profits. Thus in rising prices businessmen and all those whose incomes respond quickly and in the same direction as the movement for prices, tend to gain, whereas those groups who get relatively fixed incomes, such as salaried employees, bond holders, landlords receiving fixed rentals etc., suffer losses in terms of real purchasing power. Debtors gain, creditors lose. Workers suffer because wages lag behind prices. However they get jobs.

But when prices start going downwards the general demand for goods recedes. Production levels fall down. Factories close their doors. Workers are thrown out of their jobs and resources become idle. People are tempted to convert their goods and properties into cash. Creditors gain, because they had lent low valued money in the past but now they receive high valued money. Debtors therefore, stand to lose. All those groups getting relatively fixed incomes, gain. Real investments decrease drastically resulting into severe depression for the economy.

The larger the extent of price changes, the greater will be the resulting injustice. Not only real incomes of the various groups change, but also wealth shifts from person to person during inflation or deflation, because shifts in income are related to shifts in the ownership of property. Most of the economists, therefore are of the opinion that a comparative price stability is highly

desirable for maintaining economic justice[1] and economic enterprise in a free-market economy.

RISING PRICES AND ECONOMIC DEVELOPMENT

Most of the economists are of the opinion that a moderate upward drift of prices is essential to economic growth. They further contend that without a consistently rising trend of prices there will be mounting unemployment in the economy. They also maintain that major economic units, such as labour, business and farm are now so effectively organised important segments of the market that they are able to hold prices and wages at levels above those which are consistent with maximum sales and production. Because of their actions chronic unemployment tends to increase and the governments, with their full-employment responsibility have no choice except to expand the money supply and deliberately inflate prices. It is also argued that moderate amount of inflation is desirable when inducements are necessary for large scale movements of labour and for increased supplies of food stuffs and raw materials to be made available by the villages for the towns. Furthermore, it is contended that saving rate in poor countries is very low, therefore the desired rate of investment may not be attained if there is rigid insistence on orthodox financing principles. For achieving a certain level of capital formation poor countries are bound to resort to forced savings through inflation. Thus creeping inflation is necessary in order to stimulate appropriate economic growth and hold the economy at continuing levels of full-employment.

If we look to the experience of economic development of advanced countries, we find that in the 16th and 17th centuries, when substantial economic development took place in England, France and Spain, the prices in these countries were also rising continuously. The early

1. Economic justice is a relative term. The concept of justice in a particular society emerges from the level of its intellectual advance and the state of its social growth. Thus the concept of economic justice in an enterprise economy differs widely from that conceived by a communist economy. However, prices play a great role, whether it be a market economy or a command economy, in introducing eeonomic justice as conceived by their social milieu.

part of the 'Industrial Revolution' in the second half of the 18th century was also accompanied by rising prices. In Japan the prices went on rising for full sixty years from 1860 to 1930 and ultimately rose to 350 per cent, but Japan witnessed continuous economic development during this period. Even in Soviet Russia the 1930s was accompanied by equally massive inflation when her economy was on the van of development. On the other hand, we see that a very high rate of economic development was experienced by England in the first half of the 19th century when the prices were continuously falling there. Even in the last quarter of the 19th century when Britain witnessed substantial economic growth, the prices were on the decline. In America even, growth and price behaviours have been inconsistent. However, it depends upon the conditions prevailing in each country under which growth has been taking place.

In many instances inflation has been a potent factor in stimulating growth. But there are limits to what inflation can achieve for economic progress. A policy of creeping inflation may help in breaking deadlocks, may also encourage forced savings and thereby investment, may also induce idle labour and raw material to move from villages to urban industrial centres, and may even encourage the farmers to produce more food stuffs to be used by those engaged in the task of economic development in other sectors, but market imperfections, especially rigidities and inflexibilities may not even allow inflation to do the needful to the extent desirable. Furthermore, creeping inflation may result into trotting, galloping, runaway or rocketing inflation and may therefore eat up the gains of development of the economy in the long run. However, recent experiences of undeveloped countries have demonstrated that the policy of inflationary financing has been helpful in encouraging development only in the short run but in the long run it has a discouraging effect on voluntary savings, because when prices of consumers goods go up, the power to save of the savers is jeopardized and therefore long-term lending needed for development is discouraged. Price rises wipe out benefits of fixed interest incomes thereby depressing long-term lending further. Inflation results in misdirection of

savings away from more productive outlets towards short term projects because of uncertainty about the future of such an economy. Moreover, rising prices encourage the holding of stocks of goods, gold, foreign currencies, and investment in real estate. Such speculative investments do not only discourage real investment and thereby development but also intensify inflation. Mal-allocation of resources may take place; land, labour, capital and technique etc. may not be utilized to the best advantage of the economy in times of rising prices. Efficiency of production falls because it becomes easier to earn profits during inflation. Prices of exportable goods go up which discourage exports and therefore such needed foreign exchange earnings fall which could be utilized for development imports. Foreign public and private investments are discouraged because of general uncertainty and payments difficulties arising out of balance of payments difficulties in such an economy. Therefore some economists regard inflation as the biggest enemy of development. They contend that the maintenance of relative stable prices create favourable conditions for savings and investment, attract foreign capital for long term investment, and protect the economy from the wastes of inflation.

In sum, we can say, that a mild inflation has proved beneficial in inducing development in the short run in most of the under developed countries of today but in long-run, inflation has impeded norms of social justice in most of these economies resulting into socio-political reactions which have taken the forms of social unrest, political chaos and mounting demands for a change in the economic systems.

However, growth is a long range process which calls for the maintenance of sufficient flexibility so that there could be desirable movement among the self-adjusting forces of the economy. This desirable limit of movement is that range of fluctuation of the economy which should neither impede the tendency towards long run economic growth nor should jeopardize social peace by increasing prices to untolerable levels. Therefore, extreme fluctuations either up or down should be moderated by

countering actions so that the economy could fluctuate within the desirable range.

CAUSES OF PRICE CHANGES

Pricing phenomena are highly complex and complicated and outcome of a large number of inter-acting factors and forces. However, the fundamental cause of price changes is the mal-adjustments in the money-goods balance. These mal-adjustments may be due to changes in the following variables.

(i) Changes in the supply of money and its velocity.

(ii) Changes in the supply of credit and its velocity.

(iii) Changes in the external value of money.

(iv) Changes in the volume of production of goods, including services and property rights.

(v) Changes in the cost of production of goods.

(vi) Changes in the demand for and supply of goods.

(vii) Changes in the distribution of goods.

(viii) Changes in the value of imported and exported goods.

(ix) Changes in the government tax policy including direct controls and subsidies etc.

These variables are mutually inter-related and inter-dependent, therefore, a change in any one of them will have its influence on all other variables.

CAUSES OF RECENT PRICE RISES IN PAKISTAN

Devaluation of Pakistan Rupee by 131 percent on 11th May, 1972, abrupt increases in currency in the last quarter of 1972, national budget deficits[1] causing internal

1. Exact figures of 'deficit financing' are not available. Unofficial figures amount to Rs. 100 to Rs. 150 crore.

currency depreciation, undue swelling of commercial credits, Pakistan's rising exports and defence costs, currency transfers from East Pakistan to West Pakistan following East Pakistan political disturbances in early 1971, international price hike in most of the imported inputs and other commodities, increases in costs of production because of new labour policy, non availability of the goods coming from East Pakistan, sluggish investment activity in the private sector because of political disturbances, strikes, lock-outs, mass retrenchments of labour in early 1972, and smuggling, stock holding and profiteering, are the major causes of recent propagation of prices[1] in Pakistan. Thus the total monetary assets which were Rs. 1910 crore in 1968-69 increased to Rs. 2110 crore in 1969-70. But in April, 1972 they stood at Rs. 2561.60 crore, and then increased to Rs. 3079.21 crore in April, 1973. However it is encouraging to note that the G.N.P. growth rate which had fallen to 0.8 percent in 1970-71, increased to 1.7 percent in 1971-72 and now in the year 1973 it has risen upto 5.5 percent. All these figures should be studied in relation to population growth rate which has touched 3.5 percent per annnm.

However, the economy is on the way to recovery. The private investor has begun to regain his confidence after a long interval of fearful uncertainty. Exports have touched the current year's target of Rs. 618 crore, and the hopes for more aids from abroad are becoming bright day by day.

PRICE AND SOCIAL TRANSFORMATION

Social transformation will call for a redistribution of income, which is inflationary in character. Changing the existing pattern of our economy into a socialist pattern will have its influence on consumption, savings, investment and thereby on the prices. Therefore, it will not be out of place to explain briefly the aims of social change and their impact on prices.

1. Over-all price level has gone up more than 12% since the outbreak of Indo-Pak War of Decmeber 1971. Item wise study of the causes and cure is required to maintain prices desirable levels.

There is a mounting desire among our people adopt a 'socialist pattern of economy'. By 'social pattern' we mean a society with egalitarian ideology. order to specify this aim we usually use the term 'Islan Socialism'. In our view 'Islamic Socialism' is neither ideological compromise between Islam and Communis nor a conceptual confusion, nor a verbal jugglery, but is a vivid exposition and manifestation of Islamic values economic equitableness in practice. Islam being su total of all the positive social truths or values, manifes its economic programme in the form of 'Islamic Socia ism' which aims at countering the wrongs inflicted upo our society by unrestricted capitalism. 'Islamic Socia ism' is a primary stage in which congenial socio-econom environments will be created to facilitate the society imbide moral and spiritual values of Islam. Our ideolog goes still higher, from equitable distribution of income equal distribution of income and from this level to altr ism. But the demonstration of such high humanitaria values is conditioned by the cultural growth of individu and society at a given time. Thus 'Islamic Socialism' in no way inimical to Islam but it is an economic pro gramme within the Islamic ideological framework.

As regards the transformation of the organisationa patterns needed to bring about 'Islamic Socialism' it ma be pointed out that if the proper place of ideology an organisation in a society are clearly understood, ther cannot be any difference of opinion in religious circle about its practical implementation. By 'ideology' w mean a system of ideas developing around an ideal in th course of its application to the various aspects of practi cal human life. Ideology is a normative construct explicitly held beliefs or value judgements, implicit i analytical system. Whereas 'Economic Organisation' i the sum-total of devices which through their interaction and interdependence translate economic ideas into action. Thus ideas or ideals are provided by ideology, and they are put to action by organisation. However, we under stand that ideology gives shape to the forms of organisa tion, and organisational patterns cast their influence on ideology and both must have consonance with each other. Even then a large variety of organisational patterns may

be experimented to achieve the high goals of Islam. These organisational patterns will have to be transformed according to the changing social conditions so that they could effectively assist the society in the achievement of its high ideals. Rigid adherence to the forms of organisations, as our religious leaders do, whether or not, they are harmonious to the social goals of Islam, cannot serve the true purpose of our ideology. Our view is that the organisational patterns should be changed according to the needs of the time so that we could achieve the high social ideals of Islam in the changing socio-technological conditions. Even institutional modifications for the attainment of high goals of the ideology are not forbidden.

Thus for instance, the state control of a part of land, peasant proprietorship, co-operatives, landlordism, all or any of them may be applied on agricultural sector according to the needs of the time, to achieve the high ideals of equality, justice, economic growth and for bringing about congenial environments for the growth of moral and spiritual value of Islam. Thus under the present conditions, when there is heavy pressure of population on land, landlords being absentee, do not take part in production, exploit the petty tenants and are an unrequired element in the cost of production, thereby unnecessarily bidding up the prices of agricultural product, there is a clear case, that landlordism or any other intermediary interest should be abolished forthwith and instead, peasant proprietorship, co-operatives, and state farms be established to achieve the socio-economic aims of 'Islamic Socialism'. Or by providing suitable outlets for savings to the society in the forms of life insurance, social insurance schemes and equity participation etc., excess rural and urban properties should be resumed to be redistributed among the 'havenots'. Such organisational and institutional re-arrangements[1] and modifications aiming at the achievement of high social ideals of Islam are in no way un-Islamic. But instead, without such modifications the emergence of

1. Without a fundamental re-arrangement of institutions and organisations and a suitable readjustment of the incentive forces of the economy, an income redistribution programme aiming at narrowing the gulf between the 'haves' and 'have nots' will result in high prices, low rate of savings, low real investment and thereby less availability of employment opportunities and a retarded long-run growth of the economy.

a society congenial to the attainment of Islamic ideals wi be impossible.

Under 'Islamic Socialism' the fundamental guide line to policy may be eradication of extreme poverty, uplif of the poor classes, control on the power of capital an the creation of a strong middle class in the society. I fact the existence of a strong middle class in a societ poses an automatic check against an overall totalitaria revolution. However, the following steps may be adopt ed to maintain stability side by side with the socia transformation programme :

1. Where there are acute shortages of basic necessi ties of life, and their prices have a strategi position in the economy, they should be import ed and their prices may be fixed as a stop-ga measure.

2. Steps should be taken to arrange for the regula supplies of imported raw materials, spare part and other inputs so as to enable the industries t work in full capacity.

3. Idle labour force should be harnessed for gainfu employments enabling them to produce initia capital.

4. Immediate steps be taken to establish consumer goods industries to increase the supply of such goods, especially those which form part of the basic necessities of life of our masses. It is presumed that the social reform programmes initiated by the Government will have to increase the demand for such goods, which must be me by increasing their production, otherwise prices are bound to go up further.

5. If after accomplishing the above mentioned steps domestic or foreign capital is available, that should be utillized in the establishment of basic industries so that productive capacity and long-run growth of the economy could be enhanced.

6. Profit percentages may be fixed for the employers Even production targets may be determined. Prices may also be fixed where necessary.

7. Fair price shops and consumers co-operative stores be popularized in order to discourage the hold of stockholders and profiteers.

8. Effective steps should be taken to check smuggling.

9. In the agricultural sector, in the short-run the supply and prices of domestic and imported inputs, such as improved seed, fertillizers, machnery and spare parts and water etc. should be regularized. In the long-run the production of seeds, fertilizers and machinery etc. should be arranged at home, as far as possible. Moreover there should be an appropriate institutional frame to assist the farmer directly or indirectly in marketing, finance, and mechanization of agriculture ete. Also immediate steps should be taken to introduce general education[1] programme for the mental, moral and technological uplift of our agrarian masses. In fact, institutionalization of agriculture is a desirable policy in the long-run to attain self-sufficiency in agricultural products.

10. Cautious policy of money supply be adopted, otherwise the above mentioned steps will not produce the results desired.

There is a big gap between the resources needed to implement the programmes and the resources actually available. According to one estimate about Rs. 1300 crore are required to finance a plan based on the new strategy, whereas the available domestic resources range between Rs. 150 and 200 crore. It is, therefore, quite

1. The broad aims of education may be "ideology and technology", ideology to create an appropriate "frame of mind" so that our masses could imbibe a value premises suitable for socio-economic requirements of our economy. The growth of technology should be in harmony with the resource balance of our economy.

clear that most of the programmes will not take any practical shape, or if money supply is increased to fulfil the social aims, the economy is bound to propagate inflation. Our people are pressing for reforms. They are impatient and demand immediate gains, but social transformation requires time, hardwork, efficiency, tolerance and devotion to the task. Thus in order to overcome this aggravating situation the following steps may be suggested.

1. There should be continuous diffusion of literature in the form of books, pamphlets, leaflets and articles etc. among the labour, businessmen, tenants and the general public, telling them about the benefits of socialization programmes, and explaining to them the measures with which these programmes can be accomplished. Let them come forward with energies, abilities, enthusiasm, zeal, devotion and sacrifice to join hands in the task of socialization rather than demanding immediate gains which are difficult to achieve.

2. The "leadership groups" we here mean the politicians, journalists, lawyers, teachers, religious leaders, trade union leaders, and all those whose opinions carry some weight should work in harmony for popularizing the benefits and measures to achieve the aims of socialization programmes. They should educate the general public that with hardwork, sacrifice and devotion, they can transform their society according to their wishes and can reap the fruits of transformation.

The existence of devoted and dynamic leadership, educated and devoted masses, appropriate modifications in the institutions and organizations and development of skill and technology are the pre-requisites for a successful transformation of the society. Social ideals should supercede profit motive and self-interest. Competitions should be replaced by appropriate incentive system within the

producing units, so that the momentum infact of progress of the economy should be maintained. Infact a change in the 'frame of mind' is required which should be harmonious to the achievement of "moderation ideals". We believe that all the conflicting aims of the economy can be reconciled provided we could bring about an appropriate change in the "frame of mind" of the society. Thus a cultural revolution is a precondition for a desirable socio-economic change. We also believe that steps should be taken in all directions simultaneously, let them work in harmony and co-ordination to achieve the desired results in the shortest possible time.

Income Tax Incentives and Industrial Development in Pakistan

SALAHUDDIN CHAUDHRI*

SECTION I

Introduction

Today almost all developing countries in the non-communist world offer to private enterprise income-tax incentives as an inducement for industrial expansion. The degree of success or failure of this policy has varied from country to country depending upon the way the incentive programme has been designed and administered in a particular country and above all on the overall economic setting in which the programme has to work. Pakistan too since its inception has used tax incentives as a tool to accelerate industrial development.

The purpose of this short study is (1) to describe the main features of the incentive programme in Pakistan in the background of the economic situation and policy objectives and (2) to attempt to indentify the main areas of the success or failure of the programme. Section II briefly describes in general terms the role of income-tax incentives in the less developed countries. In Section III the overall objectives of government policy and the specific objectives of tax concessions have been summarised. While Section IV gives in outline the story of the two decades of progress in manufacturing industries mentioning also the major determinants of progress, Section V contains the summary of each of the provisions relating to various reliefs, exemptions, rebates etc. in the Income-tax Act. The next Section is an attempt to appraise the experience with the operation of these incentive provisions in Pakistan. The discussion in this section on investment and capital formation has been confined to the domestic field because foreign private investment did not play any significant role in Pakistan. Preference

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was given to foreign assistance in the form of aid or loans channeled through government agencies. The last section contains brief concluding observations. It is not the purpose of this study to make any suggestions regarding the optimum tax policy. The analysis is, therefore, confined to studying the impact of the policy that was adopted by the government.

SECTION II

Role of Tax Incentives in Less Developed Countries

Every less developed country in the world today has rapid economic growth as its foremost objective and so all efforts and policies in these countries are being directed toward its attainment. Perhaps without exception, these countries in the initial stages of their development were, and some still are, heavily dependent on the export of primary products.

Agriculture's share in the gross national product being substantial, its role in the respective economies is obviously very important. Yet, growth in the agricultural sector alone is not the complete answer. Industry too, which has an important role to play, is an urgent necessity. The authorities responsible for economic planning in the less developed countries are convinced of the need for according very high priority to investments in industrial sector at least till such time as a better balance with other sectors is reached. Industrialisation, they believe, will provide the much needed "breakthrough" for a sustained economic growth. The thinking on the subject has been greatly influenced by the thesis of Raul Prebish, former Director of the Economic Commission for Latin America. He believes that the development of manufacturing must be promoted in order to redress the adverse trend in the terms of trade experienced by primary producing nations vis-a-vis industrial nations.[1] Hence special emphasis on the promotion of industries in the fiscal and monetary policies in the developing economies.

One fiscal measure that has very widely been adopted for stimulating industrial expansion is tax incentives. The aim is to encourage the private sector to save and invest either in projects considered an economic necessity or invest in such geographical regions as are less

developed compared with other parts in that particular country. The most frequent and substantial tax incentives are in the form of exemption from customs duties, excises and taxes on income. These concessions reduce the cost of projects through custom duty exemptions and also reduce the investment risks by allowing the initial capital recouped in shorter period through income-tax concessions. The income-tax incentives, with which this short study is concerned, greatly vary in extensity as well as in structural design. Relief from tax may be provided for investments in specific ventures or for income earned by those investments. Sometimes exemptions are total for a limited period of time (popularly known as "tax holiday") and sometimes restricted to a percentage of capital invested or income earned. The concessions may be effective for the whole country or be limited to certain regions only.

Whether tax incentives are really as effective an instrument as would appear from their widespread use, is a matter in dispute. The opponents of incentive legislation doubt that incentives can alter investment patterns to a sufficient degree to justify revenue costs or tax unfairness[2]. This argument finds support from the following points.

(1) Influencing Investment Decisions

It is highly doubtful that tax concessions effectivly influence domestic investment decisions in developing countries. "Unquestionably, investment responds to a multiplicity of factors, such as the size of the market, the cost and availability of skilled labour, and general economic and political conditions. In the total context of these factors that determine investment decisions, it is believed that tax concessions are of marginal importance.[3]" Expected profit margins, in fact, play greater role in the decision making process. With very few exceptions, markets in developing countries being highly protected, the profit rates are high and it is this factor which tilts the balance in favour of investment. A small survey conducted by Ross and Christensen in Mexico indicated that over-whelming majority of firms surveyed would have made investments even if there were no exemptions[4]. The combined ratio of profit to equity in 1955 in Puerto Rico was as high as 36 after payment of taxes at 35 per cent[5].

Similarly a study based on the balance sheets of 104 public limited industrial companies in Pakistan showed that the five year average (1959-63) of profit ratio to paid up capital worked out to 34.1 per cent[6]. Obviously then, tax incentives would not have been necessary elements in investment decisions in the cases cited except within the industrial sector if the incentive provisions favoured some particular industries. Investments, most probably, could have been made even without them. According to Professer Surrey, tax incentives merely permit pleasant windfalls by paying tax-payers for doing what they would do anyway.[7]

(2) Revenue Cost

The price paid for the results of an incentive programme is an important consideration particularly in the context of a developing country. If the concessions are too liberal or they extend to non-essential industries the cost or fiscal sacrifice may outweigh the revenue benefits yielded by the economic activity generated by the incentive programme. Such a situation is more likely in a country where tax administration is not very effective and evasion is widespread.

(3) Inequity

Every tax incentive programme involves inequity both horizontal and vertical. Two individuals may have equal incomes and so equal ability to pay, but the one enjoying "preference" under the programme pays either much less than the other or does not pay at all. Also, higher the income bracket greater the relief. In other words, tax concessions are worth more to the rich than to the poor. This is against the progressivity principle of taxation, an essential instrument of income and wealth redistribution. Thus. these tax incentives create a new class of privileged people, sometimes called tax-millionaires. Such a phenomenon may not only lead to concentration of wealth and economic power in still fewer hands but may also have repercussions in the social and political fields.

4) Effect on tax rates etc.

The pressure on revenue resources in developing countries is very heavy because of social and economic growth promotion programmes. Therefore, to make up

for the current revenue sacrificed through incentive programmes, the governments in these countries resort either to fresh taxation or to a raise in the rates of existing taxes. Many a time such measures can have adverse economic implications.

(5) Administrative and other complexities

Income-tax statutes are invariably very complex documents embodying complicated legal provisions and procedures. The incoporation of incentive provisions in these statutes add to the complexities resulting in greater burden on the administration as well as increased chances of evasion. In most countries where exemptions are not automatic, there are fairly lengthy and complex procedures to be gone through before one can become eligible for the benefits under the incentive laws. Under Maxican Law the prospective investor's application for exemption requires to be disposed of within ninety days from the date complete data and documents are submitted. But in actual practice, it takes 12 to 18 months on the average[8]. In Ghana, the average is about a year[9]. Obviously, such delays and accompanying expenses discourage rather than encourage the investors.

It will, however, be wrong to conclude from the above discussion that the tax incentive programmes are totally devoid of merit. Their contribution towards the attainment of economic objectives may not be very substantial but they do create a psychological climate favourable for investment. Their lure attracts interest in the potentialities of a particular sector or geographical area. Tax holidays in particular, have a dramatic appeal for the prospective investor specially a foreigner. Whether foreign capital will actually flow in, is another matter. That will depend, among various other factors, on the general economic conditions in the capital importing country and also on the treatment the exempted profits will on repatriation get under the tax laws of the investor's own country.

Another aspect of the role of income-tax exemptions which can be fairly significant in the context of some developing countries is in the field of capital formation. For a sustained economic growth domestic capital formation is an essential pre-requisite. When the policy is to

permit this to happen in the private sector, the tax con cessions can be a useful instrument. The grant of ta reliefs in itself is no guarantee that capital formation o any economic significance will take place, because i most of the less developed countries the propensity t consume is very high. Yet, the increased after-tax profit ibility does provide the possibilities of higher saving which in turn contribute towards self financing of expand ed economic activity. The experience in Puerto Rico, Mexico and Philippines shows that although incentive programmes did attract foreign capital, yet they did not result in much of domestic capital formation.[10] In Pakis tan, on the other hand, tax concessions played more signi ficant role in stimulating corporate savings and capital formation.

The directional aspect of an incentive programme also has a role to play, though a minor one. When any particular type of industry of national importance is desir ed, selective tax benefits along with other assistance like credit facility, foreign exchange availability etc. can facili tate the diversion of resources to that particular direction.

The upshot of the above discussion is that a tax incentive scheme as such is neither a magic formula for solving industrial growth problem nor it is totally irra tional and useless piece of policy instrument. The correct approach would be to appraise it in its actual setting. No two countries are similar as regards their conditions and circumstances. So, the overall economic conditions, the level of development at a particular point of time, the resources, and above all the growth objectives within the framework of planning strategy in the country are the factors to be considered. In one country social goals like equitable income distribution may be considered more important, while in the other economic growth may be given more weight. Even in the same country the emphasis may shift from one goal to the other with the change in conditions. It would be unfair to judge an incentive programme in total isolation and in disregard of the factors mentioned. Also, the role of incentives is supplementary. Given a proper setting and certain favourable condition, they will show results. In the absence of them or by the presence of some adverse extraneous factors even a very carefully designed legis lation may be defeated.

SECTION III

Objectives of Tax Incentives in Pakistan

What policy objectives income-tax incentive programme in Pakistan was intended to achieve? An attempt to answer this question will be made in this brief Section.

The social and economic objectives of government policy have been spelled out in various official documents and policy statements; but the precise objectives of the tax incentive programme as such, as an aspect of tax policy, do not appear to have been stated formally in any official statement. The latter objectives will, therefore, have to be identified through deduction from the stated objectives of the growth policy and the tax policy.

The government Resolution announcing the appointment in 1953 of the Planning Board (later converted into Planning Commission) and its Terms of Reference describes the social and economic objectives of Government policy in the following words :

> "The economic and social objectives of Government's policy are well known. They are to develop the resources of the country as rapidly as possible so as to promote the welfare of the people, provide adequate living standards, and social services, secure social justice and equality of opportunity and aim at the widest and most equitable distribution of income and property."[1]

With these stated objectives in view, the Board in drawing up the First Five Year Plan (1955-60) fixed the priorities. Expressing confidence in the competency of the private enterprise to shoulder the responsibility of undertaking developmental activity, it observed that although the industrialist extorts an unduly high price for his services, yet his high incomes serve a social purpose and since the building of productive mechanism must have high priority, it would be advisable not to take any step which might act as dis-incentive to development.[2] On the subject of income taxation, the Board made the following observations :

> "We consider that the rates of income-tax and the exemptions granted to industry should be reviewed, particularly in the light of incentives necessary to

secure the desired distribution of physical resources' We consider that a stage has been reached in t economic development of the country when conce sions for stimulating investments should be grant only on a selective basis.....Considering both t large profits earned openly and clandestinely and t substantial concession granted on these swoll profits, it appears to be a fair conclusion that t public revenues have not obtained a fair share of t betterment and prosperity which have attended t development of these industries".[4]

In the Second Five Year Plan (1960-65) documen the Planning Commission while referring to the need f capital formation expressed the view that tax poli should be oriented to direct a large part of high incom into savings and investment tolerating the resultant initi growth in income inequalities.[5] Discussing direct taxatio guidelines, the Commission qualified its observation wi the following words :

"The existing tax concessions need to be rationalise The justification for continuing certain tax conce sions to established industry is somewhat questio able, whereas the need for tax concessions t encourage a particular location (East Pakistan or th underdeveloped areas of West Pakistan) may deser consideration. All general tax concessions should b examined and made more selective and discrimina ing. Tax Concessions should also be so adjusted a to increase the bias towards the re-investment o profits".[6]

In his budget speech for the year 1959-60, the the Finance Minister stated the objectives of tax policy as th increased availability of goods in the country, encourage ment to exports and the creation of investment climat through incentives to attract foreign and domestic inve tors as well as to encourage the local industrialist t reinvest his savings and profits[7].

Five years later, in the Third Five Year Plan th Planning Commission, taking note of the fact that savin effort had till then been identified almost exclusively wit large scale industry which had grown at a rate of 1 percent per annum during 1950-65 and had saved and rein vested nearly 75 percent of its profits, refused to the nee

for broadening the base of this saving effort. The Third Plan placed relatively greater emphasis on more equitable distribution of incomes as it considered that was possible without sacrifice of essential growth because of the growth already achieved[8].

From the various references quoted above, two main objectives of government policy stand out clearly. First, to achieve rapid industrial growth in the private sector by giving the private enterprise sufficient encouragement through incentives and secondly, equitable distribution of income in so far as it does not act as a dis-incentive.

In legislating tax incentives, however, the latter objective seems to have been lost sight of. The programme as actually designed aimed at :

(a) the promotion of investments in the industrial sector

(b) the stimulation of savings and their re-investment for domestic capital formation

(c) the encouragement of the location of industries in less developed regions.

(d) the promotion of the exports of manufactures.

The performance of tax incentive programme in Pakistan will, therefore, have to be judged with reference to these four aims.

SECTION IV

Performance of Industries

This Section outlines the story of the growth of manufacturing industries in Pakistan since its inception and the main factors that contributed towards this growth.

A predominantly agricultural economy at Independence (1947), Pakistan is now semi-industrialised although agriculture still remains the main source of income. The shares of agriculture and of industry in the GNP in 1949-50 were 60 percent and 6 percent respectively. About 85 percent of the total labour force was dependent on agricultural sector. The exports of primary commodities which contributed 5 percent to the national

income were the only source of foreign exchange earnings. The ratio of taxes to GNP in 1949 was 3 percent and per capita income figure stood at Rs. 311, Table I below shows percentage structural changes in GNP in the last two decades and Table II indicates growth of GNP and per capita income over time and growth rates.

TABLE I

Structural Changes in GNP

Sector	1949-50	1959-60	1969-70
Agriculture	60	53.2	45
Manufacturing	6	9.3	12
Services and others	34	37.5	43
	100	100	100

Sources : 1. Fourth Five Year Plan p. 2
2. Pakistan Economic Survey 1969-70 p. 4

TABLE II

GNP and per capita Income

Period	GNP (1959-60 factor cost)	Population	Income per capita (1959-60 factor cost)
	(Million Rupees)	Million	(Rupees)
1949-50	24,466	79	311
1959-60	31,439	99	318
1969-70	54,140	132	409
Growth Rates (Compound)			
1949-50 to 1959-60	2.5	2.3	0.2
1959-60 to 1969-70	5.6	3.0	2.6
1949-50 to 1969-70	4.1	2.6	1.4

Source : Outline of 4th Five Year Plan p. 1

The manufacturing industry in Pakistan grew very rapidly at rates "that bordered on the spectacular".[1] At the time of Independence, the territories which formed part of Pakistan had virtually no industry. In 1949-50 the contribution of the manufacturing sector to GNP was 5.9 per cent. Over the next two decades industry grew at an average rate of about 14 per cent per year. The slowest period of growth was the First Plan period (1955-60) when the rate was 9.3 per cent per year.[2] By 1969-70 the share of manufacturing has risen to 12 per cent of GNP.[3]

During the first two years of independence, most of consumer goods requirements were met through imports from India. In 1949 when pound sterling and Indian rupee were devalued and Pakistan decided not to devalue, strangely enough India stopped trade with Pakistan. This gave the initial spurt to the local industry because the vaccum created in the supply of consumer goods was filled in by domestic products. In 1952, Korean war boom ended and export earnings sharply declining, the country ran into serious foreign exchange difficulties. The Government clamped import controls. In a protected market the infant consumer goods industry received sudden boost and with that began the process of rapid industrial growth in Pakistan. The cotton textile industry was the first to make great strides followed by other items. The private enterprise which had shown great initiative and entrepreneurship in response to the opportunities offered, was however, found reluctant to undertake investments in the fields requiring relatively larger capital and longer gestation period. In view of this, the government set up in 1952 Pakistan Industrial Development Corporation (PIDC) with the specific and limited purpose of undertaking ventures of economic significance neglected so far by the private industrialist. The PIDC showed the way and later, the private enterprise went in for bigger projects. By 1960 with the country attaining self-sufficiency in practically all consumer goods, the industrialists began diverting their attention and resources to intermediate and capital goods industries. The industrial base gradually expanded, output rose rapidly and many industries set up initially as import substitution industries were now exporting their products in substantial quantity. Between 1959-60

and 1968-69 export of manufactures rose from 527 millio rupees to 1687 million rupees.

Thus over a twenty year period industrialisation i Pakistan came a long way. Table 3 below tells th story.

It would be appropriate to mention here briefly th determinants of this remarkable progress. Besides th non-policy variables like cessation of trade in 1949 wit India and the domestic production of agricultural ra materials used by local manufacturing industries, wha largely contributed towards the industrial growth i Pakistan were the industrialisation oriented trade an fiscal policies pursued by the government. The foremos among these is the policy which turned the terms of trad against agriculture. As mentioned earlier, Pakistan di not devalue in 1949 and instead relied on exchange con rols and quantitative restrictions to control imports Consequently agricultural produce which was normall exported, received unfavourable exchange rates, whereas with decrease in imports of manufactured goods domesti manufactures got a better deal. In mid 1950s the manu facturing sector received more than Rs. 7.00 for sale worth $ 1.00, while it paid only Rs. 3.50 for its agri cultural purchases. In mid 1960s, as a result of th narrowing of the gap between the implicit exchange rate of the two sectors, the manufacturing sector got abou Rs. 7.00 for goods worth $ 1.00 while it paid about Rs 5.25 for agricultural raw materials worth $ 1.00.[4] Thu the prices of agricultural goods fell, whereas those o manufactured goods rose. This high profitability induce people to enter the industrial field or expand the existing capacities.

TABLE III

Output, Quantum Index and Export of Manufactures

Output of Major Items	1949-50	1954-55	1959-60	1968-69
Sugar 000 tons	33	95	144	550
Cotton cloth (million yards)	106	387	606	900
Cigarettes '000 million	1.5	4.8	9.3	38.2
Matches million boxes	0.5	6.7	9.1	14.4
Jute goods '000 tons	—	103	265	518

Chemicals '000 tons	—	31	49	145
Newsprint '000 tons	—	—	12.1	39
Cement '000 tons	413	681	1027	2800
Quantum Index of Industrial Production (59-60 base year)	18.2	60.9	100	279.7
Export of Manufactures (million rupees)	—	34	527	1687

Sources : 1. The Far East and Australia 1970 p. 302
2. Pakistan Economic Survey 1969-70, 1964-65
3. Statistical Pocket-Book of Pakistan 1969

The system of import licensing also had its direct impact. The industry owners received preferential treatment in the matter of import licence issuance. Under this facility they were able to obtain their requirements of raw materials not produced locally at substantially low prices. This further increased the rate of return from industrial investments. These controls, thus, helped speed up the process of industrialisation by providing inducements to invest in industry and by transferring substantial amounts of income to industrialists who reinvested them in this profitable sector.

The foreign exchange allocation policy had been industry oriented since the beginning. A fairly high percentage of foreign exchange resources was utilised for the import of industrial machinery and raw materials although most of this exchange was earned by the agricultural sector.

In the institutional framework for industrial development the setting up of two financial institutions, Industrial Development Bank of Pakistan (IDBP) and Pakistan Industrial Credit and Investment Corporation (PICIC), made not too insignificant contribution by providing financial project assistance to the private sector industry in the form of loans.

To stimulate exports of manufactures, Export Bonus Scheme was introduced in 1959. Under this scheme the exporter was provided subsidy in the from of bonus

ranging from 20 to 40 per cent of export price. Th subsidy enabled the exporters to quote lower rates th increasing the competitive position of Pakistani produc in the world market. The bonus was paid in the shap of import entitlement voucher which could either b sold in the market at premium or could be utilised fo the import of industrial raw materials or consume goods. The post-1959 boost in exports referred in th section, was largly due to this incentive.

The last but not the least is the policy in the fiel of taxation of income. Liberal tax concessions wer given in the form of exemptions, rebates, allowance etc. to industry and for savings invested or re-investe in industry. The details of these incentives are give in the following section.

Thus we find that a number of factors and govern ment policies were at work simultaneously. For lac of statistics and empirical data on the subject, it ma not be possible to determine precisely the contributio of tax incentives towards overall industrial growth. A attempt will, however, be made to examine, as far a possible, as to how far the tax incentive programme succeeded in attaining the policy objectives set by the government.

SECTION V

Income-tax Incentives In Pakistan

The various incentive provisions incorporated from time to time in the Pakistan Income-tax Act (here in after to be called the Act) can, for the sake of convenie nce, be grouped under the following heads.

A. Concessions for personal private savings and investments

B. Concessions to Industry

Given below is the summary of each of the provisions falling in these two groups. This summary is based on the law as of July 1, 1970 unless otherwise indicated.

A. Concessions For Personal Private Savings and Investments.

(1) Exemption of investments in Government Securities, Savings Certificates etc. (Sec. 15 AA)[1]

No tax is payably by a tax-payer, other than a company, on so much of his total income (subject to certain limits to be explained later under (5) below) as is invested by him in the purchase of Post Office Savings Certificates, National Investment Trust Certificates, and such Government securities as may be specified by the Central Board of Revenue.

(2) Exemption of investments in public companies (see 15C). The amount invested by an individual in the acquisition of any fresh issue of stocks or shares of an approved industrial public corporation is exempt from income tax. The concession is subject to a ceiling of 20 per cent of the total income or Rs. 12,000 whichever is less. The essential conditions are that :

(a) the company in which the investment is made is a "public company" as defined in the Companies Act 1913 ;

(b) the company is incorporated in Pakistan ; and

(c) the company is declared by the Central Board of Revenue or the Controller of Capital issues to be engaged in an industrial undertaking.

These conditions, for obvious reasons, are intended first, to exclude from the scope of this concession such investments as are made in "private" companies which are usually family concerns controlled by a few persons with share transfer rights restricted. Secondly, the object is to channelise investments in economically essential industries listed in the industrial schedule approved by the Government.

(3) Exemption of contributions to Provident Funds etc. (see 7)

Any contributions to provident fund or deferred annuity scheme made by a salaried individual are exempt from tax. Such contributions are compulsory in the case of Government employees but optional for others. The provision is intended to encourage savings for public sector investment.

(4) Exemptions of insurance premia payments (sec 15). Tax is not payable in respect of any sum paid to effect an insurance on the life of a taxpayer or her spouse.

Originally the considerations for the grant of this concession might have been other than the promotion of savings but in recent years tax payers have been making use more often of this concession to minimise their tax liability. Thus this provision has in effect contributed to the promotion of private savings since the funds of the insurance companies ultimately become available for investment.

(5) Exemption of investment in debentures etc. (15CC)

Under this provision, the amount invested by an individual tax-payer in the purchase of debentures or debenture-stock of a company duly approved by the Controller of Capital Issue is exempt provided these are held for a period of at least three years. When the small investor does not get a return on his investment in the initial years, it not only causes hardship to him but also affects the investment climate adversely. Therefore, it was considered necessary to build up a market for fixed-interest bearing securities with a view to providing an avenue for investment to persons who might be interested in the security of their investment and a fixed return.[2] Hence this inventive.

(The exemptions referred to under clauses (1) to (5) above, are subject to two overall limits. First, that the aggregate sum exempted under these provisions will not exceed the sum computed as here under :

1. Where the total income does not exceed Rs. 30,000	40% of the total income
2. Where the total income exceeds Rs. 30,000 but does not exceed Rs. 50,000	Rs. 12,00 plus 30% of the amount exceeding Rs. 30,000
3. Where the total income exceeds Rs. 50,000 but does not exceed Rs. 70,000	Rs. 18,000 plus 20% of the amount exeeeding Rs. 50,000
4. Where the total income exceeds Rs. 70,000 but does not exceed Rs. 100,000	Rs. 22,000 plus 10% of the amount exceeding Rs. 70,00
5. Where the total income exceeds Rs. 100,000	Rs. 25,000

Second, the relief in tax shall not exceed half the amount admissible for exemption. For instance, if a tax payer with an income exceeding Rs. 100,000 and falling in the 60 percent rate bracket, invests in a particular year Rs. 30,000, his tax saving shall be restricted to Rs. 12,500 being half of Rs. 25,000 the maximum amount of income entitled to exemption.

(Prior to 1959 the exempted income was eligible for tax rebate at the average rate, but after 1959 it is allowed as straight deduction.)

(6) Tax benefit for income from dividends, interest on securities and debentures (Sec 4(3))

Not only the amount invested in the purchase of shares of approved corporations, securities and debentures is allowed, subject to prescribed limits, as deductions outlined under clauses (1) to (5) above, portion of the income from such investments is also totally excluded from the total income. Where the dividend income does not exceed Rs. 30,000 and is received from a company whose shares are not quoted on the stock exchange, the entire dividend receipt subject to a maximum of three thousand rupees is excluded. If the total dividend income exceeds Rs. 30,000, ten percent of it is excluded. Where the dividend is from a company whose shares are

quoted on the stock exchange, the amount ent ed to the benifit is five thousand rupees wh the total dividend income does not exceed R 50,000, and ten percent of the dividend inco when it exceeds Rs. 50,000.

Similarly any income, not exceeding five thousa rupees, derived from interest on any securities the Central Government or a Ptovincial Gover ment ; or on debentures of an approved compa is not included in the total income.

The aggregate sum excluded under this clause is n to exceed five thousand rupees.

(7) Concession for interest income from savin accounts (Sec 4 (3) (xvi))

To promote savings habits, interest received by tax-prayer from the Postal Department, scheduled Bank, Cooperative Society on an savings account deposit is not included in th total income subject to a maximum of fiv hundred rupees.

B. Concessions to Industry

(1) Accelerated depreciation allowance

As in a large number of developing countries Pakistan has used accelerated depreciatio allowances as a tool for promoting quicker in dustrialization in the country. No doubt th undertaking getting such allowances does no save any amount in tax—the total tax paid ove a number of years remaining the same—but th concession does enable it to write off the asset earlier than it would otherwise be possible. Thi makes replacement and modernisation of machi nery easier. Also, if the enterprise makes con tinuing replacements, a substantial part of th tax liability gets deferred and this in effec amounts to the grant of interest-free loan to th enterprise which is a valuable assistance in a economy where capital is scarce.

Depreciation allowances admissible under the Ac are quite liberal. These are as follows :

(a) "Initial" depreciation allowance at 25 per cent of the cost in the case of plant and machinery used for the first time in Pakistan, 15 per cent in the case of factory building and 25 per cent on residential buildings for industrial labour. is allowed. This "initial" allowance is admissible once only, that is, in the year in which commercial production begins. The initial allowance on machinary was originally fixed at 20 percent and was not taken into account for the purposes of written down value for the following year. In 1955-56 the rate was raised to 25 percent but it was made deductible from the cost.

(b) "Normal" depreciation allowance at different rates prescribed for different types of machinery, plant, buildings and furniture used for business purposes is allowed on what is known as simple declining balance method.

(c) "Extra shift" allowance at 50 per cent of the "normal" rates for double shift working and at 100 percent of the normal rates for triple shift working of the machinery or plant is also admissible. This allowance is, however, proportionate to the number of days during which double or triple shift is worked.

(d) "Additional" depreciation allowance for a period of five years at rate equal to the "normal" rate was allowed on plant or machinery not previously used in Pakistan. This was applicable to machinery or plant installed prior to July 1, 1965 and thus admissible upto the year ended June 1970. The concession has not been extended.

(e) "Special" depreciation allowance for one year is to be allowed at 15 per cent of the cost on machinery used by an industrial undertaking set up between July 1970 and approved by the Central Board of Revenue for the purposes of this special allowance. This provision was incorporated in the Act in 1969.

Thus we find that till 1970 in the case of mach
nery working three shifts and entitled to a no
mal allowance of 10 per cent. an industrial ente
prise recovered 55 per cent of the cost in th
first, 13 per cent in the second and 10 per ce
in the third year.

There are two more provisions regarding depr
ciation allowances which require to be mentio
ed. First, any unabsorbed depreciation allo
ance not wholly set off against the profits of t
year is allowed to be carried forward to th
following years without any limit. Second,
the event of any building machinery or pla
being discarded or destroyed, the amount b
which the written down value thereof exceed
its scrap value, is allowed as a business expen
in the relevant year.

(2) Exemption for New Industries (Sec. 15B)

One of the first incentive provisions introduce
in the Act in 1948 was in the form of investmen
allowance to newly established industrial unde
takings employing 50 or more persons, usin
electric energy and set up between August 194
and March 31, 1958 for a period of 5 years t
the extent of five per cent of the capital emplo
ed in each year. The exemption was availab
to enterprises which :

(a) manufactured or processed goods

(b) engaged in ship-building and navigation

(c) generated or transmitted electric or hydrauli
power

(d) worked mines, oil wells and mineral deposits
and

(e) engaged in any other industrial undertaking t
which the exemption is declared applicable.

The exemption was not dependent upon the prio
approval of the Government and was automatic so lon
as the undertaking fulfilled the conditions prescribed i
the relevent section. Whether the enterprise fulfilled

the requisite conditions was examined by the tax authorities at the time of assessment.

Dividends paid from the exampted portion of the profits of the exterprise were also exempt in the hands of the shareholder.

This exemption for new industries was not extended to industries set up after March 31, 1958.

(3) Tax Holiday (Sec 15 BB)

In 1959 a new provision granting complete tax holiday to industrial undertakings, set up after first of April 1959 and fulfilling the following conditions, was introduced.

(a) It is owned and managed by a limited company registered in Pakistan and having paid-up and subscribed capital of not less than two million rupees. From 1961 onwards the limit of paid-up capital was reduced to fifty thousand rupees extending the benefit of tax holiday to smaller companies.

(b) It uses wholly or mainly raw materials produced in Pakistan. This condition may, however, be waived by the Central Government under special circumstapces.

(c) It invests 60 per cent of its income for expansion or development of the existing enterprise or invests in any other industry included in the Industrial Investment Schedules issued by the Central Government from time to time. In 1967 this per centage was reduced to 40 but a further condition that the remaining 60 per cent should be declared for distribution as dividend was imposed. Also eligible for the tax holiday are the existing industries, but in their case the benefit is restricted to such expansion or development as would constitute either an indentifiable new process carried on either directly by itself or through a wholly-owned subsidiary company. For the purposes of claiming exemption for the unit, an existing undertaking is required to adopt such system of accounting as would enable the profits of the indentifiable unit to be determined separately.

Originally "tax-holiday" was admissible for two years only which period was later raised to 6 years. In 1961 for the purposes of the grant of this concession, the country was divided into three areas and the exemption limit was fixed at 8 years, 6 years and 4 years depending upon the stage of industrial development reached by such area. The object was to remove disparity among regions by accelerating industrialisation of less developed areas. In 1965 the holiday period was lowered to 6 years, 4 years and 2 years.

In computing the profits of the tax-holiday unit, the usual depreciation allowances are deductible not during the holiday period but after its expiry. In other words, the whole amount of profit before deduction of depreciation are tax free during the tax-holiday period and when that period ends, the enterprise starts enjoying the concession of depreciation allowances up to 100 per cent of the actual cost of the capital assets. The income of tax holiday units set up on or after July 1, 1965 is, however, computed after allowing normal depreciation.

In the absence of any definite provision to the contrary, the loss sustained by a tax-holiday unit could be set off against any other income of the enterprise. Through an amendment in 1963, it was provided that such loss would be carried forward and set off only against the profits which are exempt under tax-holiday provisons and that such loss shall not be carried forward beyond the period of "holiday". This restrictive provision was necessitated by the fact that after the expiry of the tax-holiday period, if the unabsorbed loss gets added to the depreciation allowances deferred till then, the uudertaking will be enjoying too liberal a treatment. In fact, a unit which even without deperciation allowances is still in loss at the end of 8 or 6 year period, counot be called economically viable and. therefore, should not be subsidised at the cost of revenues as well as other more efficient units.

(4) Exemption to foreign technicians on salary income (Sec 4 (3) (xiii)

Foreign technicians employed by approved industrial undertakings, under contracts of service approved by the Ceneral Government

have been exempted from tax on their salary income in Pakistan for a period of three years. Where under the terms of service contract. the employer is responsible for the tax due on the salary of the employee after the expiry of the said three years, the tax paid by the employee is not treated as the imputed income of the foreign technician for five years.

This concession, as is obvious, is intended to make the conditions of service more attractive to foreign technicians whose services the local enterprises require during the first few years.

(5) Allowance for scientific research technical training etc. (0 (2) (xii) - (xiv).

Any expenditure including of capital nature incurred by the tax-payer or paid to an approved institution for scientific research and technical training related to the class of business carried on by him is deductible from the profits. This concession does help encourge industrial research but the possibilities of its abuse make the provision a little more difficult to administer.

(6) REBATE ON EXPORTS

Since 1963, a rebate at rates reproduced below in respect of tax attributable to profits derived from the export of goods other than tea, cotton, raw jute, jute manufactures and such other goods as may be notified by the Central Board of Revenue from time to time is admissible :

	Amount
(1) Where the exporter is not the manufacturer of goods exported	15% of the tax atributable to export saler
(a) and where the export sales during the year exceed the export sales of the preceeding year	plus additional 1% for every increase of 10% in export sales over those of the preceding year subject to an overall maximum of 25%

(b) and where the export sales during the year do not exceed the export sales of the preceding year	minus 1% for eve decrease of 10% export sales over tho of the preceding ye subject to an over minimum of 10 (This means that wh ever the percentage crease in exports, t export rebate will n be less than 10%).
(2) Where the exporter is himself the manufacturer	
(a) Where the export sales do not exceed 10% of total sales	Nil
(b) where they exceed 10% but do not exceed 20%	15% of the tax attr butable to export sal
(c) where they exceed 20% but not 30%	20% of the attribu able ro export sales
(d) where they exceed 30% of total sales	25% of the tax attr butable to expo sales.

The profits and tax attributable to exports are com puted in accordance with the rules framed by the Centra Board of Revenue.

As will be discussed in a later section, the actua relief under this provision is very nominal. Moreover the provision as designed is inequitous because of the "notch" problem. The rebate admissible is 15% or 20% if the export sales are 20% or 30% respectivily of the total sales. But the moment the export sales increase the 20% or 30% limit by even 1 rupee, the rebate on the whole of the export sales increases by 5%. This is too much of concession for the additional exports of the nominal value of one rupee.

(7) SUPER-TAX REBATE TO COMPANIES

(i) A rebate of 15 per cent on the amount of income of a company as is distributed as dividend to its shareholders is allowed.

(ii) A rebate of 5 per cent is on the industrial income of a company whose paid up capital plus free reserves on the last day of the accounting year do not exceed 1 million rupees.

(8) TAX CONCESSIONS TO MINING INDUSTRIES

As an incentive to investment in mining industries, the following tax concessions under the Act have been allowed to enterprises engaged in the extraction and exploration of minerals in Pakistan :

(a) All capital expenditure on machinery and equipment is allowed as ordinary revenue expenditure.

(b) All expenses incurred on exploratian and prospecting up to the stage of commercial production is allowed to be deducted from future profits after commereial production starts.

(c) Profits equal to 5 per cent of the capital employed in the refining undertaking are exempt for a period of five years if the mineral is refined or "concentrated" in Pakistan.

Existing mining concerns can also set off the cost of exploration of new areas against their current income. Also, they can deduct from their current income any capital expenditure on machinery and equipment purchased for an existing mine in one lump sum instead of recouping it through the depreciation allowances over a number of years.

An undertaking set up after July 1961 and which is engaed in refining or concentrating the mineral deposits extracted by it in Pakistan, has been given the option to get its income computed with the above-mentioned concessions or to avail of the "tax-holiday" provision explained earlier.

SECTION VI

An Appraisal

Having stated the facts in the preceding sections the stage is now set to appraise the degree of success or failure of the incentive programme in attaining the policy

objectives. The task is rendered difficult for want of sufficient data and empirical studies on the subject. The issue will, therefore, have to be dealt with largely in description form.

In Section III, four objectives of the incentive programme were identified. These are discussed below separately.

A. Promoting Investments in Industry

That the growth of manufacturing industries over the two decades period (1949-69) has been rapid and spectacular is beyond any doubt. Section IV contains sufficient statistical evidence. The private sector investments that flowed into large scale industry during this period, as per official estimates, were as under :

Period	Million Rupees
Total upto mid- 1955	2300 (First Plan p. 237)
First Plan 1955-60	1268 (Third Plan p. 103)
Second Plan 1960-65	4234 (Third Plan p. 104)
Third Plan 1965-70 (upto March 70)	6320

Source : Economic Survey 1960-70, p. 27.

Thus we find that increasing number of enterpreneurs were entering the industrial field with more and more capital. The questions, however, that arise are : What induced the investments, the promise of tax benefits or potential high profits or both. If both, what share of credit can tax incentives legitmately claim ?

The fact is that in early 1950s the investors in manufacturing industries faced an extremely farourable situation. As has been discussed in Sec. IV, shortage of consumer goods because of import restrictions has created in the market a high demand for home products. The prices consequently shot up. On the other hand the cost of producing goods domestically was relatively very low because of a number of factors like non-devaluation decision, turning the terms of trade in favour of industry. very low tariffs on capital goods as well as on imported raw materials. That meant very high rates of profit. In Papanek's estimates annual after tax profits of 50-100 per eent on investment were possible.[1] Thus in a case

where the profit margin was say 50 per cent and corporate tax rate was also 50 per cent. even without any tax benefit the entire initial investment could be recouped in four years. In deciding to enter such an economic paradise will an investor care to think of any tax incentives ? Certainly not, particularly when there were no alternative avenues for attractive investments. After the Korean war boom, import trade had lost much of its attractiveness. No doubt under the licensing system introduced after the enforcement of import controls, commercial importers with their entitlements very much curtailed, were still making handsome profits, but the volume was small and future uncertain. With terms of trade already against agriculture, investments in that field were not rewarding either.

By late 1950s there was a decline in profits but still they were substantial. In their study based on the balance-sheets of 104 public limited industrial companies a representive sample of the corporate sector - Haq and Baqai summarise the profitability trends during 1959-63 as shown in Table IV below.[2]

TABLE IV

Rates of Profit To Paid-up Capital

(In Million rupees)

	1959	1960	1961	1962	1963	Average 1959-63
Paid-up Capital	780.6	927.2	1119.9	1263.4	1402.7	118.8
Ratio of Profit to Paid-up Capital	33/6 %	35.9 %	32.8 %	33.4 %	34.7 %	34.1 %

If we make allowance for evasion, the actual profits would be still higher. Any tax benefit over and above this profit margin would certainly have been very welcome to the industrialist, but the profitability without incentives alone was attractive enough to induce investments. The primary motivating force in private investment decisions almost always if the desire for profit. No amount of tax benefit can persuade an enterpreneur to

invest in ventures which are not likely on the long ru to yield reasonable amount of return. In the case o Pakistan, as we have seen, there was sufficient scope fo continued handsome profits.

In the context of a developing country, the availabi lity of foreign exchange is the most important factor in fluencing the pace of private investment in industry. Ta exemptions may help accumulate demestic funds for ready investments, but in a country where foreign exchange is strictly controlled unless the entrepreneu is sanctioned foreign exchange component of the cost o a project, he will not enter the field. In Pakistan thi factor has had a very significant bearing on the pace o industrial development. A close look at the 20-yea industrial growth history of Pakistan will show tnat more substantial investments were made during years when availability of foreign exchange was greater. In early 1950s foreign exchange position being relatively eas because of Korean boom earnings, industrial investmen tripled (Table V below).

TABLE V

Year	Investment (million rupees 59-60 constant prices)
1948—49	180
1949—50	240
1950—51	300
1951—52	440
1952—53	470
1953—54	720
1954—55	960
1955—56	950
1956—57	500
1957—58	590
1958—59	630

By 1955-56 foreign exchange reserves were depleted, and with that dropped the level of investment.[3] That this stagnation in growth was due to paucity of foreign exchange is proved by the fact that sufficient funds in domestic currency were lying idle for want of investment goods. Data available on a few large companies show that in 1958 about Rs. 780 million, over 15 percent of their total industrial assets, were idle reserves[4] The point is also proved by the fact that in this period the same tax concessions that were available during pre-1955 period were continued. In fact in 1955 the accelerated depreciation allowance was a little further liberalised by raising the rate of initial depreciation allowance from 20 to 25 percent of the original cost and by allowing full year's allowance instead of the previous practice which restricted it in proportion to the number of days the machinery was actually utilised in a given year. In 1959 the most attractive incentive provision-- tax holiday—in Pakistan tax law, replaced the investment allowance at 8 percent of capital employed for a period of first five years. Still, there was no immediate and appreciable impact. It was not until 1961 when following the increased inflow of foreign aid and introduction of Export Bonus Scheme foreign exchange situation improved, that investment activity revived with full vigour.

Mention must also be made of the fact that although investment allowance (now withdrawn) and tax-holiday exemption are automatic under the statutes, yet the claims are subject to scrutiny. The investment allowance claims used to be verified by the assessing authorities at the time of assessment and these could be - some actually were - rejected on the ground that the requisite conditions had not been fulfilled. Tax holiday exemptions require the approval of Central Board of Revenue. The prescribed procedure requires the application to contain among host of other information, the dates of the installation of machinery, start of commercial production etc. The final disposal of the application usually takes a year or two. Obviously, the entre preneur's decision to invest is taken and implemented long before the actual grant of exemption.

From the above discussion it is thus clear that tax incentives hardly played any direct role in investment

decisions particularly in the earlier years. However, in later years although profitability continued to remain the prime motive, yet the influence of tax incentives was more marked. Tax concessions helped step up the rate of capital formation, as will be discussed in detail later in this section, which fact made new investment decisions easier.

B. Stimulating savings and capital formation

The diversion of resources from current consumption to capital formation is a "must" for accelerating the pace of economic development. Therefore, the major goal of development policy in Pakistan has been the stepping up of the rate of capital formation. Since, it was decided that the public sector should concern itself mainly with the development of the infrastructure leaving other fields of economic activity, especially industrialisation, to private enterprise, the encouragement of capital formation in the private sector was considered a necessary consequence. Mahboobul-Haq says, "It is immaterial who owns this surplus - whether "the capitalist", as in a free enterprise economy, or "the state", as in a communist economy. What is important and intellectually honest is to admit frankly that the heart of growth problem lies in maximising the creating of this surplus"[5]

Pakistan's saving and investment effort in the economy as a whole has been fairly impressive as the figures in Table VI below indicate.

TABLE VI

Investment and Sayings

	1949-50	1959-60	1964-65	1968-69
Current prices (Rs. Million)				
Gross investment	705	2900	8890	10220
Gross savings	440	2000	5700	7840
Percent of GNP				
Gross investment	3.5	8.9	18.3	14.2
Gross savings	2.2	6.1	11.8	10.9

Source : Fourth Five Year Plan (1970-75) p. 8

Since for the purposes of this Paper we are concerned with savings, stimulated by income-tax incentives, the discussion will be confined to private savings, non-corporate and private savings in the industrial corporate sector.

(i) **Private non-corporate savings**

Little reliable data are available on this type of savings. But indirect evidence indicates that savings by small businessmen, workers, government or private employees were meagre.[6] Income-tax base in Pakistan being very small (total number of tax-payers in 1970 out of a total population of 130 million was 347,000), tax inventives did not mean anything to the vast majority of the people. Even from amongst the tax-payers not many could save enough to avail of the concessions. Still, it cannot be denied that over the years the various investment allowances available to the individual tax-payer succeeded in attracting larger savings. The figures of investments in Savings Certificates, Postal Life Insurance and Post Office Saving Accounts (Appendices A, B, and C respectively) indicate the trend. At the same time, mention must also be made of the fact that these concessions were sometimes abused by the tax-payers. Quite often investments in savings schemes were made just at the close of the financial year, and withdrawn at the beginning of the new financial year because the primary objective before the tax payer was to reduce his tax liability in respect of the year of investment. This "tactical" investment could get the allowance because of a lacuna in the relevant provision in the statutes (Sec. 15AA) as in force till 1960. Subsequently an amendment was made to plug in the hole so that now allowance is admissible on so much of the investment as together with the investments in the preceding four years exceed total withdrawals in the said five years. This modification of the law has largely decreased the possibilities of abuse and has also increased the utility of these savings to the development effort. Even if the same amount is rotating either in the same form of investment or from one form to the other, it is at least a five year cycle. In other words, any investment made in the saving schemes in any one year, is generally available for five years for utilisation in the public sector.

(II) Private Corporate Savings

It is the private industrial corporate sector which has made a very remarkable contribution to the savings and capital formation effort. About half of industrial after-tax profits were saved and reinvested in industry. If investments made outside industrial field are taken into account, total savings have been at the rate of 60—80 per cent of industrial profits.[7]

The study by Haq and Baqai to which reference has been made earlier, also showed that of the inerease in gross capital employed by the 104 companies during 1959—63 which was Rs. 2054 million, internal savings of the companies accounted for Rs. 984 million or about 48 per cent as the figures in table VII below indicate.[8]

TABLE VII

Savings By Public Limited Companies—1959—63

(In million rupees)

Year	Gross Capital Employed	Increase in Gross Capital Employed	Corporate Savings	Net worth	Increase In Net Worth
1959	1829	...	130.3	982.2	...
1960	2I86	347	160.5	1202.7	230.5
1961	2673	487	196.4	1463.9	261.2
1962	3166	493	228.1	1996.0	230.1
1963	3893	727	269.2	2053.3	359.3

It would be of interest to workout here the tax incentive induced savings included in the total savings of Rs. 984 reffered to above. The figures of gross profit and provision for taxation as compiled from the balance sheets of these companies in the sample, were as summarised in table VIII below.

TABLE VIII

(Million rupees)

	1959	1960	1961	1962	1963
(1) Profit	262	333	368	422	522
(2) Tax Provision	78	101	96	111	158
(3) Percentage of (2) to (1)	30	30	26	26	30

It is true that very often tax determined at the time of final essessments might be higher than the amount provided in the balance sheets, but that will not greatly disturb the percentages given in column (3) because the enhancement in tax will mean higher assessed profits. Lower figures of 26 per cent for the year 1961 and 1962, as compared with the other three years, most probably are because the rate of supertax on companies was reduced in 1960-61 by 5 per cent and again raised in 1963-64. So the ratio of tax provision to profits has remained stable at 30 per cent. Since the basic combined income tax and super tax rate on the income of industrial companies was 50 per cent, this ratio of 30 per cent, would indicate that only 60 per cent of the profits suffered tax and 40 per cent remained exempt because of tax incentives. The incentives availed of during the period (1959-63) to which the figures pertain were accelerated depreciation allowance and an investment allowance at 5 per cent of the capital employed for the first five years. Although the more generous incentive of tax holiday had been introduced in 1959, yet it is very likely that most of tax holiday units had not by 1963 started earning tax-free profits. The exempted portion of the aggregate profits for the five year period comes to Rs. 760 million (40% of Rs. 1904 million - Table VIII) and the amount of tax exempted at the rate of 50 per cent would work out to Rs. 380 million. In other words, without special tax reliefs internal savings of Rs. 984 million would have been less by Rs. 300 million. Thus the contribution of tax concessions to the total savings

comes to 38.7 per cent. Obviously, with tax holiday profits occurring in subsequent years, the said precentage may be as high as 50.

From the above discussion one comes to the conclusion that in stimulating savings and capital formation in the industrial corporate sector, the tax incentives played a very substantial role.

C. Promoting regional Industrial development

Too much of disparity in regional development in any country is considered not desirable. In Pakistan at Independence, different regions were at differen levels of development. Later when the process of industrialisation got under way, the gap widened as industry tended to to concentrate in a few towns. The government has, since the beginning of Second Plan (1950—65) period, been trying for the dispersion of industries. Apart from using administrative controls and providing infrastructure, it also employed the tool of income-tax incentives to induce the private sector to locate new units of industry in the desired areas. For the purposes of tax holiday exemption, the country was divided in 1960 into two areas and in 1961 into three making them eligible for 4, 6 and 8 years holiday depending upon the stage of industrial development reached by each region.

The whole of East Pakistan except for the city limits of Dacca, Chittagong, Narayanganj and Khulna became eligible for 8 year holiday. In the case of the above cited four cites, the concession was for 6 years. In West Pakistan except for very remote areas the period of holiday was 4 to 6 years. For industries set up after 1965, the 4, 6 and 8 year period was curtailed to 2, 4 and 6 years.

Data on the location of industries which is readily available relates to West Pakistan only. Based on this data, value added gross and as per cent of the total in various types of industries in some select districts in 1966-67 have been worked out and summarised in table IX. A cursory glance at the figures in the table will be sufficient to prove that the lure of tax-free profits for 6 to

8 years could attract very little industry to the underdeveloped areas during eight long years since the incentive was introduced. By and large, industry continued to be located around developed areas even those areas promised lesser tax benefits than the others.

The fact of the matter is that the entrepreneur's decision in favour of one location or the other is motivated not by temporary gain considerations but by factors which are to contribute to the success of the venture on a permanant basis. The economists have tried to construct models to explain the lacation pattern of industrial activity.[9] Alfred Webber advanced the idea of least cost location. Others lay stress on cheapest location and maximum profits.

TABLE IX

Value Added in Manufacturing in Select Districts of W. Pakistan in 1966-1967

	Textile		Light Industries		Heavy Industries		Food Production		Miscellaneous	
Districts	Gross :	%	Gross	%	Gross	%	Gross	%	Gross	%
A. 6—8 year Holiday										
D. I. Khan									5331	.2
Mianwali									158849	4.8
D. G. Khan									7567	.2
Larkana	9940	.3							4959	.2
Thatta									2464	.1
Quetta									17791	.5
B. 4—6Ycar Holiday										
Kohat									11105	.3
Jhang	5072	.2							1962	...
Sheikhupura			251	.1			3715	.3	158944	4.8
Bahawalpur	8401	.3					212	...	1300	...
Sargodha	50158	1.7					196	...	I15842	3.5
C. 2—4 Year Holiday										
Lahore	86959	3.0	70578	21.3	85232	14.5	82599	7.4	162853	4.9
Lyallpur	406245	14 0			10441	1.8	105957	9.4	17897	15.4
Multan	410378	14.1			205	...			168940	5.1
Murdan									275326	8.4
Hyderabad	165425	5.7	8713	2.6			86119	7.7	152770	4.6
Karachi	1172289	40.3	217215	65.7	440772	75.0	749194	66.8	593068	18.1

SOURCE: Worked out from Census of Manufacturing Industries West Pakistan 1966—67.

Still others give more weight to the sale potential of the area. Economic considerations apart social, cultural and regional interests too play a fairly influential role in the location of industries.

In Pakistan's case, Papanek's analysis of the location of industry based on sample survey shows that in the beginning, for the entrepreneural class displaced from India, considerations of congenial residential environment and the seat of the government were important. The success story of the Pioneers attracted later investments. To meet the growing demand from industry, the government improved the infrastructure which in turn encouraged concentration in the same areas. The availability of facilities like repair, same finished inputs helped reduce the cost of the newcomer industries. So, the external economy factor also contributed to concentration.

The use of direct controls over the sanctioning of industry by the government did not have, as we have seen in Table IX, as much impact as would be expected. What happened was that industries started springing up in Hyderabad, just 2 hours drive from Karachi, and in Sheikhupura - 20 miles from Lahore. Perhaps the factor of external diseconomies - the increased cost of labour, transport, labour housing in big industrial towns which make the industry more costly for the newcomer did cause some dispersion after 1960. It is likely that in such cases, while looking for alternative location, the entrepreneur might have preferred a 4 year holiday area over a 2 year holiday district if other things were equal. But generally tax incentives made little impact because among other things, profit margins were high and effective rates of tax were low due to accelerated depreciation allowances and evasion etc.

D. Promoting exports of manufactures

Pakistan became interested in export diversification as soon as its infant manufacturing industry could turn out some exportable surplus. Also, with the export earnings gradually falling due to some external as well as domestic factors, boosting of foreign exchange earnings became essential. The devaluation measures including the introduction of export bonus scheme, export performance licensing and fiscal concessions like

exemption from import duties, sales-tax and income-tax rebate on export earnings as well as tax holiday for industries exporting more than 30 per cent of their production. The combined impact of these measures was a rapid increase in the export of manufactures as is apparent from the following figures.

Year	Value (Million rupees
1950—60	527
1964—65	792
1966—67	1261
1967—68	1464
1968—69	1687

Source : 1. Statistical Pocket Book of Pakistan 1969 p. 87.

2. Pakistan Economic Survey 1967—70 p. 131

Among the measures referred to above, bonus scheme introduced in 1959 was by far the most important. Under this scheme an exporter is entitled to get bonus at 20% to 40% of F.O.B. value of exports depending on the item exported. This entitlement "voucher," a permit to buy foreign exchange at official rate, is freely transferable in the market at premium averaging 150 per cent. Since foreigh exhange is strictly without government sanction, the sale of these vouchers in the open market yields profit. Through this mechanism, the exporter sells goods in the foreign market at low rates, sometimes even below cost and gets compensating subsidy in the form of bonus vouchers. This incentive coupled with the facility of export performance licence—facility of importing at official exchange rate inputs for exportable goods—is the main causal factor that boosted the exports. The supplemntary measures of income—tax export rebate, as we shall presently see from the illustrations below, could not have much of an impact. In thes illustrations we are assuming that the exporter is a limited company engaged in manufacturing, its tax rate is 50%, the bonus entitlement 30% and the prevalent rate of premium on bonus vouchers is 150%.

Example I

1.	Domestic sales	Rs.	1,000,000
2.	Estimated gross profit at 25%	Rs.	250,000
3.	Export Sales	Rs,	120,000
4.	Profit on exports (sale at cost price)		Nil
5.	Bonus at 30%	Rs.	36,000
6.	Sale of bonus vouchers at 150%	Rs.	54,000
7.	Total gross profit	Rs.	304,000
8.	Less estimated overhead expenses	Rs.	104,000
9.	Net Profit	Rs.	200,000
10.	Tax on (9)	Rs.	100,000
11.	Tax attributable to export sales : $\frac{10000 \times 120000}{1120000}$ =	Rs.	10,714
12.	Rebate at at 15% of Rs. 10714 =	Rs.	1,606

Example II

All other assumptions remaining the same as in Example I, two figures are varied for the purpose of this example, Export sales now are supposed to be Rs. 400,000 and overchead expenses Rs. 130,000. The results would be :

1.	Sale proceeds of bonus voueher	Rs.	180,000
2.	Net profit	Rs.	300,000
3.	Rebate	Rs.	10,750

Example III

Let us suppose that the export of goods at cost, as in example I, was not possible and so the exporter sells for Rs. 120,000 goods that cost him Rs. 140,000. The position in this case would be :

1.	Sale proceeds of bonus vouchers after adjusting loss of Rs. 20000	Rs.	34,000
2.	Net Profit	Rs.	180,000
3.	Rebats	Rs.	1,500

We find that in the above three examples the ratio of rebate to total tax liability is only 1.6%, 3.6% and 0.8% respectively which is too weak an incentive to stimulate exports. It is sometimes argued that the exporter has very often to sell below cost and, therefore, needs to be compensated. In example III we have seen that whereas the loss on export before bonus subsidy was Rs. 20,000, the tax relief was only Rs. 1500. This is the compensation. What really figures in the calculations of exporter is the export subsidy, which is substantial, and not the paltry amount of tax relief. No doubt a businessman will always welcome any gain watever its quantum if it is coming anyway, but the question is : does that revenue giveaway at all tilts the balance in favour or against exporting goods ? The answer is : No except perhaps in some rare cases. As long as a reasonable amount of export subsidy under the export bonus scheme is available one can safely predict that exports will be made even without export rebate.

In 1964 an undertaking which exports at least 30 per cent of its production was declared eligible for tax holiday. No information on the impact of this incentive is available because it is of very recent origin. The concession, however, appears to be fairly liberal benause it means exemption of not only export profits and subsidy but also profits on 70% domestic sales for the period of holiday. At the same time, it is not likely to stimulate exports to an appreciable degree because it is doubtful that a big unit will be able to export more than 30% of its total production in the inital years of its going into prodution.

The attempt so far in this section has been to find out the contribution, if any, made by the incentive programme towards the attainment of objectives. For a fair overall appraisal we must see the other side of the picture too, the glaring ill-effects produced by these concessions. The following points stand out very clearly.

Too Liberal

We have been in earlier sections how great were the economic incentives, apart from tax concessions, for industrialisation in the first decade of Pakistan's history.

Add to that the concessions of ac celerated depreciation allowances under which most of the cost of machinary could be recouped in the first three years of installation and the investment allowance computed with reference to the total capital employed. These incentives appear to be justified in the initial stages in view of urgent objective of economic development. However, by mid-1950's a stage was reached which suggested the exercise of a little restraint in the liberal policies adopted towards private sector industry. The Planning Board is on record having concluded in 1955 that public revenues had not obtained a fair share of the prosperity which attended the development of the private industry and therefore recommended the grant of tax concessions "only on a selective basis." The Planning Commission in the Second Plan document repeated in 1959 similar recommendations briefly quoted in Section III. But the new regime that had come in power in 1958 thought it fit to even further liberalise the tax incentive programme by introducing tax holiday in 1959 for two years which period was later extended up to 8 years. An important clause in the tax holiday legislation provided that in computing the exempt profits during the holiday peried depreciation allowances will not be adjusted but held in abeyance till after the expiry of that period. Thus in effect the tax holiday period was 10 to 2 years. Such a generous treatment could be justified in a country where the entrepreneural class was lacking or the profitability scope was limited. But that was not the case in Pakistan. It is true that in some consumer goods industries ratio of gross profit to gross sales declined by late 1950s due to domestic competition but the over all profits did not fall because with incomes gradually going up, particularly in the agricultural sector, the demand for goods continued to grow.

The tax holiday legislation on paper appears to be selective as only those industries are eligible for the concession that are approved by the government. But the list of eligible industries which is large and includes all industries that use wholly or mainly locally produced raw materials. The result is that some of the industries which were quite well establishcd by the end of 1950s

and needed no crutches, continued to enjoy the concession. The textile industry is an instance in point.

Tax holiday is available not only to new undertakings but also for the expansion of existing ones if such expansion constitutes an identifiable unit for the production of similar goods or a similar unit for an indentifiable industrial process. To avail of this opportunity of enjoying tax-free profits, the existing undertakings put up such identifiable units which they would have set up anyway in course of time. For instance, bleaching and dying or printing units were added under the tax holiday scheme although there was every likelihood of their being set up as a part of existing unit to make it economically more viable and attractive.

The explanation for the liberalisation of the incentive programme in 1959 can be found perhaps in the overall liberal approach adopted in that period by the then government in tackling the economic problems. With a view to accelerating economic growth, a number of measures were adopted to free the economy from various direct controls and administrative red tapes. The same approach appears to have been extended to the field of tax incentives. The late 1950s were characterised by stagnation in industrail investment and growth ; and the authorities might have thought that the remedy lay in making the tax incentive programme more attractive whatever the cost.

Costs of Incentive Programme

The cost factor in any programme is always an impartant consideeration. Many accomplishments are possible but it may well be asked what price was paid for them. The tax incentive groramme in Pakistan, as has been seen earlier in this Paper, made a very small contribution in attaining some of the objectives but in capital formatian it did an excellent job. What, then, was the cost ?

Unfortunately no statistics have been maintained of the fiscal sacrifice i.e. the amount of revenue that was due but was exempted under any of the incentive provisions. A precise answar is, therefore, not possible : nor even an estimate can be ventured. However, a brief discussion of the following factors that have gone into this cost would be of interest and can be revealing.

(i) **Tax exempted**

Major portion of the exempted tax went to the industry, particularly the corporate sector. According to estimates already referred to in this section, 40 per cent of the total profits of the corporate sector were exempted upto early 1960s and the figure for the subsequent years is estamated to be higher. Calculations also indicate that for every rupee saved and capitalised by the companies state's cost was half a rupee. By no means is this an ordinory cost.

(ii) **Tax evaded**

Every tax system has to face the problem of tax evasion. In developing countries like Pakistan, this problem is relatively more acute The tax incentive programme, particularly tax holiday provisions as designed, added new dimensions to the problem of evasion. As already metioned, identifiable unit of an existing undertaking was made eligible for tax holiday if the former is owned by a company all the voting powers of which are with the existing company. It was also not necessary that the new unit be housed in a separate building. Succ an arrangement provided excellent opportunity for easy evasion. The profits of the taxable unit were transferred to the tax holiday unit, The usual modus operandi was the transfer of materials or stocks in semi-processed form taxable units to exempt units at cost, the debiting of expeneses relating to holiday unit to the taxable unit etc. At times the profits of the tax holiday companies were artificially inflated to cover the intended foture evasion during post holiday period. This explains why in many cases the profits of tax holiday undertakings sharply declined with the expiry of the holiday period.

So actually the cost of the programme was revenue giveaways plus substantial amount that was never intended to be given away

(iii) **Leakage**

In is true that a large part of the industrial profits were ploughed back but still a substantial portion was consumed in luxury living by the industrialists. When in late 1950s domest capital was available but fresh

investments in industry were not possible owing to to paucity of foreign exchange, considerable amount was spent on private luxury houses.

The profits that were not converted into savings and capital would obviously form part of the cost of the programme which through exemptions was allowed to remain in the hands of private enterpreneur instead of becoming public savings.

From the foregoing discussion it seems pretty obvious that the cost of the results obtained from the incentive programme was fairly high. Whether the benefits to the economy were greater than the cost, only a cost-benfit analysis can show.

Inequity

Like any other less developed agricultural economy and feudal society, Pakistan started with great inequity in income and wealth distribution. Industrialisation rapidly widened the gap and tax incentives made liberal conttibution to this process. It is true that some sacrifice of socal justice for economic growth particularly in the initial period of development in a country, is unavoidable. Equity objective may justifiably be temporarily subordinated to economic objectives. But this policy must remain limited to to an extent and upto a time that it is considered economically essentirl. As soon as sound economic justification ceases to exist, equity objective must receive due recognition.

In Pakistan the objective of government policy was industrial growth as equitable distribution of income in so far as it did not as a disincentive, Economic incentives, other than tax concession, wcae so substantial that if by late 1950's, as recommended by Planning Commission, the tax incentive programme had been reviewed to make it more selective, such a step would surely not have acted as a disincentive. But this step was not taken and equity objective continued to be subordinated to growth philosophy. This lead to concentration of economic power into still fewer hands and created near monopoly conditions with all its unhealthy consequences likc social disharmony, labour management conflicts and political instability. No wonder that

Mahboob-ul-Haq who, in 1963, so forcefully advocated philosophy of growth in preference over philosophy of distribution[11], talked in 1968 of the control by 20 families of 66 per cent of industrial assets, 70 per cent of insurance funds and 80 per cent of bank assets.[12]

Because of ploughing back of profits into the industry, the market value of shares increased rapidly. So, the big shareholders made huge capital gains which were exempt from tax from 1949 to 1963. Many private limited companies converted themselves into public companies and the directors profited by offering a part of their share holdings to the public. From 1963 the realised capital gains of the company were taxed was levied on the dividends distributed. In the case of individuals, two-thirds of the capital gains was exempted and the balance taxed along with other income at normal rates The unrealised capital gains continued to be exempt. As a result of this generous treatment of capital gains and liberal tax incentives, the effective rate of tax for those connected with industry was very low For others, it was fairly high. This was surely inequitous.

Mention has been made in section V that exemption is allowed on all amounts subject to a ceiling, invested by an individual in approved companies, securities, postal certificate etc. The relief in tax provided by this exemption is also inequitable in as much as the lower income person gets much less in relief than the higher income bracket tax-payer for every rupee that is invested. The poorer person in all fairness should get, if not better, at least equal treatment because sacrifice involved in saving is higher in the case of the former. A rupee is worth more to a man earning Rs. 10000 a year than to the one enjoying annual income of Rs. 100000. It might well be argued that since it is the richer person who can make large investments, any rationalisation of the existing concession may adversely affect the savings and investment levels. This is not a well founded fear. Those in industry or trade make investments not marely to reduce tax liability but mainly to get regular and attractive return. Since investment climate and market conditions were favourable in Pakistrn, the surplus with

the businessmen would certainly have found its way into one or the other investment even if the tax relief had been a little less. In fact it is likely that a fairer treatment of the investments by the low income bracket people would have broadened the savings base stimulating much larger savings in the long run.

These inequities result in further inequity of another form. Arbitrary exemption from tax for one group of potential tax payers means that others who do not enjoy this exemption must bear larger and larger burden as the revenue needs increase. The unfairness of this situation increases as tax levels became higher and the consequent disparities in the tax burden of these taxpayers become greater.

Adverse Economic effcct

When the directors of companies, encourged by incentive laws, ploughed back large segments of the profits to avoid heavy personal taxation in the present on the one hand and to increase future capital gain potentials on the other, declared divided rates remained very low. With small shareholder getting very little return on his investment, stock market was depressed and wider participation in the growth effort was discouraged. Surely, it is this wider participation and broading the base of ownership which is so essential for a sustained growth in the long run. It was to remedy this situation that in recent year the government took steps to ensure regular and adequate declaration of devidends with a view to broadening the base of ownership of corporate sector and containment of further concentration of industrial incomes and wealth.

To sum up, whereas the incentive programme in Pakistan succeeded very little in attaining objectives like dispersion of industries and promotion of exports, it played a fairly significent role in domestic capital formation in the industrial sector. No doubt a number of other factors also aided in bringing this about, but the fact remains that tax concessions did increase the availability of domestic funds for reinvestment which in turn helped raise productivity. This, however, was achieved at considerable cost both in terms of fiscal sacrifice and inequity. Industry, no doubt, grew rapidly but it also helped swell the coffers of a few "robber barons."[13] The

questions whether or not the overall benefit to the economy justified the cost and whether or not the sacrifices of social justice to an extent withessed in Pakistan in the last two decades was necessary or even unavoidable, falls in the domain of political economists to answer.

SECTION VII

Concluding observations

The existing incentive programme, as we have seen, favours pure economic growth. Since it is being continued into the Fourth Plan period (1970-75), the implication is that the policy objectives remain unchanged. On the other hand, the Fourth Plan as drafted, talks of a big shift in development strategy in the following words :[1]

> "The development strategy for the 1970's has to change fundamentally. The country has by now reached a stage where this is possible. In the new strategy, there must be a far greater emphasis on considerations of social justice even when this affects the overall growth of the economy."

Obviously, the incentive programme objectives and Plan strategy are contraditory. If economic growth is desired, then incentives can have a role. The programme may, however, need to be reviewed with a view to rationalising it in the light of past experience and in keeping with the change in circumstances. But in case equity and social justice are to be preferred, fiscal polities can hardly deliver the goods. A change in the economic system will be required to achieve that objective.

Post Script

The new government in Pakistan that came into power in December 1971, aims at having an egalitarian society. It is opposed to the pure growth oriented pholosophy of development planning that neglects issues of socıel justice. The basic objective of economic development, it believes, is to achieve economic prosperity as well as social justice. The Finance Minister in his budget speech in 1972 observed :

> "For the last 5 years, the strategy of development planning in Pakistan is based on the

> premise that rapid growth of gross national product was the means to the solution of the economic ills. The greater the rate of growth of GNP in the partianlar plan period, the greater was assumed to be the increase in prosperity of the nation.....This concept did not reflect the well-being of the over-whelming majority of our people.
>
> Unscientific estimation of increase of G N P without taking into account the mix of goods and services, and without knowing, or caring to know, the ultimate user of these goods and services, rendered this growth indicator of little use for measuring national economic progress. Instead of increasing prosperty it merely increased disparity."

As soon as the new government was in the saddle, it redirected the planning policy towards the aim of removing disparity and bringing about a more equitable distribution of wealth. A number of reforms were launched covering a wide range of socio-economic activity including land ownership, nationalisation of life insurance business and some key industries, abolishing managing agencies through an amendment in the company law.

In this new setting a change in the taxation policy was inevitable. The first and the most significant step taken was the total withdrawal of tax holiday seheme. Announcing this decision the Finannce Minister said :

> "In never achieved its purpose of industrial dispersal but has contributed to the concentration of economic power and wealth and has encouraged the establishment of uneconomic units."

The other modifications in the income-tax incentives scheme were :

(i) The exemption limit for dlvidends income received from public and private companies was reduced to Rs. 2000. Prior to this reduction, the exemption limit was Rs. 5000 in the case of companies listed on the stock exchange and Rs. 3000 in the case of unlisted companies.

(ii) The concessional tax rate on inter-corporate dividends was withdrawn in respect of unlisted companies. This was done to stop tax avoidance by individuals or family groups that set-up private companies to channelise dividend income from other companies and to enjoy this income without payment of the full amount of tax.

Notes (General)

(a) One crors is ten million

(b) One lakh is : 100,000

(c) Rupees 4.76=$ 1 U. S.

(d) Most statistics in Pakistan are for a July 1 to June 30 of every year.

(e) "Large Scale" industry means industrial establishment employing 20 or more workers and using electric power.

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1. Denotes the relevant section of the Act.
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APPENDIX A

Statement showing progress of investment in Savings Certificates

Crore-10 million (*Amount in crores of Rupee*)

Year	Opening Balance	Invest-ment	Encash-ment	Net	Closing Balanee
1947...48	18.16	0.32	1.80	(—) 1.48	16.68
1948...49	16.68	1.08	1.22	(—) 0.14	16.54
1949...50	16.54	1.62	0.61	1.01	17.55
1950 ..51	17.55	1.32	0.62	0.70	18.25
1951...52	18.25	1.61	0.61	1.00	19.25
1952...53	19.25	1.92	0.63	1.29	20.54
1953...54	20.54	2.35	0.72	1.63	22.17
1954...55	22.17	2.63	0.87	1.76	23.93
1955...56	23.93	3.24	1.07	2.17	26.10
1956...57	26.10	3.60	1.49	2.11	28.21
1957 58	28.21	3.87	1.71	2.16	30.37
1958 59	30.37	7.55	3.17	4.38	34.75
1959...60	34.75	9.42	3.49	5.93	40.68
1960...61	40.68	9.45	4.68	4.77	45.45
1961 ..62	45.45	10.01	4.92	5.09	50.54
1962...63	50.54	9.99	5.14	4.85	55.39
1963...64	55.39	11.31	5.16	6.15	61.54
1964 65	61.54	11.37	6.64	4.73	66.27
1965...66	66.27	11.88	8.82	3.06	69.33
1966 ..67	69.33	14.24	11.15	3.09	72.42
1967...68	72.42	17.90	11.02	6.88	79.30
1968...69	79.30	25.52	15.68	9.84	89.14

Source : Directorate of National Savings, Government of Pakistan,

APPENDIX B

Statement showing Progress of the Postal Life Insurance Funds

Lakh-100,000 (*Amount in Lakhs*)

Year	Opening Balance year	Credits during the year	Debits during the year	Net accretion during the year	Closing Balance
1947...48	96,19	4,73	2,86	1,87	98,06
1948...49	98,06	6,90	3,74	3,16	101,22
1949...50	101,22	9,58	4,18	5,40	106,62
1950...51	106,62	14,87	6,33	8,54	115,16
1951...52	115,16	17,40	9,28	8,12	123,28
1952...53	123,28	19,98	10,92	9,06	132,34
1953...54	132,34	21,05	12,44	8,61	153,27
1954...55	153,27	20,57	21,75	(—)1,18	152,09
1955 ..56	152,09	33,62	15,82	17,80	169,89
1956...57	169,89	46,03	17,16	28,87	198,76
1957...58	198,76	58,52	18,30	40,22	238,98
1958...59	238,98	87,22	28,06	59,16	298,14
1959...60	298,14	89,43	25,58	63,86	362,00
1960...61	362,00	101,00	29,94	71,06	433,06
1961...62	433,06	121,94	36,71	85,23	518,29
1962...63	518,29	137,52	41,71	95,81	614,10
1963...64	614,10	141,87	55,32	86,55	700,65
1964 . 65	700,65	176,18	76,49	99,69	800,34
1965...66	800,34	194,83	92,30	102,53	902,87
1966..,67	902,87	228,77	111,89	116,88	1019,75
1967...68	1019,75	310,00	103,75	206,25	1226,00
1968...69	1226,00	290,00	160,00	130,00	1356,00

Source : Directorate of National Savings, Government of Pakistan,

APPENDIX C

Statement showing progress of investment in Post Office Savings Certificates

(*Amount in crores Rupees*)

Year	Opening Balance	Deposits	With-drawals	Net	Closing Balanee
1947...48	29.03	9.22	14.73	(—) 5.51	23.52
1948...49	23.52	15.47	14.51	0.96	24.48
1949...50	24.48	13.66	12.33	1.33	25.81
1950...51	25.81	15.60	14.21	1.39	27.20
1951...52	27.20	15.84	14.09	1.75	28.95
1952...53	28.95	17.05	17.81	(—) 0.76	28.19
1953...54	28.19	17.37	15.85	2.12	30.31
1954...55	30.31	18.93	16.68	2.25	32.56
1955...56	32.56	24.61	18.79	5.82	38.38
1956...57	28.38	28.75	23.55	5.20	43.58
1957...58	43.58	32.13	26.44	5.69	49.27
1958...59	49.27	38.82	37.19	1.63	50.90
1959...60	50.90	31.35	29.09	2.26	53.16
1960...61	53.16	33.21	33.20	0.01	53.17
1961...62	53.17	35.40	32.17	3.23	56.40
1962...63	56.40	36.51	33.81	2.70	59.10
1963...64	59.10	40.71	37.31	3.40	62.50
1964...65	62.50	40.40	38.08	2.32	64.82
1965...66	64.82	38.55	38.15	0.40	65.22
1966...67	65.22	42.20	40.05	2.15	67.37
1967...68	67.37	39.07	38.86	0.21	67.58
1968...69	67.58	40.33	40.38	(—) 0.05	67.53

Source : Directorate of National Savings, Government of Pakistan,

SUGAR DILEMMA

——A SHORT NOTE.

By

MOHAMMAD NAWAZ*

In December, 72 the sugar feverchart showed new heights every sunrise. The price per maund of sugar touched the peak of Rs. 240/-[1] from controlled price of Rs. 62/[2]

In our country, the consumer is so weak that even Galbraithian "Countervailing Power"[3] Principle or Naderism[4] is not operating here. The producers control output and fix prices of various products. In the various productive and distributive fields the entreprenurs have joined hands to fix some uniform price for their products. The price fixture is such that it creates bigger gap between marginal revenue and marginal cost, thus giving them maximum profits. The consumer is helpless. He can see at the price chart but his force cannot work as a countervailing power. He cannot dictate prices.

The prices of many a necessary good are rocketing. In many a case the prices have increased by 50%. As far warm cloth, the entrepreneur has doubled the price of their products in one stroke. In the chilly cold the purchase of warm cloth is beyond the reach of the poor folk. In a poor country like ours, consumer is the poorest influencing factor. For example, according to a Report of Punjab Board of Economic Enquiry on Sugar, in 1968, imported Sugar price (CIF) was Rs. 10/- per Maund[5], but this very product was sold at much higher price in the country. The petty consumer could not project his point of view against this high price. This time the price of sugar per seer increased from Rs. 1.60 to Rs. 6.50.

In this foul game played by the producers and distributers the Government had to intervene, to safe-guard the interest of the exploited consumers. The Govt. has started with rationing at all levels.[6] The private dealing has been done away to eliminate all anamolies which is

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a new pratice in our country. In India, whole,-sale business of wheat and rice has already been nationalized to allow systematic flow of the products to the consumers' In our country this measure may also prove successful.

The present sugar-price-push from Rs. 1.60 to 2.50 per seer or to Rs. 100/- per maund will give sufficient dividends to the sugar entrepreneurs. The incentive given to the sugarcane growers in the form of price increase will make them produce maximum output at the farms. This time maximum sugar cane price per maund has been fixed at Rs. 4.25.[8] I hope this feverish-plough and machine game for sugar production will bring sugar boom by next year. Moreover Sugar rationing will remove the anamolies of hoarding, black-marketing and smuggling. It will also ensure its proper flow to all consumers including commercial and industrial establishments.

There are many factors which created sugar shortage this year. Firstly, in 1970-71, we had a surplus of one lac tons. This was exported with ample subsidy of Rs. 17/- per maund and with 45 percent bonus rate. All or part of the surplus could have becn stored and used in the period of shortage. It is interesting to note that one doller earning cost us more than Rs. 20/- in the case of sugar export. Secondly, the there was a price cut in the sugar cane procurement price. It had a far reaching adverse effect in punjab where most of the sugar mills are located. Here Sugar cane price of Rs. 2.50 per maund was not lucrative to the farmer. He sowed more of cotton and less of sugar cane. So this year, we reaped dividends out of cotton crop but faced crisis on the sugar front. Now sugar cane procurement price has been fixed at Rs. 4.00 per Maund in the N.W.F.P., Rs. 4.25 in the Punjab and Rs. 4.40 in Sind.[10] The benefit of this policy will be felt fully in the next sowing season. Even then this year much of the cane which used to go in the machine for Gur and Khandsari making, will be channelised to the mills. Other factors remaining the same, by next year we will have bumper sugar cane crop and boom of sugar production.

Third factor which is responsible for the sugar shortage was lack of availablity of Transport facility.

This was due to December 1971 War. Most of the Trucks were procured by the Government. So in the harvesting and milling period of December 1971 and Jan-72 most of the sugar cane could not find its way to the mill gates. Fourthly, due to high sugar price in Afghanistan our smugglers took every risk to make their fortune and diverted a bigger chunk of the output to that area and left our domestic consumer in lurch.

Lastly, in the post devaluation period, mill owner debt servicing obligation inereased. On the old sugar price line, they could not reap the same dividends. They wanted new priceline. They had their own tactics. they depended on the market forces. they exploited them fully to create an artifial shortage. Sugar which was available at Rs. 62/- per Maund previously, came out of the mill gates at Rs. 130/- per maund. In the Market it touched the peak of Rs. 250/- per Maund. The mill-owner brought the market-forces-play to the precipice. The Government intervened and fixed the price at R. 2.50 per seer or Rs. 100/- per Maund. Therefore, in the post devealuation period, the sugar entrepreneurs have got new deal. They have played a long hide and seek game, and have been successful in manouvering the affairs in their own favour. To understand them if we take the trouble of checking cost of production per Maund of Sugar the revelation will be quite interesting. According to the Punjab Board of Economic Enquiry Report on Sugar production (page 190). The cane requirement and cost of production per maund of sugar which is as follows, can serve as basis for the year 1971-72 as well.

THE CANE REQUIREMENT AND COST OF PRODUCTION OF SUGAR (1970-71) PER MAUND[11]

	White Suggr
1. Sugar Recovery Rate.	8.76 per eent
2. Cane per maund of Sugar	11.42 Maund
3. Cane price	Rs. 2.76
Cost of Cane per Maund of Sugar.	Rs. 31.52
Conversion Cost· ·	11.47
Total cost of production :	Rs. 42.42

The above cost is with Rs. 2.76 per maund of sugar cane whereas in the year 1271-72 the cane price in Punjab was Rs. 2.50 per maund, therefore the cost of production per Maund can be reduced by Rs. 2.85., for this year. This reduction could be adjusted against increase in the depreciation cost (which was Rs. 1.93 per Maund of sugar)[12] which has got some boost after devaluation. All this did maintain the same cost of production line for the year 1971-72. The Sugar tycoons which earned, 20 per cent profit on this cost production, manouvered the market forces in such a way that they started biting deep in the flesh of the consumers and reaped 200 per eent profit in one stroke. The whole-sale and retail dealers also gained in this dirty game. In the new policy of rationing the game of retailers and whole-sale dealers is over, but the mill-owner is still in the field. He has been in a position to convince the Government of his stand and got the controlled price doubled on the plea of devaluation and hence increase in the cost of production.

As far the plea of increase in the cost of production, there is no doubt that it has increased due to wage increase and devaluation. If adjustment is made for both, even then, the cost of production per maund could not cross the line of Rs. 50/- per maund of sugar. For example, according to the Punjab Economic Enquiry report, on the production of one maund of Sugar, depreciation and interest on capital is Rs. 1.93 and Rs. 0.36 respectively in the pre-devaluation period. As for the salaries and wages, per maund expenditure in this case was Rs. 3.28. If depreciation and interest on capital may be doubled due to foreign exchange content, we get an increase of Rs. 2.87. As far wages and salries, there is hardly 25 per cent increase. So wage increase per maund of sugar cost of production is hardly Rs. 1.00. Taken all this collectively, there is an increase of Rs. 3.87 in the cost of production of per maund of sugar in the post-devaluation period. Therefore, for the year 1971-72 per Maund cost of production could not be beyond Rs. 46.86 (42.99 + Rs. 3.87). The product with this cost of production was sold at Rs. 240 per Maund, so this is the myth of exploitation of consumers at the hands of sugar barons, wholesale dealers and retailers upto Dec. 16, 1972.

With the new sugar policy, the farmer in the country will get ample return in selling sugarcane to the mills at

Rs. 4.00 per Maund in NWFP. Rs. 4,25 in Punjab and Rs. 4.40 in Sind. He will be stimulated to produce more of sugar cane on every inch of available land. Much of the area reserved for cotton crop will be used for sugar-cane cultivation to reap economic benefits by next year. So there will be sugarcane rush on the farms. The fix-ation of new sugar price for the mills will give the owner sufficient dividend, which is three times of the prevalent maximum rate of interest. Therefore, he will put every cane, from where-ever it is available in the machine to make his fotune. This endless-machine rotation-fever is supposed to make a mini-sugar-boom visible by next year. (5.1.1973)

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