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REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES



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U.S. Assistance To Pakistan Should Be Reassessed

Department of State
Agency for International Development

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This report discusses problems impeding the economic development of Pakistan and efforts of the U.S. and Pakistan to remedy these problems. Although various actions have been taken, problems still exist in the areas of external debt, defense spending, food production, use of emergency funds, fixed-cost reimbursement, and malaria control.

U.S. bilateral assistance programs should be reexamined along with consideration of other means to help Pakistan over the longer term. Possible alternatives are the increased use of multilateral assistance and achievement of a coordinated commitment by developed nations to ensure Pakistan a reasonable market for goods resulting from assistance to develop its resources and productivity.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-173651

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses basic factors contributing to Pakistan's general economic condition and the need to reassess the United States assistance program for Pakistan.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget, the Secretary of State, and the Administrator of the Agency for International Development.

A handwritten signature in cursive script, reading "Thomas A. Heath".

Comptroller General
of the United States

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ABBREVIATIONS

AID	Agency for International Development
GAO	General Accounting Office

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

U.S. ASSISTANCE TO
PAKISTAN SHOULD BE
REASSESSED
Department of State
Agency for International
Development

D I G E S T

The U.S. continues to provide Pakistan with substantial amounts of economic assistance--an estimated \$174 million for fiscal year 1976. Pakistan, however, has not taken sufficient action to improve its general economic condition.

Pakistan has not resolved basic factors contributing to debt problems and maintains a high level of military spending, which detracts from funds available to develop its natural resources.

Furthermore, Pakistan's policies discourage increased food production.

The Agency for International Development requested funds for disaster relief purposes, but some of these funds were used to replace regular development assistance funds which had been used elsewhere.

It also applied its fixed-cost-reimbursement method to certain projects without reaching agreement on the amount of reimbursement before work began.

The Agency entered into a large new malaria program, but Pakistan has not demonstrated the necessary continued support for such a program.

Details of problems noted

Debt problems

Pakistan announced in April 1971 that it no longer could service its external debts, totaling about \$4.6 billion. An Aid-to-Pakistan Consortium, including the U.S.,

provided partial debt rescheduling and, in June 1974, rescheduled additional debt owed its members.

Pakistan has adopted some economic reforms recommended by the Consortium but, unless more are adopted, further debt rescheduling may be needed. In the longer run, Pakistan must increase its exports to make sufficient foreign exchange available to pay for needed imports and debt servicing.

The value of debt relief is not included as part of AID's foreign assistance appropriation requests to Congress. Furthermore, the U.S. has little to say about how the country granted such relief uses its foreign exchange.

The Department of State and the Agency for International Development maintain that debt relief should not be equated with assistance since the rescheduling only constitutes temporary acquiescence in nonpayment of resources the debtor does not currently have. We believe, however, that debt relief is a form of assistance to the extent that it releases a country's resources for other purposes. (See ch. 2.)

Defense spending

Pakistan's fiscal year 1975 defense spending was budgeted at about \$564 million--about 45 percent of its estimated domestic revenues. This high level of defense spending detracts from funds needed for the long-term development of its natural resources.

U.S. economic aid makes a higher level of defense expenditure possible to the extent that Pakistan would have to use its own revenues for these purposes.

The Department of State and Agency for International Development agree that Pakistan's defense spending should fully be considered in determining aid levels. (See pp. 16 to 18.)

Government policies discourage
increased food production

Price and marketing controls and other Pakistan policies, together with the availability of Public Law 480 commodities, have combined to discourage increased food production. As a result, Pakistan imported significant amounts of food and fertilizer in fiscal year 1975, compounding its serious debt situation.

The Department of State and Agency for International Development agree that, before providing concessional assistance, the U.S. must satisfy itself that related self-help measures are being carried out by the recipient government and that providing such assistance would not contribute to the continuation of policies which discourage increased food production. (See pp. 24 to 31 and 61.)

Fixed-cost reimbursement

To assist Pakistan reconstruct small rural facilities damaged in the flood, the Agency for International Development provided a \$27.5 million grant under its fixed-cost reimbursement method.

Under this method the Agency and the grant recipient agree that, after a project has been satisfactorily completed according to specifications and the Agency has inspected the project, the Agency will pay a previously agreed fixed amount to that government.

However, lengthy delays in implementing this grant largely nullified the method's advantages. Reimbursement requests will most likely be based on actual cost rather than on predetermined amounts.

The Agency said that, due to the need for timely rehabilitation, Pakistan, with its concurrence, proceeded with the construction of certain projects

after U.S. mission officials reviewed only a sampling of designs, specifications, and cost estimates.

In addition, the grant agreement provided dollars for mostly local currency costs in an excess currency country, thus resulting in a further U.S. balance-of-payments drain. The Agency said that, in the future, serious consideration would be given to precluding this circumstance from occurring. (See pp. 45 to 47.)

Malaria program

The U.S. has provided more than \$27 million to help Pakistan control malaria. However, the program's objectives have not been accomplished because Pakistan did not provide sufficient financial and political support.

The Agency for International Development has authorized another \$20 million loan for malaria control and told GAO that it has assured itself of Pakistan's firm commitment for the new program.

Pakistan might be more receptive to the program and more resources and coordinated efforts might be available through a multilateral program. (See p. 39.)

Disaster relief funds

GAO also noted several instances where disaster relief funds, granted to help Pakistan recover from 1973 floods, were not effectively used. (See ch. 5.)

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GAO's recommendations for improving administration of assistance to Pakistan are on pp. 13, 34, 42, and 51.

CHAPTER 1

INTRODUCTION

Pakistan is a relatively new country, gaining its independence from the United Kingdom in 1947. It is a rural, agricultural nation with a population of about 70 million. Wheat is the main staple food. Agriculture contributes more than 35 percent to Pakistan's \$7.9 billion gross national product and employs about half the country's work force. About 80 percent of Pakistan's foreign exchange earnings come from agriculture and agro-based industries, particularly cotton, cotton textiles, and rice.

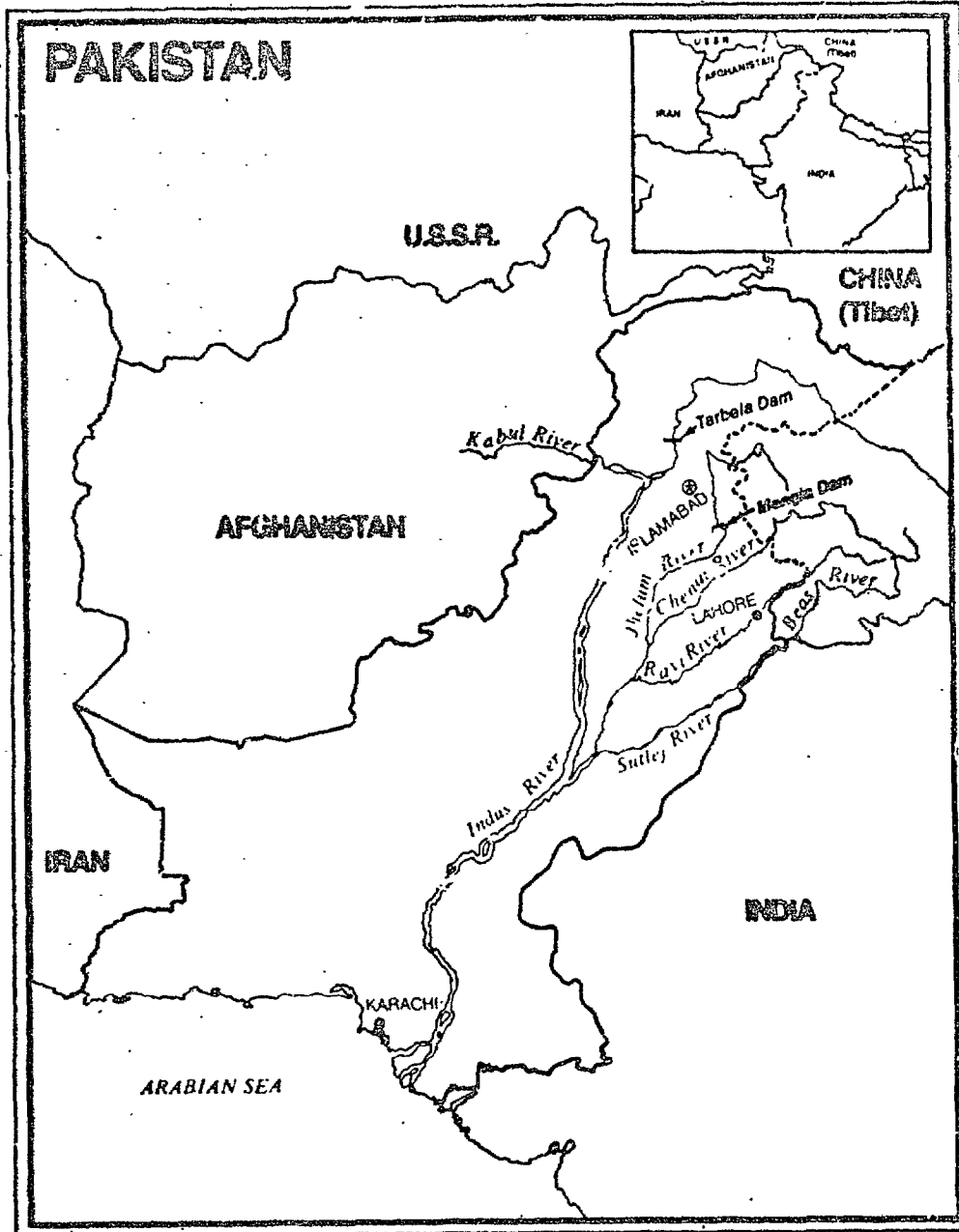
Pakistan has adequate natural resources, except oil and coal, to develop a viable economy. Sufficient revenues, however, have not been generated through taxes, other domestic savings, and foreign trade to finance development at a desirable rate. Consequently, Pakistan has relied heavily on foreign assistance, and more than \$9.8 billion has been provided in the form of grants and loans through June 30, 1974 (see app. I). The U.S. share has been almost \$4.9 billion (see app. II).

Economic data prepared by the Agency for International Development (AID) Mission indicates that Pakistan's

- population has been increasing rapidly,
- underemployment is high and literacy is low,
- crop yields and annual incomes remain among the lowest in the world,
- inflation has been running between 20 and 30 percent,
- poor health conditions still exist and diseases such as malaria are again nearing epidemic levels.

Recent economic growth has had better than a 6-percent annual increase in gross national product, but the estimated annual 3-percent population increase has negated its economic benefits. Per capita income only increased from about \$100 in 1973 to \$103 in 1974.

Pakistan considers China to be its best friend because of China's military, political, and diplomatic support, and good relations with China are an essential element of Pakistan's foreign policy. In recent years, Iran has



substantially increased its support to Pakistan, and relations between the two have improved. Pakistan's relations with other oil-producing export countries are also good, and it maintains a basic relationship with Russia.

Pakistan's relations with Afghanistan and India, however, have been complicated by longstanding controversies, skirmishes, and wars. Recent conventional military equipment additions by India and Afghanistan and India's explosion of a nuclear device on May 18, 1974, are of major concern to Pakistan Government officials.

The United States is concerned for Pakistan's well-being and security as well as for overall stability on the subcontinent. The Indo-Pakistan war, which began in September 1965, led to a U.S. policy of not selling lethal equipment to either country. India has continued its military development by turning to Russia. In February 1975, the United States informed the governments of India and Pakistan that it had ended its embargo on the export of lethal military equipment and had effected a new policy of considering requests for arms exports for cash on a case-by-case basis. The State Department emphasized that this is a cash-only policy and that no equipment will be provided through grant military assistance or on credit. State also indicated that sales which will affect the overall strategic balance would not be in the interest of the United States.

POLITICAL AND ECONOMIC CONDITIONS

Zulfikar Ali Bhutto, leader of the majority Pakistan People's Party, gained control of the government on December 20, 1971, after the military defeat in East Pakistan and cease-fire with India. For the next several months, President Bhutto, continuing to govern under martial law, tried to bolster the morale of the Pakistanis, who were shocked by the military defeat and loss of half their nation. Numerous military leaders were dismissed, several social and economic reforms were enacted, and the civil service was purged of alleged corrupt elements. Bhutto, under increasing pressure to return to democratic rule, convened the first directly elected national assembly and lifted martial law. A constitution was adopted in August 1973. The subsequent naming of Bhutto as Prime Minister of Pakistan's democratically elected majority party ended 16 years of military rule.

The platform of the Pakistan People's Party called for a mixed economy, with many industries being nationalized and only minor industries continuing in the hands of private enterprise. This platform was an attempt to eliminate the

exploitation of the masses by a small group of energetic businessmen, generally known as "the 22 families," who had long controlled a vast majority of the nation's heavy industry.

Economic conditions rebounded quickly after the war. New markets were found for commodities that previously had been shipped to East Pakistan. The economy was growing at an impressive 7-percent rate when, in August 1973, the worst floods in the century inundated more than 10 million acres and 10,000 villages.

Total damage was estimated at \$600 million, with crop damage of \$475 million. The United States provided about \$76 million to help Pakistan recover from this disaster. Despite the flood damage, Pakistan estimated that the gross national product still would increase by 5 percent. More recent unofficial estimates place the fiscal year 1975 growth rate at 3 percent.

AID-TO-PAKISTAN CONSORTIUM

In October 1960 the Aid-to-Pakistan Consortium,^{1/} chaired by the International Bank for Reconstruction and Development (World Bank), was formed for the purpose of coordinating assistance to Pakistan. Other donors include the People's Republic of China, Russia, Austria, Denmark, and several East European countries and Middle East oil producing countries.

Consortium members and Pakistan representatives meet annually in Paris to discuss the world economic situation and Pakistan's current problems as reported by the World Bank. Consortium members usually express their views about government policies affecting economic development and agree on approximate levels of assistance for the coming year. AID uses information from these discussions and from the World Bank in developing bilateral U.S. assistance programs for Pakistan.

The Consortium does not formally assign development areas to specific member countries, but some informal specialization does exist. There is an understanding that some countries have a "comparative advantage" in certain areas--that is, they have experience and capabilities to

^{1/} Consortium members include Belgium, Canada, France, the Federal Republic of Germany, Italy, Japan, the Netherlands, Norway, Sweden, the United Kingdom, the United States, World Bank Group, Asian Development Bank, Ford Foundation, and United Nations.

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better assist Pakistan in specific areas. For example, the United States is specializing in agriculture. There is general agreement that countries will not unilaterally develop new programs in the specialized areas of other countries.

In previous years, AID directed a large percentage of its programs in Pakistan toward industrial development, and an extensive pipeline of unexpended funds still remains to support this sector of the economy. In keeping with the congressional mandate stated in the Foreign Assistance Act of 1973, AID has attempted to redirect its program emphasis to benefit the poorest majority and has emphasized agricultural productivity and population and malaria control programs.

CHAPTER 2

EXTERNAL DEBT RELIEF

The Government of Pakistan announced in April 1971 that it could no longer service all its external debts. The debt total had reached \$4.6 billion, fourth highest among developing countries ^{1/}, and Pakistan had the highest debt to gross national product ratio among the 13 countries having the largest external debts.

In 1972 and 1973, the Aid-to-Pakistan Consortium agreed to reschedule part of the debt to help relieve some of Pakistan's repayment problems. However, as debt problems continued to increase, additional rescheduling became necessary and each Consortium member agreed in June 1974 to reschedule some of the debt owed to it.

The need to reschedule debt has been attributed mainly to the 1971 war with India and its effects. However, despite this war, two basic long-term problems leading up to the need to reschedule debt were Pakistan's reluctance to make timely economic reforms proposed by the Aid-to-Pakistan Consortium and its increasing reliance on hard-term borrowing to finance economic growth. Although some reforms were adopted, such as the important 1972 currency devaluation, some basic problems still exist and continue to contribute to Pakistan's debt problems.

DEFAULT AND DEBT RELIEF

Before 1960 most foreign assistance from all sources was in the form of grants or grant-type assistance. During the 1960s the volume of foreign assistance increased, but its composition changed to mostly loans and credits repayable in foreign exchange. During 1960-65, grant-type assistance declined to 21 percent, and during 1965-70 it declined to 9 percent. This changing form of assistance reflected the general pattern of U.S. assistance to developing countries during the 1960s.

The impact of the switch to loans was not felt immediately because of the grace periods provided. In the mid- and late-1960s, when grace periods on a number of loans were

1/ Due to loan deobligations, partial cancellations, early repayments, and other actions, precise figures on outstanding debt are not readily available.

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expiring, debt service payments increased at an accelerating rate and, since fiscal year 1961, have grown at an average rate of 27 percent a year.

The average debt service ratio to export earnings during 1960-65 was only 9.5 percent, but by 1969 the ratio had reached 23.3 percent of export earnings, well above the 20-percent level generally considered dangerously high. The debt service ratio continued to climb until it reached a high of 34.5 percent during Pakistan's 1971-72 fiscal year. During fiscal years 1969-72, when the debt service to export earnings ratio was considered dangerously high, the United States loaned Pakistan an additional \$471 million. This was done despite the fact that, on the basis of an analysis of debt service to earnings ratio, Pakistan's ability to repay its current debts was questionable. We found that AID requests for loan funds during these years did not take into consideration Pakistan's precarious financial position nor discuss Pakistan's debt problems or the fact that it may be unable to pay the loans.

The 1971 civil war between East and West Pakistan, which culminated in the creation of an independent Bangladesh, caused a new debt problem for Pakistan. It was evident that, although Pakistan was legally responsible for the total debt, an equitable procedure needed to be worked out to divide the debt between the two countries.

In April 1971, shortly after the beginning of the civil war, Pakistan selectively stopped payments on about two-thirds of its foreign debts because the burden on its limited foreign exchange had become intolerable. Generally, Pakistan defaulted on debts contracted within the Consortium group and continued to pay debts contracted outside the Consortium and to non-Consortium, hard loan, creditors. Some Chinese and Swedish non-Consortium loans were subsequently converted to grants.

In April 1972, after the civil war and the war with India had ended, the Aid-to-Pakistan Consortium agreed to postpone about \$234 million in debt service payments over a 26-month period ending June 1973. The U.S. share of this debt relief amounted to \$51.2 million. This first temporary debt rescheduling agreement, retroactive to May 1971, relieved Pakistan of responsibility for the default. It also gave Pakistan and Bangladesh reasonable time to divide the disputed debt between them. Meanwhile, Pakistan agreed to continue servicing the entire debt. After a year, no progress had been made on the debt division and a second short-term rescheduling of \$107 million extended relief to June 30, 1974. To avoid inflicting an inequitable penalty on Pakistan, the Consortium agreed that Pakistan need not continue to make payments after June 30, 1974, for debts

attributable to projects located in Bangladesh. The Consortium said it would study the long-term debt problem and the division between Pakistan and Bangladesh, with the objective of providing a more permanent solution.

Payments postponed by the first two short-term agreements were rescheduled over 1973 through 1977. These postponed payments, plus payments normally due during that period, created an unserviceable repayment burden. After receiving the study of Pakistan's long-term debt problem from the World Bank staff, the Consortium and Pakistan began negotiations to seek a long-term solution to the problem.

Most Consortium members, including the United States, were opposed in principle to debt rescheduling. They agreed to it, however, because of their continuing interest in Pakistan's development and to avoid total default and allow for extenuating circumstances. There was general agreement that Pakistan, a country cut in half, was in a unique situation and that some relief would be needed on concessional terms. On June 28, 1974, the Government of Pakistan and members of the Consortium agreed to reschedule \$650 million on terms reflecting an average grant element of 62 percent. Each Consortium member's rescheduled share was determined by its share of Pakistan's debt to the whole Consortium. The U.S. share, about \$210 million, was to be provided by rescheduling AID loans only.

Little specific information was available on the terms of debt relief provided by non-Consortium creditors, but officials we contacted believe they provided equal or more generous debt relief. China, for example, changed outstanding loans of \$110 million to grants.

SUGGESTED ECONOMIC REFORMS NOT ADOPTED

The Government of Pakistan was concerned with its external debt problems as early as 1968 and requested long-term relief from the Consortium. The changing composition of capital inflows, uneven growth of export earnings, and budget management problems affected the country's ability to continue paying principle and interest on its debts.

The Consortium did not provide any debt relief in response to Pakistan's 1968 request; instead it recommended reforms in fiscal and monetary policies, exchange rate systems, and investment policies to correct the deteriorating economic situation. Certain individual reforms in each area were adopted, such as devaluing the rupee, abolishing the previously existing system of multiple exchange rates, and introducing measures designed to move toward a more liberal import policy.

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However, other reforms were not adopted, and thus continued economic improvement was seriously affected. Public revenue and savings are still inadequate, and the economy suffers from low investment and productivity. These latter problems were discussed in detail at the Consortium's May 1975 meeting.

Public revenue and savings

A World Bank analysis of the third development plan (FY 1965-70) showed that Pakistan had not done well in raising public revenues nor in increasing public savings to finance needed development efforts.

Pakistan's ratio of tax proceeds to gross national product grew from 8.4 percent to about 11 percent between fiscal years 1965-74. However, based on international comparisons, Pakistan's tax collections should have been at least 15 percent of gross national product. The tax structure remained inelastic by granting tax concessions to the fastest growing sections of the economy, agriculture and manufacturing. For example, much dividend income was tax exempt, tax holidays were granted on new investment, and agricultural income was not taxed. To further encourage investment, even larger tax concessions were granted in East Pakistan. There was a relative decline in direct personal income taxation.

Public savings declined from 1.8 percent of gross national product in fiscal year 1965 to 1.4 percent by 1970 and had not increased by 1974. Despite low public revenues, defense expenditures remained high, consistently equaling more than 40 percent of Pakistan's self-generated revenues.

Investment and productivity

Import controls and industrial incentives favored imports of capital equipment over raw materials, which encouraged capital-intensive methods of production. This policy minimized the use of labor, and underemployment was and still is widespread. According to AID, these problems were even more pronounced prior to the devaluation of the rupee.

A system of high tariff barriers and low import quotas created a protected domestic market. This protection attracted investment to import-substitution industries rather than to export industries which must survive in the highly competitive international market place. Tax-sheltered investments could earn handsome returns in the domestic market without maximizing production. The bias against raw material imports also inhibited full use of manufacturing capacity.

Another serious pre-1971 problem, overvaluation of the Pakistan rupee, has since been solved. Policy changes also were made in other areas, such as the elimination of some foreign trade regulations which had caused an imbalance of investments.

FINANCING GROWTH WITH
HARD-TERM BORROWING

During the 1960s, with debt service payments rising steadily and availability of concessional assistance leveling off, Pakistan borrowed more on hard terms. Creditor countries generally recommended that hard-term loans should be no more than 20 percent of total borrowing. During the 1950s, hardterm borrowing averaged 23 percent; from 1961 to 1965 it totaled \$754 million, or 32 percent; and from 1966 to 1970 it increased to more than \$1 billion, or 39 percent of total borrowing.

In July 1972 a senior official in Pakistan's Ministry of Finance listed "unbridled growthmanship" as one of the basic causes of balance-of-payments problems, stating that:

"* * * too high an investment level has been planned relatively (sic) to domestic savings, financed mainly by increasing resource to foreign aid. * * * Failing an inflow of aid on such a massive scale, our export effort will become practically mortgaged to servicing and repayment of foreign debt. * * * Foreign aid-financed growth has had another unfortunate effect insofar as it compromised the domestic savings effort. * * * It also follows that if a more intensive effort had been made to mobilize domestic resources * * * an equally high investment rate would not have put as much strain on the balance of payments."

AID agreed that Pakistan had attempted to continue its rapid economic growth with external assistance when the borrowing terms were too hard. Although we believe this course of action prejudices future repayment prospects, AID explained that:

"Pakistan, it seems to us, had no practical alternative option. A deliberate slowing down of the nation's development, and the continuance of its peoples' poverty because of the unavailability of external assistance at more reasonable terms is simply not an available option for a government dependent upon public support."

AID did inform the Government of Pakistan that, if a future debt problem was incurred by reason of borrowing on short and hard terms from oil-producing export countries or other sources, recourse for relief would have to be those sources and not the United States or other creditors who provided concessional assistance.

CURRENT DEBT SITUATION

Pakistan's debt burden remains heavy, and debt re-scheduling has not solved its financial problems. Increased prices of such essential imports as petroleum, fertilizer, and food grains will reduce the foreign exchange available for debt repayment and development. Commitments of new assistance have increased, but the terms have not softened.

Many serious economic problems have not been resolved. For example:

- Tax collections, although increasing in absolute terms, are projected to decline in terms of gross domestic product and to remain well below the median for developing countries.
- Private investment in large scale industry has not recovered from the effect of the recent nationalizations and the excess manufacturing capacity created during the 1960s. Recent indications are that some of this investment has been redirected to light industry.
- Some government policies do not provide incentives needed to improve agricultural productivity.

These and other current problems and prospects are discussed in more detail later.

Several oil-rich countries loaned Pakistan \$700 million in 1974 to help offset increased prices of oil imports. Most of these loans are at low interest rates, have a few years of grace, and have repayments terms ranging from 8 to 30 years. In contrast, AID loans are to be repaid over 40 years. Pakistan has had to borrow more than \$200 million from the International Monetary Fund on a short term basis. Although these inflows of new assistance will help to finance rising import costs and will further stimulate economic development, the relatively short repayment periods will soon affect Pakistan's balance of payments.

It has been estimated that the annual payments on Pakistan's external debt, even after rescheduling, will

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almost triple from 1975 to 1980, from \$203 million to \$581 million. To maintain a 20-percent debt service ratio, therefore, Pakistan's export earnings must more than double in just 5 years--a growth rate of almost 18 percent a year. Since exports increased only by an estimated 15 percent during fiscal year 1975, Pakistan could fall short of meeting an acceptable growth rate, which will affect its ability to maintain the desired debt service ratio.

Pakistan's exports largely depend on cotton (raw, yarn, and textiles) and rice. While AID Mission officials agree that the debt service ratio may again exceed 20 percent, they are optimistic that Pakistan's export earnings will grow sufficiently in the long run to meet debt repayments. They said that the ability to repay is a factor in AID's lending decision and is reviewed by the development loan committee before approval.

Although the AID Mission is optimistic that Pakistan's export earnings will grow, there is no guarantee, even with Consortium nations, that Pakistan will have access to sufficient markets to make this a realistic goal. Perhaps the time has come for the world community to provide increased markets for nations such as Pakistan in lieu of the temporary help provided by direct assistance. As part of this consideration, Pakistan would, of course, have to show more progress toward instituting economic reforms.

CONCLUSIONS

There is no question that the 1971 hostility with India contributed to Pakistan's debt problems. In our view, however, more basic factors which are subject to resolution, were Pakistan's (1) need to adopt reforms, such as fiscal and monetary policies, revenue collection, and investment policies proposed by the Aid-to-Pakistan Consortium and (2) increasing reliance on hard-term borrowing to finance economic growth. Unless appropriately dealt with, these factors may create the need for future debt relief and further debt rescheduling. Furthermore, Pakistan will need to increase its exports so that sufficient foreign exchange is available to pay for imports essential to expand its production and to service its debt.

Although Pakistan did not adopt needed reforms, the United States rescheduled the payments of debts owed the United States. The United States has little to say regarding how Pakistan uses its foreign exchange, and thus Pakistan was able to use foreign exchange to the extent it remained available by this rescheduling for whatever purposes it deemed appropriate. We recognize that section 17 of the Foreign Assistance Act of 1973 (Public Law 92-189, Dec. 17, 1973)

contains comprehensive reporting requirements to keep Congress informed of executive activities on foreign debts owed the United States, but such rescheduling is not subject to the constraints and restraints of the Act. AID has not quantified these amounts in its Congressional Presentation Books nor attempted to reach agreement with Pakistan on the use of those funds remaining available through debt rescheduling.

AGENCY COMMENTS

The Department of State and AID stated that debt relief is a unique financial arrangement, involving complicated relationships between the United States and other creditor countries, and designed to enhance the overall U.S. creditor position. Their position was that debt relief should not be equated with aid, since the rescheduling only constitutes temporary acquiescence in nonpayment of resources the debtor does not currently have. Accordingly, they believe that debt relief is neither a method of avoiding budgetary appropriations nor a policy instrument for providing development assistance.

We believe, however, as stated in two previous reports to Congress (Developing Countries External Debt and U.S. Foreign Assistance: A Case Study, B-177988, May 11, 1973; and United States Economic Assistance to Turkey, B-125085, Sept. 16, 1974), that debt relief provides resources to assisted countries. Our position is based on the fact that foreign exchange initially obligated for repayment of debts, then freed through debt rescheduling, becomes available to pay for needed imports.

RECOMMENDATIONS

We recommend that:

- The Secretary of State and the Administrator of AID reassess the level of assistance to Pakistan in view of the debt relief being provided and Pakistan's need to resolve basic factors contributing to continuing debt problems.
- The Administrator of AID, as part of the annual budget justification, fully inform Congress of the debt-servicing problems and quantify the assistance value of debt relief granted.

As an alternative to direct assistance, which often provides only short-term remedies, the Secretary of State might well pursue the granting of preferential trade arrangements to ensure increased markets for Pakistan's goods if agreement can be obtained from other nations to do likewise.

CHAPTER 3

ECONOMIC PROBLEMS AND PROSPECTS

If Pakistan's economy is to progress and its quality of life improve, U.S. bilateral efforts to help its people must be matched by a full commitment from its government. In our view, the U.S. agencies that administer assistance to Pakistan have not obtained this commitment.

Agriculture is by far the largest sector of Pakistan's economy. Both AID and the Government of Pakistan have made self-sufficiency in food grains, especially wheat, a top development priority. AID stated that one of the central purposes of U.S. assistance to Pakistan is to encourage and assist Pakistan in significantly increasing its food production. In this way, AID hopes to provide the benefits of development to Pakistan's most disadvantaged people, who have been virtually isolated from past economic progress. Increased production of cotton and rice, Pakistan's principal exports, is another major goal for alleviating balance-of-payments problems.

Despite the importance of agriculture in Pakistan, yields of major crops are among the lowest in the world and food self-sufficiency is still years away. Agriculture problems--especially the lack of water and fertilizer--government price control, nationalization, and tax policies have combined to limit economic growth. In addition, increasing oil prices have contributed to large balance-of-trade deficits and have prompted Pakistan to accept relatively short-term loans from oil-producing nations. A side effect of the worldwide petroleum shortage has been an accelerated search for oil in Pakistan.

Although many economic problems still exist, Pakistan has taken certain actions to overcome these problems. It has recently initiated reforms in agriculture and farmer credit, and there has been some acceleration of public and private investments. Pakistan has strengthened its economic ties with the Middle East oil-producing countries and its trade ties with India. Also, there appears to be some prospect for a slowdown in the inflation rate.

In addition to all the pressing civilian requirements, Pakistan's military expenditures, while declining as a percentage of gross national product, are still estimated at nearly 45 percent of domestic revenues. These military expenditures have drained scarce internal resources and have been a significant deterrent to further economic development.

For fiscal year 1975, AID requested \$56.3 million, about 71 percent of its total request, for food and nutrition projects in Pakistan. We believe, however, that AID's assistance in this critical area cannot be fully effective until the Government of Pakistan revises its economic policies to encourage expanded domestic production.

DEFENSE SPENDING

Fiscal year 1975 defense spending was budgeted at 5.58 billion rupees (\$564 million at current exchange rate), or about 45 percent of estimated domestic revenues. This detracts from funds needed for the long-term development of Pakistan's natural resources.

Immediately after 1965, defense expenditures were as high as 75 percent of domestic revenues. Although this extremely high rate of military spending decreased after 1971, the overall trend of military spending has steadily increased during the past decade and has been in excess of 40 percent of annual domestic revenues. Pakistan's position is that high military spending is needed since it feels threatened by the unrest along its border with Afghanistan and the military buildup within that country.

Although continuing to comprise a large portion of domestic revenues, identifiable defense expenditures have declined in recent years, to 6 percent of gross national product and 24 percent of total government spending. Nevertheless, U.S. economic aid makes a higher level of defense spending possible to the extent that it frees Pakistan's own revenues for these purposes.

In this regard, section 620(s) of the Foreign Assistance Act stipulates that to restrain arms races and proliferation of sophisticated weapons and to insure that resources intended for economic development are not diverted to military purposes, the President, before furnishing any economic assistance to that country, shall take into consideration (1) a recipient country's percentage of budget devoted to military purposes, (2) its use of foreign exchange to acquire military equipment, and (3) its purchase of sophisticated weapons systems.

Although AID's loan proposal documents contained a brief statement intended to satisfy the requirements of section 620(s), AID and U.S. Embassy officials told us they were unable to analyze in detail the percentage of Pakistan's budget spent for military purposes; the amount of its foreign exchange spent for military equipment; and, in some cases,

the type of hardware acquired. Embassy officials said that defense expenditures were probably much greater than reported by the Pakistan Government. For instance, expenditures for military equipment and construction of defense facilities are not identified in Pakistan's budget presentations. According to Embassy officials, military expenditures are very closely guarded secrets within Pakistan's Government.

Pakistan has paid cash for certain nonlethal military equipment from the United States and would like to buy sizable quantities of lethal equipment. However, because of Pakistan's involvement in wars with India, U.S. policy had prohibited sales of lethal equipment to both countries. Consequently, Pakistan turned to European countries to purchase some lethal equipment it wanted to modernize its forces.

In February 1975, the United States informed the Governments of India and Pakistan that it was ending its embargo on the export of military equipment to them and was putting into effect a policy of considering requests for arms exports for cash on a case-by-case basis. The State Department indicated that, in making this modification, U.S. policy was being brought into line with that followed by other major Western arms suppliers, such as the British and French. It emphasized that this was a cash-only policy and that no equipment would be provided through grant military assistance or credit.

In weighing any individual export request, a number of factors will be taken into account, such as the (1) high importance attached to continued progress toward India-Pakistan normalization, (2) effect of any particular sale on the outlook for regional peace and stability, (3) relationship between U.S. sales and those of other external arms suppliers and (4) relationship of the request to legitimate defense requirements and level of armaments in the region.

The Secretary of State said that the United States has no interest in upsetting the strategic balance on the subcontinent or in resuming its pre-1965 role as a major arms supplier to the region. The United States attaches the utmost importance to continued reconciliation between India and Pakistan and will do all it can to encourage that process.

Because information on Pakistan's military spending was not available to us, we could not fully evaluate the impact of these expenditures on its economic growth. Nevertheless, evidence indicates that these expenditures are significant, and U.S. officials generally agreed that

they do affect economic development. It appears that the policy of expanded sales of military equipment and the costs associated with operating and maintaining this equipment would contravene U.S. objectives for Pakistan's economic development by diverting even more of Pakistan's scarce resources to defense spending. We believe that this defense spending and its impact on the amount Pakistan has available to develop its economic resources should be fully analyzed in approving the sale of any military equipment to Pakistan and should be considered when determining the amount of economic aid to be provided.

AGRICULTURAL PRODUCTION

To achieve its agricultural goals, Pakistan must drastically increase the productivity of its existing farmland. AID has estimated that acreage yields for major crops could easily double with improved farming techniques, better use of water, and more fertilizer application. A comparison between Pakistan and Egypt--which relies on the Nile River irrigation system much as Pakistan relies on the Indus--shows that Pakistani farmers produce less than half as much wheat and cotton and only a third as much rice and maize per acre as their Egyptian counterparts. AID, the World Bank, and the Government of Pakistan all agree that the country has the natural resources to reach higher productivity levels.

Waterlogging and salinity on Pakistan's irrigated lands, which comprise 75 percent of all farmland, have seriously hampered agricultural productivity for more than 20 years. Nearly \$186 million, including about \$70 million in AID loans, has been spent to control these problems. About 3 million acres of land have been reclaimed, but an estimated 100,000 acres continue to be lost to the twin menaces every year.

Fertilizer use, virtually unknown in 1960, has increased tremendously in the past 10 years but is still well below levels recommended for peak productivity. Despite deposits of natural gas, the raw material for nitrate fertilizers, domestic production has not expanded to meet the rising demand, and Pakistan is importing \$120 million worth of fertilizer in fiscal year 1976. AID's willingness to loan money for fertilizer imports--a total of \$116 million since 1965--and its inability to convince the Government of Pakistan to move rapidly in expanding domestic production capacity have contributed to the problem.

In the mid to late 1960s, worldwide fertilizer prices plummeted. Many producers dropped plans to add further

capacity, and in some cases construction was halted. Subsequently, widespread droughts in the early 1970s stimulated many countries to begin importing fertilizer at record levels as they tried to rebuild agricultural production.

Water management

Less than 39 million acres, about 20 percent, of Pakistan's land area are suited for agriculture. Of this amount, 33 million acres depend on the world's largest continuous irrigation system in the Indus River Basin. Some 38,000 miles of canals and channels, mostly constructed by the British in the late 1800s, supply needed water to a country having an average rainfall of less than 10 inches. (The average annual rainfall in the wheat-growing region of Kansas is 28.4 inches.) However, the canal system has brought about Pakistan's major agricultural problems--waterlogging and salinity. Moreover, damage during construction to the world's largest earthfilled dam at Tarbela deprived the irrigation system of a huge supply of water for the 1974 winter season, when a serious drought threatened farming throughout the country.

Waterlogging and salinity

The Government of Pakistan estimates that waterlogging and salinity reduce agricultural output by at least 20 percent and cause about \$252 million in losses to the economy yearly. These losses occur because of improper water management on the farms and because the system of canals and channels is old and in disrepair. Studies show that about 75 percent of the water entering the canal system is lost through (1) seeping into the ground because the channels are generally unlined, (2) spilling over the top, or (3) being wasted in the fields. Over the years the water wasted has raised the ground water level, causing swampy conditions known as waterlogging in many farming areas.

Salinity is closely related to waterlogging. Even when the water table is about 10 feet below the surface, the natural salts in the soil are dissolved in the water and drawn up to the surface by evaporation. Crops like wheat and cotton cannot prosper under these conditions.

These problems have been recognized for years, and, even before independence, Pakistan's Government agencies were studying possible solutions. In 1964 a team of U.S. experts outlined a program of ground water pumping and drainage to fight waterlogging. A series of salinity control and reclamation projects was planned for constructing tube-wells, pumps, and drains.

These ambitious plans were seriously cut back by Government of Pakistan budget constraints. An AID official indicated that large expenditures for the Tarbela Dam made it difficult to fund the projects. Rising defense expenditures following the 1965 War with India may also have been a factor. An estimated 3 million acres of land were reclaimed through the construction of about 5,000 tubewells. AID officials considered this a commendable accomplishment, but it was far short of government targets.

The government recently proposed a massive new salinity control and reclamation program to continue tubewell and drain construction, at an estimated cost of \$541 million over the next 11 years, to reclaim 14 million acres of affected land. A second phase of the proposal would continue for an additional 15 to 20 years and would cost almost \$1 billion to completely control waterlogging and salinity.

AID has indicated that it will not participate in this program, because it does not believe the program will directly benefit the poorest people in the economy and because there appears to be sufficient donors to finance the program. Instead, the AID Mission has proposed an \$11 million loan for fiscal year 1976 to level land and line water channels, which AID believes will not only combat waterlogging and salinity but will also reach small farmers and rural communities more directly. AID has been studying these approaches and operating a demonstration project for several years. It is not certain of financial or political cooperation from the Government of Pakistan, but Mission officials expect some financial provision in the next Five-Year Plan (fiscal years 1976-80).

AID officials pointed out that these two approaches are complementary. Salinity control and reclamation programs are remedial, lowering the already high water table; and land leveling and watercourse lining are preventative, slowing the waterlogging process by increasing irrigation efficiency. Despite this direct relationship, the two programs were developed separately, and no study has been made to determine whether available resources will be allocated to each approach on the most cost-effective basis.

The size and significance of the waterlogging problem require concentration of financial, technical, and political resources. We do not question the merit of either AID's or the government's approach, but we believe they should work together to establish an overall water management program incorporating tubewells, drainage, land leveling, and watercourse lining.

Tarbela Dam

Pakistan experienced its worst drought in history during 1974. AID officials estimated that only about two-thirds of the normal water supply would be available for irrigation. The new Tarbela Dam was to have been ready to supply the 1974-75 winter wheat crop and would have compensated for much of the shortage. The \$1 billion dam (U.S. share about \$200 million) was completed in July 1974, but damage to one of the tunnels caused officials to empty the reservoir to make repairs.

AID officials estimated that Tarbela could have supplied enough water to increase the 1974-75 wheat crop to 9 million tons. Instead, if the drought continues, Pakistan's wheat production could fall as low as 7 million tons--0.6 million tons less than in 1973-74. As a result, Pakistan must import about 2 million tons of wheat in fiscal year 1976 to feed its people. AID has been asked for 1 million tons of wheat under Public Law 480 to help meet the shortfall, which could cost \$300 million.

The Tarbela accident is being investigated by the World Bank, the Pakistan Government, and dam experts from around the world. AID officials stated that the causes of the accident and the responsibility for financing repairs will be determined in the course of processing the insurance claims.

The World Bank has estimated repair costs at \$70 million and asked the United States to contribute \$10 million. On May 23, 1975, AID notified the cognizant congressional committees that it intended to use fiscal year 1975 funds for the \$10 million contribution. However, in response to a request from the Chairman, Senate Appropriations Subcommittee on Foreign Operations (B-173651, June 25, 1975), GAO said that this would be an impermissible use of these funds. Therefore, AID has requested that fiscal year 1976 funds be provided for this contribution.

Fertilizer use

Pakistan's fertilizer use has increased sevenfold since 1966. AID reports, however, that currently only about 20 nutrient pounds of fertilizer are used per cultivated acre. Improved varieties of wheat and rice can use as much as 150 pounds for optimum production.

Much of the increased demand for fertilizer has been met from imports, and the gap between local production and demand is widening. AID's attractive loans for

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fertilizer imports lessen pressure on Pakistan to expedite expansion of domestic production. An AID official stated, however, that this short-term lessening of pressure has been countered by a need to increase spending of Pakistan's own foreign exchange on food and fertilizer.

Two new fertilizer factories have been built since the mid-1960s, one substantial expansion is currently underway, and arrangements are being completed for two additional plants. However, construction has been delayed by political and financial problems. Moreover, in 1973, distribution of fertilizer was nationalized in the important Punjab Province and optimum use of available supplies has since been impeded. Demand has also fallen due to inadequate water supplies and other factors.

Imports

From 1965 to 1974, Pakistan's fertilizer consumption increased from 70,000 to about 400,000 nutrient tons a year. Domestic production expanded but did not keep up with the rapidly increasing demand. As a result, Pakistan imported more than 1 million nutrient tons of fertilizer valued at an estimated \$214 million, financed in part by AID loans totaling \$116 million or 54 percent of the total. Since 1971, AID's share of Pakistan's imports has been about 26 percent.

This reliance on imported fertilizer occurred despite the fact that Pakistan has large deposits of natural gas which could make the country self-sufficient in nitrate fertilizer, the major type used there. Known gas reserves are capable of serving several additional plants.

Until the last few years, fertilizer prices were relatively low and production worldwide was well below capacity. Investment in fertilizer plants was not considered especially lucrative until the worldwide petroleum crisis led to a shortage of fertilizer and dramatic price increases.

AID officials acknowledged their dissatisfaction with the rate at which new-construction decisions have been made. In 1970, for example, the government was considering three new plants, but donors and investors thought the market warranted only two. Events have proved the government right, but the perceptions of that period caused two of the plant proposals to be withdrawn.

AID told us that fertilizer loans were necessary to help stimulate demand for fertilizer and to increase agricultural

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production. It said that the political difficulties of the early 1970s and the time lags between planning a plant and getting it operational were probably the main reasons for failure to expand domestic capacity.

Nevertheless, the concessional AID loans at 2- or 3-percent interest, 10-year grace periods, and repayments over 40 years made it easier for the Government of Pakistan to import fertilizer rather than aggressively pursuing and encouraging investment in domestic production.

Domestic production

AID has also contributed the local currency equivalent of \$9.6 million to help finance construction of two fertilizer manufacturing plants. The two plants, along with the expansion of another now underway, could increase domestic capacity by two or three times the current 300,000 nutrient ton output and significantly reduce Pakistan's reliance on imported fertilizer.

One of these plants was to be financed in part by an AID loan of \$35 million, with initial proposed ownership by the Fauji Foundation of Pakistan and U.S. Steel. However, U.S. Steel recently decided to withdraw from the project. The history of the Fauji plant illustrates some of the problems that have hampered expansion of Pakistan's fertilizer capacity.

The Fauji Foundation began planning construction of a fertilizer plant in 1972. It contacted the International Finance Corporation, which offered support and recommended that the plant be owned in part by an established foreign firm which could lend management and technical expertise. Late in 1973 the International Finance Corporation learned that U.S. Steel was willing to consider the venture. AID had been approached earlier in 1973 for financial support. The projected construction cost at this time was about \$140 million.

Fauji and U.S. Steel called for lump-sum construction bids in March 1974. However, by June 1974 only one of eight firms solicited had returned a bid and it was about double the original estimates. No decision was made until September, when U.S. Steel agreed to reject the bid and try instead for a cost-plus-fixed-fee contract.

Still other problems remained. First, the Pakistan Government had to assure the partners that the Fauji plant would have priority access to the natural gas fields needed to supply raw materials for production. This was finally done early in November. Second, U.S. Steel's demands for certain assurances and concessions from the government

had to be met. These were submitted in March 1974, and the government did not respond favorably until December.

Subsequently, U.S. Steel withdrew from the project and the Government of Pakistan requested an AID loan of \$40 million for a Fauji-Agrico fertilizer project estimated to cost \$246.7 million. The project will be 30 percent owned by the Fauji Foundation of Pakistan and 30 percent by the Agrico Chemical Company of Tulsa, Oklahoma. The remaining 40 percent will be held by the Pakistan public, the International Finance Corporation, and foreign investors. The plant will have an annual rated capacity of about 244,000 tons of nitrogen and is to begin commercial production in May 1979.

AID officials acknowledged that preparation of the Fauji project had taken longer than expected. They said, however, that the problems should be solved and pointed out that several smaller plants were being considered and could be in production by 1980.

Distribution

In October 1973, the government of Punjab Province-- which has the most farmland and production--nationalized fertilizer distribution, abandoning what AID considered an effective, prospering private system with more than 1,800 retail outlets and drastically reducing the availability of fertilizer in the province. AID estimated that this action, which apparently was taken partly to control smuggling and black-marketing of fertilizer, resulted in farmers using as much as 50,000 nutrient tons less fertilizer than they would have under the former distribution system. This translates to about 500,000 tons (about \$100 million) of wheat which could have been produced in 1973-74.

AID helped to influence the Punjab Province Government to retreat from its original strong stand, and 1 year after the action about 600 private outlets were selling fertilizer in Punjab, along with an additional 600 nationalized outlets. AID pointed out, however, that this number is still well below the optimum; currently, there is one outlet for every 5,000 farms in the province and AID recommends that there be one for every 200 to 300 farms.

GOVERNMENT POLICIES

Even if Pakistan's water and fertilizer problems were solved, economic progress would still be impeded by current government policies. Price and marketing controls and other government policies, together with the availability of

Public Law 480 commodities, have combined to hinder agricultural expansion. Pakistan's inelastic tax system provides too little public revenue for development projects. Moreover, nationalization of basic industries has contributed to declining domestic investment.

The economic policies adopted by the government tend to be politically popular and often have short-run benefits. In the long-run, however, some changes in these policies are necessary for Pakistan to reach its full development potential. In commenting on our report, AID stated that current policy discussions focus on steps which need to be taken in time to influence the farmers' decisions prior to the next planting season.

Agricultural output

Pakistan has the climate, soil, and water resources to increase agricultural productivity. However, some government policies act as disincentives for farmers, and Pakistan must continue to import food. It will import at least an estimated \$558 million worth of food and fertilizer in fiscal year 1975. These imports drain Pakistan's scarce foreign exchange and require extensive borrowing from foreign sources to meet development objectives, adding to its already serious debt situation.

Pricing and marketing controls

A goal of the Government of Pakistan is to provide inexpensive, abundant, nutritious food for the poor. However, maintaining low food prices for consumers conflicts with giving farmers the incentives to increase production. The government's involvement in pricing, processing, and marketing of agricultural products has grown over the years, and its handling of wheat demonstrates how price distortions and marketing controls discourage increased domestic production.

The government began purchasing wheat and distributing it through subsidized ration shops in response to a 1962 drought. Another drought during 1965-67 deepened government involvement, and much food was imported. The subsidy-ration shop system became increasingly institutionalized and politicized as urban populations increased. Rural areas still comprise 70 percent of the total population, but the urban consumer has become politically powerful. Low food prices for the urban consumer has been a top priority for the government; however, in April 1975, it increased the price of wheat available to consumers through ration shops by about 49 percent. The government has maintained low consumer

prices for wheat by holding its procurement price to farmers well below world market prices.

Such actions have discouraged increased domestic production. The government subsidizes agricultural inputs, such as water, fertilizer, and pesticides, for the farmer to compensate for low farm prices, but these subsidies increase total subsidy costs and only partially offset low wheat procurement prices. Because farmers don't have sufficient incentive to produce enough wheat to meet Pakistan's needs, scarce foreign exchange must be used to import wheat rather than items needed for economic development.

The World Bank has stated that eliminating or reducing price distortions could greatly improve agricultural productivity in Pakistan. The Bank's 1975 report on Pakistan acknowledged that wheat production had increased but stated that Pakistan could be self-sufficient if the government would set the price closer to world market levels. In an effort to achieve this, the government increased the purchase price of wheat harvested between March and June 1975 from \$69 a metric ton to \$100 a metric ton.

Price and marketing controls have also discouraged increased production of edible oils, livestock, cotton, and sugar cane. As a result, Pakistan has had to import large quantities of edible oils, along with wheat, as basic foods for the poor people. In fiscal year 1975 these imports will probably cost about \$446 million, more than the total foreign aid disbursements for Pakistan for 1974. We noted that recently the price of edible oil and sugar has increased significantly.

Public Law 480 imports

The Agriculture Trade Development and Assistance Act of 1954, as amended--commonly referred to as Public Law 480--authorizes grants or sales of agricultural commodities on highly concessional terms.

The stated purposes of Public Law 480 are to combat hunger and malnutrition and to encourage economic development, with particular emphasis on assistance to those countries determined to improve their own agricultural production. Section 109 directs the President to consider each recipient country's self-help efforts, specifically in establishing and maintaining government policies to insure adequate incentives for producers.

Although AID appears to be aware of many Government of Pakistan policies that do not provide adequate incentives to producers, this information is not presented to Congress. Thus, Congress may not have the necessary information to consider whether the Public Law 480 Title I program for Pakistan discourages expansion of domestic production.

The quantities of food available through the Public Law 480 program have declined in the last 2 or 3 years. However, the value of this assistance still amounts to a significant share of Pakistan's food imports and the Public Law 480 financing contains a 67-percent grant element.

Embassy and AID Mission officials agreed that, in the past, relatively inexpensive Public Law 480 imports have helped the government to maintain domestic food prices below those of neighboring countries and well below world market prices. Relatively low domestic prices for these commodities have discouraged productivity increases and prolonged the need for Public Law 480 assistance. Public Law 480 imports, in effect, subsidize the ration shop system for wheat and edible oils and the low government procurement prices that the system requires.

Other policies

AID and other Consortium donors have identified numerous other government policies and practices which are, or have been, disincentives to increased agricultural production.

- The agricultural credit system discriminates against small farmers by limiting approvals and imposing higher interest costs.
- Individual tubewell subsidies are limited to farmers having 50 acres or more, although farmers who combine acreage to share a tubewell are eligible.
- Bans on interprovincial movement of rice and vegetable oil distort market prices and encourage smuggling.
- The present distribution of land ownership and tenancy is not conducive to the pattern of intensified agriculture which must develop.
- Technology suitable for small farms, rain-fed areas, and village-level processing has been largely ignored.
- The agricultural extension service is poorly trained, apathetic, and lacks credibility and government support.

It appears that AID has established a positive and often productive dialog with the government on many of these policies and practices. Since early 1974, the government has (1) been

trying to increase the availability of credit from institutional sources to small farmers, (2) introduced a system of credit passbooks and established lending quotas for banks, (3) increased interprovincial movement of agricultural produce, and (4) shown interest in improving farm product processing at the village level and resolving fertilizer distribution problems in Punjab Province. The government is also showing increased confidence in the cost effectiveness of agricultural research by borrowing to finance research.

The AID Mission summarized its views on Pakistan's agricultural policy problems and progress as follows.

"* * * it is worthwhile considering Pakistan policies in terms of their strengths as well as their weaknesses. Over the past decade and a half Pakistan's agricultural sector has performed remarkably well. The statistics describe a doubling or better in production of wheat, rice, and cotton. While at no time during this period would an objective observer have called Pakistan's agricultural policies optimal for maximizing production, the overall environment for agricultural production must have been reasonably good to have secured these achievements."

Tax policies

Pakistan's tax policies and resulting problems are very complex. The government does not generate enough public revenue through taxes. The inadequacy of the current tax structure has been pointed out by Consortium members, and AID has reported that tax revenues recently have been as low as 11 percent of gross national product, which is low even for less developed countries. Adequate tax revenues are important to help finance needed development projects.

About 80 percent of government tax revenues are from indirect taxes, such as import-export duties and sales and excise taxes. Direct taxes, such as those on incomes and real estate, account for only a small portion of total revenues. Agricultural incomes, which have grown rapidly in recent years, are not taxed directly. Other problems include:

--Income tax exemptions. Only about 7 percent of Pakistan's households have incomes large enough to be taxed, and only 200,000 persons (less than 1 percent of the population) are paying personal income taxes.

--Tax evasion. Some industrial firms nationalized in 1972 are now paying 10 times or more the taxes paid previously because of former evasion.

--Low provincial taxes. Major sources of provincial revenue are shares of central government tax collections and loans and grants from the central government. Provinces, however, could be taxing agricultural income, urban property, and irrigation water.

The Pakistan tax structure not only provides inadequate revenues, but also tends to aggravate inflation. Indirect taxes are typically charged to the seller and passed on to the buyer in the form of higher prices. Because duties on foreign trade are the greatest source of indirect tax revenues, these duties have added to the already increasing cost of imported goods. Instead of fighting inflation by curbing consumer demand, the indirect taxes generally contribute to a cost-push effect on domestic prices. This is a complex issue, however, and the cost-push effect of indirect taxes depends on the relative elasticities of supply and demand.

Another effect of reliance on foreign trade duties as the major revenue producer is that a decline in the world price of Pakistan's exports could significantly reduce revenues. Such was the case when cotton prices fell in fiscal year 1974.

The government has generally tried to alleviate the effects of higher prices on the poor by controlling the prices of essential food goods. Nevertheless, generally rising prices mean that there are fewer and fewer nonfood items the poor can buy. Failure to tax agricultural incomes, moreover, widens the income disparity between large and small farmers.

AID and the World Bank believe a tax on agricultural incomes would be an effective way to reduce Pakistan's reliance on indirect taxes. According to AID officials, the major obstacles to enacting such a tax are political considerations. The current governing political party's support is based on the large rural agricultural population, which, of course, strongly opposes new taxes. Any solution to the problem would have to involve the complicated price control and subsidy system for agricultural products. As AID officials have pointed out, the sheer mass of the analytical problem encourages inertia.

AID officials told us that taxation is an area in which they rely primarily on the World Bank and International Monetary Fund to take the lead. They also pointed out the difficulty of equitably administering a tax system in a less-developed country, such as Pakistan.

Needed tax reforms have been recognized and proposed for some time, and the government has shown some willingness to consider changes; however, a comprehensive reform of the tax system has not been undertaken. We recognize that the whole question of income and agricultural tax policy is an extremely complex and difficult matter with which to deal. Nevertheless, tax reform is important to the economic development of Pakistan, and we believe that AID should take the lead in encouraging the Consortium and the government to undertake a comprehensive study to identify specific actions which could be taken to develop and implement a more effective tax system.

Nationalization

The current government, since taking office in December 1971, has assumed the ownership and management of 58 domestic enterprises in 11 basic industries, as well as the banking, life insurance, shipping, and cotton and rice exporting businesses. Foreign firms, except for three insurance companies, were not affected. The nationalizations, coming when the investment climate in Pakistan was already uncertain, alienated the country's private businessmen and helped to precipitate a 4-year decline in new large scale industrial investment. Although difficult to account for statistically, some increased smaller scale investment has been noted by the World Bank.

Investment in new industrial capacity is important to economic development because it creates jobs, raises the level of income, and results in greater output of goods for sale. Increasing investment indicates a vigorous, expanding economy and helps to attract private foreign investment and financing to further stimulate development. Industrial investment in Pakistan steadily declined since 1970, however, it has been projected to increase significantly in 1975. Pakistan businesses invested about the same amount in new capacities in 1973 as they did in 1964--just over 1 billion rupees. Because of inflation during those years, real investment actually declined. The government, moreover, has assumed control of about 20 percent of the industrial sector through nationalization, but public and private investment have only recently been projected to expand.

Nationalizations are not the only reason for the declining investment. Pakistan lost half its domestic market after the 1971 war, and there was excess industrial capacity as a result of investment in the late 1960s.

Nationalization actions came as no surprise to businessmen. The current government clearly stated its intentions in the election campaign of 1970. The government believed that nationalization was necessary to ensure more equitable distribution of wealth and to meet more fully the needs of the people.

Two factors, however, have led to suspicion and skepticism of the government. First, in the initial wave of nationalizations, compensation paid to the owners was considerably less than market value. This was finally changed in March 1974 and, as a result, more than half the owners have received market value. Second, in late 1973 the prime minister said there would be no more nationalizations, but on January 1, 1974, more takeovers were announced. Thus, businessmen are skeptical of an October 1974 guarantee by the prime minister that no further nationalizations will occur during his term of office.

Indications are that it will be some time before investment picks up. Businessmen--although heartened somewhat by recent cabinet changes and by a generally warmer relationship with the government--will continue to look for signs of genuine government interest in relying on private enterprise as a major factor in industrial development.

If further government actions continue to stifle private investment, Pakistan's industrial development will have to rely heavily on public-sector investments, which in turn will largely depend on foreign aid. Thus, Pakistan's nationalization policy could cause a need for more foreign aid at a time when AID is redirecting its assistance away from industrial development.

AID must recognize the right of the Pakistanis to choose their own political and economic systems, but we believe AID should encourage the government to promote a more stable economic environment, conducive to full use of domestic resources.

FUTURE ECONOMIC GROWTH

Two recent developments could have a significant impact on Pakistan's future economic growth. Both are related to the worldwide petroleum crisis and both have hopeful as well as disturbing aspects. First, the dramatic rise in oil prices has aggravated Pakistan's already serious balance-of-payments problems while at the same time touching off unprecedented widescale exploration for oil throughout Pakistan. Secondly,

Large loans from oil-producing countries are helping to offset some of the import price increases but are also adding to Pakistan's already substantial external debt.

Oil prices and domestic exploration

Pakistan produces only about 12 percent of its oil needs. In fiscal year 1973, it imported 3.03 million tons of crude petroleum and products at a cost of \$59.4 million. The World Bank estimated that in 1975 Pakistan would import approximately 3.9 million tons, 28 percent more than in 1973. However, the cost of these imports was an estimated \$286 million, or almost five times the cost in 1973. These price increases, together with increased costs for Pakistan's other imports and softening export prices, create a balance-of-trade deficit estimated at as much as \$700 million for fiscal year 1975.

When the price of crude oil rose from \$3 a barrel to more than \$11 in late 1973 and early 1974, oil companies became interested in finding new sources of petroleum. Pakistan was one of the countries chosen for intensive exploration. As of November 1974, seven foreign companies, as well as the government, were exploring large areas of the country. The government will be a partner in the ventures, sharing any profits if oil is discovered.

An official of one oil company described Pakistan as a "natural" for oil deposits. There are proven hydrocarbon deposits and large natural gas fields have been discovered as well as a small oil field. All the right geological formations are present. The country is relatively unexplored. These factors are encouraging for finding significant oil deposits.

Even if oil is found, it will take 3 years or more for Pakistan to realize the financial benefits. In the meantime, Pakistan will face a difficult balance-of-payments situation requiring large amounts of foreign assistance.

Petrodollar aid and Pakistan's debt

Pakistan is tied by religion, geography, and politics to the oil-producing states of the Middle East, so it has obtained all the oil it needs. Although the oil-producing states have not granted price concessions, several of them made loans in 1974 to help offset price increases. Iran alone will disburse \$580 million to Pakistan over the next 3 years.

These loans have been at low rates of interest, with a few years grace period and relatively short repayment periods. The Iranian loan, for example, has a 2-1/2 percent interest

rate and is repayable over 8 years, with a 3-year grace period. Pakistan has already received the first installment of \$250 million and will probably use the money to finance imports of such critical food items as wheat and vegetable oil.

While this inflow of new aid will help to finance rising import costs and to further stimulate economic development, the relatively short repayment period will place an increasing burden on Pakistan's already high external debt service. In contrast to AID loans, which typically are repaid over 40 years, these recent loans generally must be repaid in only 10 years. Estimates are that annual payments on Pakistan's external debt, even after the rescheduling, will almost triple from 1975 to 1980, rising from about \$200 million to almost \$600 million. The potential ill effect of this rise was discussed in chapter 2.

CONCLUSIONS

Although many economic problems still exist, Pakistan has recently taken some actions to overcome them. It has the resources needed to increase agricultural productivity and become self-sufficient in food production, but its agricultural productivity is among the lowest in the world. Imports of food and fertilizer in fiscal year 1975 were at least an estimated \$558 million, and its serious debt situation is being compounded by extensive foreign borrowing.

In commenting on our report AID officials stated that complex difficulties in reconciling policy goals exist for Pakistan. Nevertheless, policies adopted by the government have significantly deterred increased agricultural production and, although AID has made some efforts to obtain policy reforms, the government generally has been reluctant to adopt important changes. Government-imposed controls and policies and the federal-provincial division of responsibility discourage increased agricultural output and hamper agricultural development.

Although AID sees a shift in its emphasis in response to the 1973 congressional mandate that U.S. aid be directed to the poorest majority, we believe certain AID programs foster continuation of Pakistan Government policies which hinder agriculture production. The government imports extensive amounts of wheat, vegetable oil, and fertilizer on U.S. concessional loan terms, which tends to discourage domestic production. In chapter 2, we suggested that preferential trade arrangements to ensure markets for Pakistan's goods be pursued as an alternative to the short-term relief usually provided by direct assistance.

Agriculture productivity is also significantly affected by problems of water management and fertilizer. Waterlogging and salinity reduce agricultural output by an estimated 20 percent annually, and fertilizer use is far below necessary levels due to inadequate domestic fertilizer production and to distribution problems which limit availability.

Although we did not make a detailed analysis of Pakistan's military expenditures, they are significant and use resources that would otherwise be available for economic development. We believe Pakistan's military expenditures should be further evaluated when considering Pakistan's economic progress and U.S. contributions to it.

RECOMMENDATIONS

We recommend that, before providing concessional assistance the Secretary of State and the Administrator of AID be satisfied that related self-help measures are being carried out by the Pakistan Government and that providing such assistance would not contribute to continuation of policies which discourage increased food production. We further recommend that Pakistan's military expenditures be considered in light of this assessment of U.S. assistance.

CHAPTER 4

POPULATION-PLANNING AND MALARIA

CONTROL PROGRAMS

A serious population explosion and near-epidemic malaria conditions are impairing Pakistan's economic development. Although AID has given or loaned Pakistan more than \$72 million (excluding the former East Pakistan) for population-planning and malaria programs, stated objectives have not been accomplished primarily because the Government of Pakistan has not provided sufficient financial and political support. AID is now entering into large new programs in these areas with no assurances of continuing government support.

The population explosion has long been recognized as one of Pakistan's most serious problems. The population, estimated at 70 million and growing at a 3-percent annual rate, could reach 205 million in only 36 years. We believe that AID has entered into the current population-planning program without adequately evaluating problems of supply and distribution, personnel training, and management information feedback.

Malaria has plagued Pakistan for years. Despite extensive programs for controlling this dread disease, AID estimated that 10 million Pakistanis would have malaria in fiscal year 1975. Existing health facilities provide care for only 10 to 20 percent of the population, making Pakistan's health care among the world's worst. Previous malaria control programs were successful only while AID financing continued. Twice AID stopped financing the programs and malaria quickly reestablished itself with high incidence rates. AID is now entering a new program with little assurance that the government will provide the necessary support.

AID requested \$20 million, about 25 percent of its total budget request for Pakistan, for population-planning and health programs in fiscal year 1975. This represented a significant increase over previous years. Although the Government of Pakistan has increased its expenditures in these areas, foreign assistance continues to provide the major financial support for these programs.

POPULATION PLANNING

AID has supported a population-planning program in Pakistan since the early 1960s and has contributed about

\$45 million toward controlling the growth rate. AID officials have stated that it was not expected that the initial program would quickly result in a measurable reduction in Pakistan's rate of population growth; however, a significant beginning was made. The success of past efforts has been reduced by religious and cultural mores of the country and by government reluctance to actively promote family planning.

In September 1973, Pakistan's Prime Minister stated that no objective was more vital than population planning. Government support of population-planning concepts has improved since then, but the fiscal year 1975 allocation was still only about \$4 million. With additional support from the government, efforts by both AID and ministry officials could be more successful in controlling or reducing the population growth rate to a more acceptable level.

Conservative leaders of the Muslim religion, which is predominant throughout the country, have expressed opposition to the concept of family planning. Also, families, especially on small farms, want several sons who can help them farm and who can provide financial support in their old age. Old age security is in the minds of most heads of families, because the government has no social security system.

In 1973, Pakistan announced its expanded 5-year population-planning program. Under this plan, priority has been given to developing community-based plans for supplying and distributing oral contraceptives and condoms. Teams of village-level workers will teach families how to use contraceptives.

AID is supporting this new program with about \$16.4 million, including about \$5.8 million in U.S.-owned rupees committed in fiscal years 1973 and 1974. About \$7.4 million of this amount was included in a project agreement signed by AID and the Government of Pakistan on June 30, 1973. AID had inadequate plans for the funds when the agreement was signed, and Mission officials acknowledged that the agreement was signed on the last day of the fiscal year so that these funds would not be lost to the Pakistan program. AID officials in Washington indicated that this date was used as a lever in forcing the Government of Pakistan to take affirmative action. Mission officials said that they merely lacked final specifications for commodities to be procured under the agreement, yet it was not until December 1973 that three of the four project implementation orders for contraceptive purchases were issued. The 1974 agreement was signed on May 31, 1974, and was again intended for expenditures in subsequent years.

We have previously reported AID's practice of obligating large amounts during the last month of the fiscal year for undefined population-planning program requirements so that funds for the program would not be lost. (Assistance to Family Planning in Southeast Asia, B-173240, May 23, 1973.)

U.S. assistance to Pakistan's program has focused on five areas considered vital to success.

- Contraceptive supply and distribution.
- Manpower and training.
- Project data feedback.
- Publicity and communications.
- Automotive fleet operation and maintenance.

AID has pointed out and has required Pakistan to agree to make, improvements in these areas in annual project agreements. However, many of these improvements have not been made. We believe these problems must be remedied for the program to be effective and successful. Objectives for contraceptive supply and distribution, manpower and training, and project data feedback have not been met.

Contraceptive supply and distribution

Under the new program, contraceptives are to be available at a price equivalent to 2-1/2 cents for a dozen condoms or 1-month cycle of oral contraceptives. They are readily available at numerous sources. AID and government officials intend to inundate Pakistan with contraceptives so that even remote areas will be adequately supplied. AID estimates that it will procure about \$7.6 million worth of contraceptives by December 31, 1975.

Mission officials stated that it is a high-risk project to flood Pakistan with contraceptives and that it may be a test case for other countries. No comprehensive analysis, such as marketing and economic studies, was made to determine the effect of inundating Pakistan before AID committed funds. Mission officials said that the population problem was too acute to wait for a study of this magnitude but that a marketing economist and a logistician were scheduled to come to Pakistan, before and after the inundation program begins, to study all program ramifications.

Continuation of the inundation program beyond December 1975 will require additional large grants from the United States. AID officials indicated that as of June 30, 1975, inputs amounting to \$6.9 million are expected from other donors.

Neither Pakistan nor AID officials know how many Pakistanis use contraceptives, but Pakistan has developed a mathematical formula from which it derives the number of users. Mission officials do not agree with the formula and indicated that a reliable basis for accumulating data and making projections on the number of "acceptors" is provided for in the information feedback system now being implemented.

About 80 percent of the Pakistani couples who use contraceptives prefer condoms. However, there has been a worldwide shortage of condoms, and AID plans to purchase large quantities of oral contraceptives. Although certain oral contraceptives have been field-tested, there is no assurance that they will not fall into public disfavor.

Foam and sterilization equipment which had been in stock at the main warehouse in Karachi were distributed to users without cost to exhaust supplies. About 43 percent of materials valued at \$49,000, for the manufacture of intrauterine devices purchased for Pakistan since 1968 remained in storage. AID purchased this material without knowing whether the devices would be accepted.

Manpower and training

Criteria for selecting workers for the population-planning program have not been applied in some cases and some unqualified personnel have been employed. Mission officials did not know the number of unqualified personnel but stated that the government has implemented its personnel buildup reasonably well since the program expanded.

Training of workers remains a problem and supervision has not been effective. However, AID is helping the government to develop supervisory training. The AID Mission commented that the government is working to improve the quality and frequency of basic and refresher worker training. However, the government has not developed a satisfactory method of evaluating training programs at any level.

Project data feedback

An information feedback system has not been fully developed. Without a feedback system, program objectives

cannot be effectively measured and decisions must be based on quantitative measures that Mission and government officials believe to be inadequate. Currently available quantitative measures include the number of condoms sold, staff employed, and training sessions held. Evaluative information, such as number of users and potential users, would provide demand data to help measure progress in achieving program objectives and to determine more appropriate contraceptive procurement levels. We believe that lack of feedback information could have a far-reaching effect if Pakistan is to be used as a test country for inundation and that it may even impede progress of the current program in Pakistan.

Problems have put the implementation of a feedback system a year behind schedule. Most of the problems were attributed by the Mission to the U.S. Bureau of Census, which is acting as consultant and program designer and which, according to the Mission, has overcomplicated the system and slowed implementation. The Bureau has accepted some responsibility for delays but claims the Government of Pakistan and AID have contributed to the delays. The Mission acknowledged its contribution to the delays, but said the Bureau has recently begun to implement a new and simplified system which the government has carefully reviewed. The Mission believes that program implementation should not wait for fully adequate information systems to be designed. This system, however, should and probably could have been designed long before now with proper coordination.

MALARIA CONTROL

Since 1952 the United States has contributed more than \$27 million to Pakistan for two malaria control projects. Despite this assistance, malaria was near epidemic levels in 1974, and the Government of Pakistan requested an additional \$60 million (including the equivalent of \$25 million in U.S.-owned rupees) for a new 5-year control program. The two previous programs collapsed when U.S. funding stopped, and it appears that this same fate could befall the new program unless AID gets firm commitments from the Government of Pakistan to support the program on a continuing basis.

Previous programs

The United States, the World Health Organization, and the U.N. Children's Fund have been the major contributors to Pakistan's malaria programs. The first program, from 1952 to 1957, was relatively small, with the United States contributing about \$1 million. It was terminated because the Government of Pakistan would not make the commitment necessary to completely eradicate the disease.

The second program, begun in 1961, was a major effort to eradicate malaria from Pakistan by 1975. The Government of Pakistan and the World Health Organization jointly designed a program that reduced the number of cases from about 7 million annually to about 9,500. However, by the time AID's major support for the program was phased out in fiscal year 1968, the Government of Pakistan, despite competent and clear advice to the contrary, decided to reduce its financial commitment to the program, which was then in the "maintenance phase." By 1969, resurgence of malaria began in some areas (18,142 cases were detected). Malaria has again reached epidemic proportions and AID estimated there would be more than 10 million cases in 1975.

Proposed program

In 1974 the Government of Pakistan proposed a new assault on malaria, requesting a \$35 million AID loan to finance insecticide purchases from 1976 through 1978 and a grant of U.S.-owned rupees equivalent to about \$25.3 million for local costs through 1980. Under this proposal, Pakistan would pay 40 percent of the foreign exchange costs. By December 1974, AID was evaluating the government's plan of operations, with the advice of the World Health Organization. On June 30, 1975, the Administrator of AID authorized a \$20 million loan to support a multiyear program of malaria control in Pakistan. This is the first part of \$35 million to be provided over 3 years.

Mission officials acknowledged that the greatest problem would be maintaining a full commitment from the Government of Pakistan for 5 years, but they believe the government is currently genuinely interested. Whether the interest will continue or the difficulties of the past will be repeated is impossible to determine. AID indicated that its funding will continue for only 5 years; after that, the government will once again be on its own.

We believe the government's commitment already may be faltering. In November 1974 Pakistan was to obligate more than \$27 million in foreign exchange so that it could order insecticides in December. The Mission told us that without this commitment AID probably would not join the program. In mid-1975, the government was preparing to issue invitations for bid for nearly 7,000 tons of chemical pesticides.

We recognize that any program which saves lives and improves the living conditions of thousands of Pakistanis is extremely popular and worthwhile if implemented effectively. However, we do not believe AID's role is to continuously support a program which the Government of Pakistan has repeatedly allowed to lapse. In the past, malaria programs

have been successful only while U.S. funding continued, and we see little evidence that the new effort will be any different.

CONCLUSIONS

The United States has given or loaned more than \$72 million in past years to help Pakistan control population and malaria, but the programs have not been successful primarily because the Government of Pakistan did not fully support them. AID is now entering into large new programs in these areas and we noted the following problems which may hamper these programs.

- Many population program workers are not qualified.
- The information feedback system to quantitatively evaluate population program results and provide management information is a year behind schedule.
- In November 1974 the Government of Pakistan jeopardized the new malaria program by again failing to commit funds to purchase insecticides needed for spring spraying.

Regarding the malaria program, it might be just as well that programs of this nature be provided on a multilateral rather than bilateral basis. The World Health Organization would probably be in a better position to acquire increased resources for the program and to coordinate their use. Furthermore, Pakistan might be more receptive if the program had an expanded identity.

With respect to the population program, we believe that AID has entered into the current population-planning program without adequately evaluating problems of supply and distribution, personnel training, and management information feedback. For the past several years AID has concentrated primarily on supplying contraceptive devices, on the assumption that, if adequate contraceptive supplies were available, at affordable prices, people would use them. AID is continuing this type of program in Pakistan with its plan to inundate the country with contraceptives. Merely supplying the means to control the birth rate, however, is not necessarily sufficient to solve the problem of escalating population growth rates.

RECOMMENDATIONS

We recommend that the Secretary of State and the Administrator of AID closely monitor the Government of Pakistan's progress on malaria control programs and obtain assurance of Pakistan's continued support before providing more than the \$20 million recently authorized. Moreover, consideration should be given to having programs of this nature provided on a multilateral rather than bilateral basis.

We recommend that the Secretary of State and the Administrator of AID seek additional support for the population-planning program from the Government of Pakistan in conjunction with the provision of any additional U.S. funds. We further recommend that this program be reassessed giving full recognition to basic management problems that hamper the program and constitute an obstruction to a decline in the population growth rate.

CHAPTER 5

DISASTER RELIEF

The August 1973 flood was the most devastating in recent Pakistan history, causing damage estimated at \$600 million. The value of destroyed crops alone was estimated at \$475 million. According to AID, Pakistan required large amounts of assistance because the disaster had adversely affected not only the domestic scene but also the country's export earnings and import priorities.

The United States responded to the disaster by committing \$76.5 million in loans and grants from the following sources.

<u>Type of Assistance</u>	<u>Amount</u>
Foreign Disaster Assistance Act funds:	(millions)
Emergency relief operations grant	\$ 4.5
Flood relief and rehabilitation grant	27.5
Agricultural production loan	<u>18.0</u>
	50.0
Public Law 480 funds:	
Title I sales agreement (sorghum)	4.6
Title I sales agreement (wheat)	11.0
Title II grant agreement (wheat)	<u>8.5</u>
	24.1
Foreign Assistance Act contingency fund:	
Helicopter grant	<u>2.4</u>
Total	<u>\$76.5</u>

The \$4.5 million emergency relief operations grant was generally effectively used. U.S. aircraft and boat crews evacuated more than 2,600 people stranded in flooded areas, distributed more than 358,000 pounds of food and other cargo, and sprayed pesticide to protect rice crops. However, some disaster relief funds were ineffectively used.

AGRICULTURAL PRODUCTION LOAN

AID provided an \$18 million emergency agricultural production loan in November 1973 for the stated purpose of reviving and expanding Pakistan's food production ability. This loan did not support an emergency situation and should have been funded with regular development assistance funds, because \$14.5 million of it was for financing fertilizer imports for the 1973 winter wheat crop.

Before the flood, AID had requested \$63.5 million for Pakistan development assistance for fiscal year 1974. These funds were to be used primarily to finance agricultural improvements and imports of fertilizer and other commodities. The amount requested in the development assistance Congressional Presentation Book included a fertilizer loan nearly identical to the loan subsequently funded with the disaster assistance funds.

At the time of the flood, AID was operating under Continuing Resolution Authority because the Congress had not passed the authorization or appropriation bills for the regular development assistance program. When the appropriation request was subsequently approved, AID allocated only \$11.8 million of development assistance funds to Pakistan. It used the balance of the funds requested for Pakistan to supplement a congressionally imposed reduction in the overall appropriation to increase assistance to other countries.

When the \$18 million emergency agricultural production loan was signed on November 15, 1973, AID should have realized that it would be difficult for Pakistan to obtain fertilizer with these funds in time to use it for the winter wheat crop, because:

- Before the 1973 flood, Pakistan, with AID's assistance, had attempted to obtain large quantities of fertilizer but had limited success and obtained only a portion of its needs.
- By June 1973 the worldwide shortage of food grains had created an unprecedented demand for fertilizer which was expected to last well into calendar year 1974.
- Requests from developing countries for fertilizer amounted to more than twice the amount AID had estimated was available for shipment between August 1973 and January 1974. Furthermore, AID had funds available from a previous development assistance loan to finance fertilizer imports needed immediately after the flood. On November 8, 1973, the AID Mission indicated it would finance 25,000 tons of fertilizer for Pakistan under the previously existing development loan.

FLOOD RELIEF AND REHABILITATION GRANT

To assist in Pakistan's flood recovery, AID provided a \$27.5 million grant to reconstruct small rural facilities, including schools, hospitals, clinics, roads, and community water sources. This grant was to be implemented using the fixed-cost-reimbursement method of disbursing assistance, a method first used in the Philippines with considerable success. To describe this method briefly, AID and the assisted government agree that, after the government has satisfactorily completed a project according to previously agreed-upon specifications and after AID has inspected the project to see that the specifications have been met, AID will pay a fixed, previously agreed-upon amount to that government. The feature distinguishing this method from the traditional cost-reimbursement method is that actual costs are not reimbursed but a fixed, predetermined amount is paid. While the fixed-cost-reimbursement method of dispensing assistance has considerable merit when adequately implemented under proper conditions, there are several problems in implementing this grant.

The \$27.5 million is a dollar grant, whereas most of the reconstruction costs are local costs payable in rupees. According to the grant agreement, Pakistan was to periodically request reimbursement from AID for project costs, including local currency costs, and AID was to issue a dollar check to the Government of Pakistan. AID officials told us they decided that the grant agreement would not specify how the foreign exchange provided through this mechanism would be used or where it would be spent.

One difficulty in using dollars to finance local costs in Pakistan is that the United States already owns a large amount of excess local currency. Section 113 of the Foreign Assistance and Related Programs Appropriation Act, 1974, states that it is the sense of Congress that excess foreign currencies on deposit with the U.S. Treasury which were acquired without the payment of dollars should be used to underwrite local costs of U.S. foreign assistance programs to the extent to which they are available. Section 113 specifically prohibits the use of dollars appropriated under title I of the act to finance local currency costs in excess currency countries.

Because the disaster relief assistance appropriation was contained in title IV of the act, AID's General Counsel determined that section 113 did not apply to this grant. We do not necessarily disagree with this technical legal opinion, but we believe the statement concerning the sense of Congress has broader application than title I. The Mission

stated that it specifically wanted additional foreign exchange dollars for Pakistan and that using U.S.-owned excess rupees would not have accomplished this purpose. It claimed that Pakistan needed the foreign exchange for other flood-related purposes.

A second difficulty in using dollars to finance local currency costs in Pakistan is that it results in a balance-of-payments drain on the United States. The question arises as to whether the use of dollars should be tied to procurement in the United States. We recognize that requiring Pakistan to purchase commodities used in the rehabilitation projects in the United States has many disadvantages from cost and administrative standpoints. Nevertheless, we believe the balance-of-payments drain could be mitigated by a system of tied credits wherein Pakistan could use the credits only in the United States for satisfying any of its import requirements.

As previously stated, the distinguishing feature of the fixed-cost-reimbursement method is that definitized plans, specifications, and a fixed dollar amount to be reimbursed for each individual reconstruction project are to be agreed on before work is started. However, we found that, despite the fact that the flood occurred in August 1973, the \$27.5 million grant agreement was not signed until July 23, 1974. The first implementation letter outlining the general procedures to be followed was not issued to the Pakistan Government until October 16, 1974, and as of December 11 the Mission had not issued implementation letters authorizing that government to begin submitting requests for reimbursement. AID told us that implementation letters had been delayed because the government had not provided necessary documentation, such as descriptive lists of facilities, detailed cost estimates, identity of preexisting facilities, and map locations. An AID Auditor General report attributed program delays to the lack of thorough precommitment and planning coordination by Government of Pakistan and AID officials.

As could be expected in an emergency situation, the Pakistan Government was already proceeding with rehabilitation efforts for which it expected to be reimbursed, despite the lack of specific plans, cost estimates, or implementation letters. In one province about 10 percent of the roads were already completely repaired, and work was underway on another 75 percent. In another province, all but one road was under construction and some rural health centers were under construction.

In our opinion, the lengthy delays in signing and implementing this grant agreement largely nullify the advantages generally credited to the fixed-cost-reimbursement method. It appears likely that, when the reimbursable costs for these projects are finally agreed upon, many of the projects will have already been completed and the requests for reimbursement will be based on actual costs rather than on a predetermined amount which would provide incentive to keep costs to a minimum. AID agreed that, while this is generally the case, the cost presented for reimbursement must stand the test of reasonableness.

PUBLIC LAW 480 ASSISTANCE

As part of the flood relief effort, the United States provided \$24.1 million in assistance under the Public Law 480 program, about \$19.5 million of it for 100,000 tons of wheat to provide immediate relief before the next harvest. The remaining \$4.6 million was a loan (long-term credit sale) for 40,000 tons of sorghum under Title I of Public Law 480. Pakistan requested more wheat, but sorghum was accepted because of the tight wheat supply situation in the United States.

In September 1973 when the wheat agreement was signed, the government requested white sorghum or bulgar wheat for blending with the wheat. The Mission recommended an allocation of 40,000 tons of coarse grains, preferably white sorghum. In October, the Mission was authorized to proceed with negotiations but was informed that white sorghum was not available under Public Law 480. According to a Mission official, the government knew before signing the sorghum agreement in November that yellow sorghum was the only type available. An official of the U.S. Department of Agriculture has also confirmed that the Government of Pakistan knew that only mixed (yellow and brown) sorghum was available. The purchase authorization requested by the government in late November was issued on December 2, 1973, and the government arranged purchases and shipping. One ship had mechanical problems and did not depart from the U.S. port until February.

Government of Pakistan officials had planned on the sorghum arriving in time for use during January to March 1974, the time of greatest grain need in Pakistan. However, it did not arrive until late March and early April, at which time the winter wheat crop was coming on the market.

Consumers were reluctant to purchase the sorghum-wheat blend because pure wheat was available and the reddish color of the blend was unattractive. Because of the lack of consumer demand and the requirement that the sorghum be used

for human consumption, most of it remained in warehouses from arrival to at least November 1974.

As part of the sorghum amendment, the Government of Pakistan agreed not to export corn, cornmeal, barley, grain sorghums, rye, oats, and any mixed feeds containing predominately such grains from November 2, 1973, to June 30, 1974. However, barley was exported in violation of the agreement, and information obtained from the U.S. Agricultural Attache indicated that the barley went to Cuba or Russia.

Embassy and AID officials were aware of this violation in December 1973. After considering various alternatives for settling the issue, Pakistan agreed to convert the long-term credit sale for sorghum to a cash sale on November 21, 1974, apparently influenced by a pending Public Law 480 credit sale for \$18 million, which was then signed on November 23, 1974.

The Mission did not agree that the sorghum purchase was unsuccessful. Officials told us that the transaction may turn out to be advantageous to the Government of Pakistan, because sorghum is in extremely short supply this year. While Mission officials are speculating that the government may be able to sell sorghum domestically for more than the purchase price, Pakistan nevertheless lost a precious resource in this transaction--nearly \$4.6 million in foreign exchange.

DONATION OF HELICOPTERS

The United States provided six UH-1 Army helicopters, with crews, to assist with disaster relief operations following the August 1973 flood. The Pakistan Government was impressed with their operation, and in September 1973 asked the U.S. Embassy whether the United States could donate the helicopters to Pakistan. This inquiry actually originated within Pakistan's military, but the ministry of foreign affairs served as a channel for conveying the request.

During Prime Minister Bhutto's visit to the United States in September 1973, President Nixon offered to donate the six helicopters to Pakistan. The Secretary of State determined that the helicopters could be financed from AID Contingency Funds because they were a form of disaster relief assistance, would be granted to a civilian agency, and would be prohibited from military use. These funds were used to reimburse the Department of Defense.

On February 25, 1974, the Government of Pakistan and the United States signed an agreement containing provisions on

eligible uses of the helicopters and Government of Pakistan procedures for allocating them among civilian users. The agreement calls for a civilian agency to authorize all flights and for flight logs to be maintained showing the purpose of each flight and the using agency. The agreement stipulates the helicopters may be used for civilian purposes only.

The helicopters were officially turned over to Pakistan on July 1, 1974, after completion of a training program conducted by a U.S. military team as part of the donation, which also included ground equipment and spare parts. The entire donation package was valued at about \$2.4 million.

Pakistan had been urging transfer of the helicopters since late 1973 and should have been ready to use them effectively, but this was not the case. A September 3, 1974, AID audit report indicated the helicopters had primarily been used for training and testing between July 1 and August 20, 1974, and had been flown only a total of 159 hours, about 30 minutes daily flying time per helicopter. Subsequently, in December 1974 the disaster relief aircraft and such other helicopters as Pakistan could deploy flew some 400 sorties in connection with an earthquake in the mountains of northern Pakistan.

Apparently their use was limited because the government had not provided potential users with procedures showing availability and usage criteria. Also, agencies using the helicopters for normal official activities were required to pay an hourly usage rate, which had not been budgeted for the present fiscal year.

In commenting on our draft report, State and AID officials indicated that the Pakistan Government agencies were subsequently informed of the criteria, procedures, and cost and that Mission officials expect increased usage of the helicopters. These officials pointed out that disaster relief missions have the highest priority and that the helicopters are serving an important purpose in standing ready for use on disaster relief missions.

At the time the helicopters were transferred to Pakistan a full-time civilian need did not exist to use them effectively. Therefore, in our opinion, the helicopter grant represents a questionable use of scarce contingency funds.

CONCLUSIONS

The United States initial response to Pakistan's request for disaster relief assistance was generally quick and effective. However, certain funds provided under the disaster relief program were ineffectively used.

- The \$18 million agricultural production loan did not support an emergency situation and should have been funded with regular development assistance funds as initially justified to Congress. AID reprogrammed to other countries funds that were initially justified for Pakistan to other countries, and this use of disaster relief funds negates the effect of the congressionally imposed limitation on the regular foreign assistance program.
- The fixed-cost-reimbursement method of disbursing assistance being used for the \$27.5 million relief and rehabilitation grant has considerable merit when adequately implemented under the proper conditions. In Pakistan, however, the lengthy delays in signing and implementing the grant agreement largely nullified the advantages of this method. Certain projects were already completed before any definitized plans, specifications, or fixed amounts to be reimbursed were agreed upon. Thus, it appears likely that requests for reimbursement will be based on actual costs rather than on a predetermined amount, which would have provided an incentive to keep costs to a minimum. This grant resulted in financing local currency costs with dollars in a country where the U.S. already owns excess local currency. Furthermore, the grant agreement did not specify how or where the dollars made available would be spent, resulting in a further balance-of-payments drain.
- The United States provided \$4.6 million worth of sorghum to Pakistan which consumers would not buy or eat. This sorghum remained in storage at a time when barley, a similar commodity, was exported, thus violating the loan agreement. To negate this violation, the Pakistan Government finally agreed to convert the loan to a cash purchase, using scarce foreign exchange resources to pay for a commodity consumers did not want.
- Neither Pakistan nor AID had any specific plans for using six helicopters funded from AID's contingency funds.

RECOMMENDATIONS

We recommend that the Secretary of State and the Administrator of AID:

- Not use disaster relief funds for development assistance programs already justified to Congress in the annual budget presentation. Reprograming these funds to other countries negates the effect of a congressionally imposed limitation on foreign assistance.
- Limit, to the extent possible, the use of Contingency Funds to emergency situations.
- Use appropriated funds only to provide material and equipment for which there is a demonstrated requirement.

In situations where the fixed-cost-reimbursement method of disbursing assistance is appropriate, we recommend that the Administrator of AID establish guidelines and procedures to require that:

- Definitized plans, specifications, and fixed amounts that are to be reimbursed be agreed upon between AID and the benefiting country before actual work is undertaken.
- The agreement include a provision that the foreign exchange provided be used to purchase commodities in the United States in order to mitigate the adverse balance-of-payments impact of the agreement.

We recommend further that, when providing Public Law 480 commodities to a country, the Administrator of AID direct the Mission Director to first ensure that the commodities are compatible with the dietary habits of the people of the recipient country so that there will be a reasonable expectation that the commodities will be used for the intended purpose.

CHAPTER 6

SCOPE OF REVIEW

Our review was directed toward evaluating Pakistan's (1) economic growth, (2) reasons for needing debt relief and action it has taken to obviate the need for future debt relief, (3) population and malaria control programs, which are primarily sponsored by the United States, and (4) disaster relief assistance provided by the United States after the 1973 floods.

We reviewed U.S. policy papers, program documents, reports, correspondence, and other relevant data available at the Washington and Pakistan offices of the Departments of State and Defense and at AID. Statistics and other data were obtained from the United Nations and other international agencies as well as from the Departments of Commerce and Agriculture. We held discussions with officials of State, Defense, AID, international organizations, and Pakistan Government officials.

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BEST DOCUMENT AVAILABLE

APPENDIX I

<u>Landing country agency</u>	<u>TOTAL F</u>		
	<u>Before</u> <u>1955</u>	<u>1955-60</u>	<u>1960-65</u>
Consortium:			
Belgium	\$---	\$-----	\$ - .5
Canada	11.719	64.268	108.2
France	---	-----	45.5
Germany	---	-----	292.0
Italy	---	-----	5.9
Japan	---	25.403	148.3
The Netherlands	---	-----	14.8
Norway	---	-----	-----
Sweden	.369	-----	1.1
United Kingdom	29.151	31.633	221.8
United States	169.403	791.609	2,002.1
United Nations	3.940	5.177	4.4
UN Development Program	---	8.175	9.7
Ford Foundation	---	17.230	19.3
IBRD (World Bank)	58.227	92.655	208.8
Internat'l Developmt Agency	---	-----	192.0
Internat'l Finance Corp.	---	1.380	9.3
Asian Development Bank	---	-----	-----
	<u>\$272.809</u>	<u>\$1,037.930</u>	<u>\$3,284.3</u>
Non-Consortium:			
Australia	26.342	2.790	34.1
Austria	---	-----	-----
Bulgaria	---	-----	-----
China	---	-----	60.0
Czechoslovakia	---	-----	-----
Denmark	---	-----	7.4
India	---	-----	168.8
Kuwait	---	-----	-----
New Zealand	---	-----	3.9
Poland	---	-----	-----
Romania	---	-----	-----
Switzerland	---	-----	.11
Russia	---	-----	36.9
Yugoslavia	---	-----	29.1
Supplier credits from various sources	---	42.285	-----
	<u>\$ 26.342</u>	<u>\$ 45.075</u>	<u>\$ 340.4</u>
Total	<u>\$299.151</u>	<u>\$1,082.605</u>	<u>\$3,624.8</u>

^a Includes contributions to Indus/Tarbela Fund in 1960. Total a

Source: Government of Pakistan

Copy microfilmed was of poor quality.

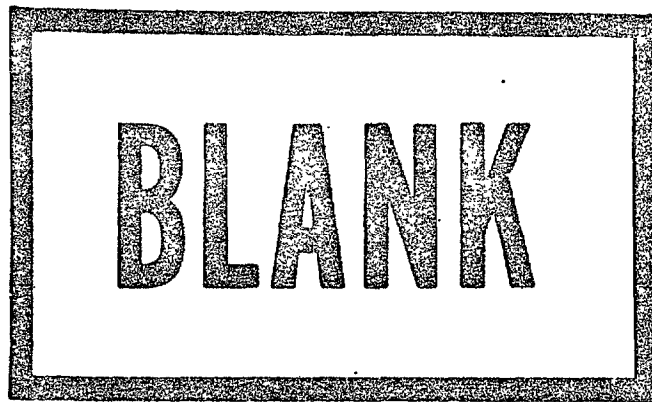
APPENDIX I

STANCE TO PAKISTAN
YEAR 1974

0 Licenses	1971	1972	1973	1974	Total	Percent grant
483	\$-1.500	\$--	\$-2.231	\$-14.037	\$ 27.768	0
887	18.799	1.872	22.000	79.125	503.930	52
704	30.000	--	19.548	23.892	192.716	0
463	38.387	3.301	24.825	61.192	621.248	9
369	74.791	1.974	.063	2.691	183.795	0
940	---	---	31.096	23.624	374.480	.3
758	4.420	3.806	4.931	6.506	55.234	0
961	---	---	1.672	---	6.633	100
966	1.114	---	---	---	34.552	48
148	9.525	5.863	15.634	67.213	547.980	19
542	125.053	60.209	223.925	91.011	4,621.967	40
312	---	---	---	---	16.417	100
351	---	---	---	---	29.769	100
116	1.744	---	---	---	52.419	100
786	---	---	---	60.000	659.556	0
377	23.000	---	95.000	53.000	510.470	0
300	---	---	---	---	13.932	0
300	23.850	---	38.500	---	72.350	0
163	<u>\$352.183</u>	<u>\$77.025</u>	<u>\$479.425</u>	<u>\$482.291</u>	<u>\$8,525.216</u>	
440	.170	---	---	---	67.931	100
84	---	---	---	.793	6.277	0
	---	---	---	3.880	3.880	0
185	2.884	---	---	---	330.369	33
20	---	---	---	---	40.120	0
100	---	---	---	---	9.409	0
	---	---	---	---	168.803	100
58	---	---	---	---	4.958	0
	---	---	---	---	3.902	100
69	---	---	---	---	9.769	0
	---	---	---	15.868	15.868	0
136	---	---	---	---	33.150	0
66	200.351	---	30.197	136.612	497.056	0
54	3.057	---	---	---	65.842	0
	---	---	---	---	42.285	0
12	<u>\$206.462</u>	<u>\$--</u>	<u>\$ 30.197</u>	<u>\$157.153</u>	<u>\$1,299.619</u>	
75	<u>\$558.645</u>	<u>\$77.025</u>	<u>\$509.622</u>	<u>\$69.444</u>	<u>\$9,824.835</u>	

was \$518,209 million.

POST-BUDGETARY VARIABLE



U.S. ECONOMIC ASSISTANCE TO PAKISTAN 1953-75

APPENDIX II

<u>CATEGORY</u>	<u>1953 to 1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975 (note a)</u>	<u>Total</u>
Loans:							
AID	\$1,718.1	\$ -	\$ 60.0	^b \$ 88.6	\$ 50.6	\$ 60.0	\$1,977.3
Export-Import Bank	111.1	12.6	-	28.2	.2	(c)	152.1
Title I, Public Law 480	1,262.2	76.5	92.6	74.6	32.4	79.5	1,617.8
Other	15.0	-	5.3	7.9	33.5	(c)	61.7
	<u>3,106.4</u>	<u>89.1</u>	<u>157.9</u>	<u>199.3</u>	<u>116.7</u>	<u>139.5</u>	<u>3,808.9</u>
Grants:							
AID	700.6	7.1	2.4	7.8	7.8	29.4	755.1
Title II, Public Law 480	166.3	24.3	10.1	6.9	10.1	4.7	222.4
Other	74.7	-	-	-	.9	.1	75.7
	<u>941.6</u>	<u>31.4</u>	<u>12.5</u>	<u>14.7</u>	<u>18.8</u>	<u>34.2</u>	<u>1,053.2</u>
Total	<u>\$4,048.0</u>	<u>\$120.5</u>	<u>\$170.4</u>	<u>\$214.0</u>	<u>\$135.5</u>	<u>\$173.7</u>	<u>\$4,862.1</u>

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GAO note: Data prior to fiscal year 1972 includes Bangladesh, pending subsequent distribution.

^aAID estimate

^bIncludes \$28.6 million in capitalized interest on prior year loans.

^cInformation not currently available.

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DEPARTMENT OF STATE

Washington, D.C. 20520

August 1, 1975

Mr. J. Kenneth Fasick
Director
International Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Fasick:

I am replying to your letter of May 16, 1975, addressed to the Secretary, which forwarded copies of your Draft Report "United States Assistance To Pakistan Should Be Reassessed."

The enclosed comments, prepared by the Deputy Assistant Secretary of the Bureau of Near East and Asian Affairs, represent a joint response of both the Department of State and the Agency for International Development.

We appreciate having had the opportunity to review and comment upon the Draft Report. If I may be of further assistance, I trust you will let me know.

Sincerely,

A handwritten signature in cursive script that reads "Williamson".

Daniel L. Williamson
Deputy Assistant Secretary
for Budget and Finance

Enclosure:

Comments.

GAO note: Page number references may not correspond to page numbers of this report.

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Comments of the Department of State and
Agency for International Development on
GAO's Draft Report, "United States Assistance to Pakistan Should Be Reassessed"

We have appreciated the opportunity of discussing the draft report with GAO's representatives and are providing the following comments concerning GAO's findings, conclusions and recommendations:

Debt Relief

Recommendation No. 1: GAO recommends that the Secretary of State and the Administrator of AID reassess the level of aid provided to Pakistan in view of the added assistance provided through debt relief and in view of Pakistan's reluctance to resolve basic factors contributing to the debt problem. In this connection, GAO suggests that AID's annual budget request inform the Congress about prospective debt problems and that it qualify the assistance value of debt relief granted. The Secretary of State should also instruct other agencies to mutually agree with the debtor country how the funds made available through this mechanism will be used.

Comment: We believe that the GAO should reevaluate two key points:

A. The relationship between the concepts of aid and debt relief are more complex than presented. We believe debt relief to be a unique financial instrument, involving complicated relationships between the U.S. and the debtor countries and between the U.S. and other creditor countries, designed to enhance our overall creditor position. We do not therefore believe debt relief should be equated with aid. Moreover, we believe there are considerable advantages accruing to the U.S. from our current strategy -- also followed by other major creditors -- of maintaining a clear distinction between aid and debt relief policies. The "logical" conclusion which organizations of LDCs are now drawing from the equation of debt relief and aid is that debt should be forgiven. As the largest creditor, we have the most to lose if this approach were to succeed.

B. The report downplays the importance of the events of 1971 as they affected creditor country reaction to Pakistan's debt problem. As is true with most acute debt problems, the deterioration in Pakistan's debt position was gradual and the result of a series of economic and noneconomic events. It was creditor country desire to resolve the debt issues resulting from the 1971 war, however, which led creditors to the conclusion that debt relief constituted the most appropriate solution.

A more detailed discussion of these two points follows:

1. The report equates debt relief with aid, and stresses that the balance of payments relief derived from rescheduling constitutes economic assistance not specifically appropriated by Congress. The rationale for agreeing to debt relief and the circumstances under which such relief is provided, however, differ distinctly from those governing the provision of aid. The whole concept of debt relief is based on safeguarding our long-term financial interests as a creditor. In our contacts with debtor governments and with other creditors, and in such international fora as the IMF, the World Bank, the OECD and the UNCTAD, the United States Government continually stresses the position that debt relief is neither a method of avoiding budgetary appropriations nor a policy instrument for providing development assistance.

We believe that our position as the world's largest creditor is well served by maximizing the distinction between policies covering aid and debt relief. Present policy is based on evaluating the merits of debt relief on a case-by-case basis, while at the same time pursuing the goal of minimizing the incidence of rescheduling. The fact that the number of multilateral debt rescheduling exercises have averaged less than three annually since 1970 indicates considerable success in both maintaining the important presumption that debtors should repay their obligations on time and in confining debt relief to exceptional cases.

Other major creditors also stress the distinction between debt relief and aid, although many debtor countries advocate a greater linkage. The traditional developing country view that debt problems have to be viewed in the broad context of the development process has in fact been reinforced by current economic conditions, and pressure by the LDCs (e.g. in UNCTAD) for debt relief as an alternate form of resource flow is increasing. In advocating that creditor countries consider debt relief as a legitimate form of aid, debtor countries hope to expand the incidence of debt rescheduling beyond the restrictive guidelines which currently confine its use to exceptional circumstances. The U.S. has taken the lead, and been supported by all major creditor countries, in resisting pressure to view debt relief in the same context as aid. It would be inconsistent for the U.S. to adopt internal procedures which treat debt relief as a supplement or substitute for aid. Such procedures would weaken the traditional creditor/debtor relationship, disadvantage our bargaining power vis-a-vis developing country debtors, and could fester an increasing incidence of applications for debt relief.

The Department of State and A.I.D. fully recognize the need to insure a meaningful dialogue with Congress on the matter of debt relief. We believe, however, that the report's recommendation to identify and quantify debt relief in the annual budget request is unnecessary. In addition to fulfilling

the reporting requirement of the 1973 Foreign Assistance Act (a fact note in the report), the Executive Branch is fully complying with Section 4 of the Foreign Disaster Assistance Act of 1974 requiring Congressional notification prior to entering into any negotiation with any foreign government regarding the cancellation, renegotiation, rescheduling, or settlement of any debt owed to the United States under the Foreign Assistance Act of 1961. All information known at the time is, and will be, incorporated in annual budget requests, but we note that forecasting debt problems in the budget process is difficult in view of global economic uncertainties.

We believe the GAO should also reconsider its recommendation that U.S. lending agencies negotiate with the debtor country the use of "funds made available through the debt rescheduling mechanism." This once again overlooks the fact that the prime function of debt relief is not aid but rather to enhance the probability of repayment of all debts to the U.S. It also erroneously assumes that the debtor has "additional" resources at its immediate disposal, whereas, in default or near-default situations which warrant debt relief proceedings, the rescheduling of a part of the debt constitutes acquiescence, temporarily, in non-payment of resources the debtor does not have. Finally, no funds are actually made available through debt rescheduling; rather the country is not required to pay a bill when due.

2. When acute debt problems arise, debt relief is just one type of remedial action available and the merits for relief must be analyzed on a case-by-case basis to determine if it constitutes the most appropriate solution. The Aid-to-Pakistan Consortium did not, for example, provide any debt relief in response to Pakistan's 1968 request for long-term relief. Creditor country desire to resolve the unique debt difficulties arising from the events of 1971 was the paramount factor in the decision reached by the creditors to finalize the unresolved debt issues within the framework of a multilateral debt rescheduling.

The emergence of an independent state from former East Pakistan created the problem of the responsibility for the debts contracted by Pakistan which had benefited its east wing. Our view of applicable international law is that Pakistan retained responsibility for all external debts contracted prior to the war. After the war Pakistan nonetheless insisted that debts resulting from programs of primary benefit to Bangladesh, which it estimated at about \$1.2 billion, should be paid by Bangladesh. For its part, Bangladesh affirmed its intention to assume the international responsibilities incumbent upon a sovereign state, including a portion of the external debt of the formerly united Pakistan, but only within the context of an overall financial settlement.

The creditor countries of the Aid-to-Pakistan Consortium agreed to work towards developing a procedure to overcome the impasse with the primary aim of avoiding a default on any portion of the total debt. The

creditor countries also sought to frame any agreement in the context of Pakistan's unique situation so as to avoid setting an undesirable precedent for other countries. In order to facilitate a final settlement which would achieve creditor objectives, the Consortium agreed to short-term rescheduling in 1972 and 1973.

Strategy to devise a resolution to the debt problem also recognized other factors:

- the long standing request by Pakistan for long-term debt relief from the Consortium.
- the political constraints preventing Pakistan from accepting an agreement framed solely in the context of "disputed" debt.
- the hump in debt service payments from FY 1975 to FY 1978 created by the interim reschedulings.

The final agreement, reached on June 28, 1974, provided for debt relief to Pakistan in the amount of \$650 million, to be provided over the four years beginning July 1, 1974. Pakistan agreed to continue payments upon all debt due to creditors and confirmed that the Government of Pakistan will not request further debt relief based on problems arising from the events of 1971. The United States share of relief to be provided is about 30 percent of the total. We believe this is reasonable since we are the creditor on two-thirds of the debt originally disputed by Pakistan. In order to emphasize the unique nature of the debt relief agreement, the United States will re-schedule on a long-term basis only those categories of AID loans which were originally disputed by Pakistan as a result of the events of 1971.

Directly related to the agreement with Pakistan is an agreement by the Government of Bangladesh to assume liability for projects visibly located in its territory. Bangladesh is willing to assume repayment obligations on approximately \$450 million in principal amount on such visible project loans. This accomplishes our objective of avoiding a default on any portion of the pre-war Pakistan debt.

In examining Pakistan's long-term debt prospects, it needs to be recognized that present-day Pakistan is a much stronger economic entity than the country which existed prior to the 1971 division. We fully agree, however, with the GAO report's concern over future debt servicing prospects. At last May's meeting of the Pakistan Consortium, the United States and other creditors expressed serious concern at the current rate the GOP is accumulating external debt. We strongly urged the GOP to increase domestic savings in order to become less dependent on external borrowings for financing investment. Furthermore, we told the GOP that, if they incurred a future debt problem by reason of borrowing on short and hard terms from OPEC or other sources, their recourse for relief would have to be those sources and not the U.S. or other creditors who provided concessional assistance.

Recommendation No. 2: GAO recommends that in providing assistance to Pakistan, the Secretary of State and the Administrator of AID give particular consideration to the extent to which this assistance permits the continuation of policies which discourage increased food production.

Comment:

We do not agree with the implied conclusion of this draft recommendation that U.S. assistance to Pakistan "permits the continuation of policies which discourage increased food production". We do, however, agree fully with GAO that before providing concessional assistance the USG must satisfy itself that related self-help measures are being carried out by the recipient government and that providing such assistance would not contribute to continuation of policies which discourage increased food production. Both State and AID will continue to make this requirement a primary factor in considering and providing economic and concessional food assistance to Pakistan. We believe the report should state that one of the central purposes of U.S. assistance to Pakistan is to encourage and assist Pakistan in significantly increasing its food production. Moreover, we believe the report should reflect the fact that during the ten year period (crop year 1964-65 through 1973-74) rice production increased from 1.3 million metric tons to 2.1 million MT, and wheat from 4.5 million MT to 7.5 million MT. The index for all food crops for that period increased from 120 to 175, an increase considerably faster than the increase of population. As our Mission in Pakistan put it to the GAO team: Pakistan obviously was doing something right to get these food results. We fully agree with GAO on the urgent necessity for Pakistan to accelerate food production as quickly as possible and close the considerable gap between food needs and food production. U.S. assistance programs which have contributed to Pakistan's progress in increasing agricultural production in recent years and those programs which either have or are designed to have a significant impact in the period immediately ahead include:

The Indus Basin Development Project, which has, since its inception fifteen years ago, built an inter-river link canal system for the distribution of irrigation water, and dams for both the storage of irrigation water and power generation (which will further increase water availability through powering of tubewells). The major work, Tarbela Dam, which is now nearing completion, will make available additional irrigation water this fall in an amount conservatively estimated to be enough for another 500 thousand tons wheat production.

Fertilizer and pesticide imports, which have demonstrated their value in increased production in response to a rapidly growing demand ensuing from the adoption of the high yielding varieties of the "green revolution."

Partial financing in the construction of two fertilizer plants

Both plants, financed in part by AID loans of U.S.-owned rupees, have American private enterprise participation in their ownership and have been operating in excess of their rated production capacity the past two years.

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Salinity Control and Reclamation (SCARP) projects, to reverse the salinization and waterlogging of older irrigated lands and, thus, to restore land to production.

Strengthening and expansion of the agricultural research system, to develop and adapt both improved seed varieties and on-farm technology on a continuing basis to support continuing growth in food production. More recent and planned assistance to Pakistan in support of its campaign to close the gap between food needs and production include:

Construction of a third major fertilizer plant with private American joint ownership, for which a loan of \$40 million was recently authorized. The output of this plant, together with that of another plant being constructed and two existing plants being expanded without U.S. assistance, will support the Pakistani effort to achieve self-sufficiency in nitrogenous fertilizer by 1979 despite a projected continued sharp increase in demand.

Field evaluation and demonstration of technology in water distribution to farms and the more efficient use of water on farms, both irrigated and non-irrigated. Technologies being evaluated and demonstrated include precision land leveling and tillage practices in conjunction with the use of improved seed varieties and fertilizer. The first major replication of these technologies and their benefits will be supported with a loan planned for FY 1976 in Water Management.

Financing the importation of agricultural inputs (primarily seed, fertilizer and pesticides) planned for FY 1976. Pakistan has just purchased and shipped from Mexico 17,000 tons of improved wheat seed, for which it is expected to seek reimbursement under the proposed loan. This seed will be replicated in the 1975 fall-planted crop season and should produce enough for 100 percent of the seed requirements for the irrigated wheat acreage in 1976.

Policy Reforms

We recognize that certain of Pakistan's policies may inhibit maximum progress in increasing food production. We disagree, however, with the statement implying that Pakistan is not making progress in carrying out necessary changes. Much needs to be done in this area, but Pakistan has, in fact, taken many policy steps to increase domestic food production. Examples include increases in government procurement prices for wheat and other commodities for distribution through ration shops (45 percent in the case of wheat), corresponding increases in ration shop prices, construction and expansion of fertilizer plants, importation of fertilizer to meet needs until domestic production is increased, subsidizing fertilizer distribution to support an adequate wheat-fertilizer benefit-cost ratio at the farm gate, investment in the Indus Basin water and power complex, subsidizing tubewell construction, now expanding at the rate of about 10 percent annually, importation and multiplication of improved seeds, and expanded farm credit. Although these are all steps in the right direction, they are not

sufficient for the most rapid and sharp increases which are both possible and needed in food production. This fact is recognized by Pakistani planners who must seek reform in a political environment. The most recent step in the direction we and the GAO endorse -- an increase in the price of rationed food -- resulted in public outcries and violence in which some deaths occurred.

Under the leadership of the World Bank, and with full support of the representatives of the U.S. and the other Consortium members, the Aid-to-Pakistan Consortium, which met in Paris in May 1975, emphasized to the Pakistan Government representatives the urgent need for policy reforms to achieve a more rapid increase in food production.

In providing PL-480 assistance careful consideration is given to the level of such assistance so as to avoid disincentives for needed policy reforms. PL-480 assistance constitutes only a minor fraction of Pakistan's total food import needs (about 20 percent of \$446 million in FY 1975), the bulk of which is bought with Pakistan's own scarce free foreign exchange. Balance of payments considerations are such that Pakistan is under great pressure to become self-sufficient in the commodities which are now imported.

The USAID Mission in Pakistan is engaged in an ongoing dialogue of several years duration with the government on needed policy reforms. This dialogue, which has been carried on in the context of overall U.S. assistance and with particular reference to PL-480 and fertilizer assistance, has been stepped up following the Consortium discussions referred to above. Examples of recent action by the Government of Pakistan in carrying out policy reforms to encourage food production are: increases previously referred to in government procurement prices for food grains and in ration ship prices; establishment of the government procurement price as the floor price rather than the ceiling price; a serious and continuing examination of output-input price relationships; decisions to increase fertilizer and seed supplies; modification of the 1973 Punjab Provincial Government takeover of fertilizer distribution; and decision to permit distribution by the private sector of imported phosphate fertilizers.

The current round of discussions is focussing on policy steps which need to be taken and announced in time to influence farmer decisions prior to planting in the fall, including:

- Holding fertilizer prices at present levels which have prevailed since April 1974.
- Continuation of the government wheat procurement price at or above its present level as a floor price for the next (1975-1976) crop.
- Avoidance of coercive government procurement practices.
- Allocation of Tarbela Dam water, available for the first time, to provinces and to specific canals and watercourses.

- Increase in the number of fertilizer distribution outlets, both public and private. Private outlets may be increased through the complete or partial dropping of licensing requirements. Consideration is also being given to increasing the retail margin to a more adequate level, and to the simplification and expansion of credit.

Recommendation No. 3: GAO believes that the impact of Pakistan's defense spending on the amount available to develop economic resources should be fully analyzed before approving the sale of military equipment to Pakistan. Further, Pakistan's defense spending should be fully considered when determining the amount of aid to be provided.

Comment:

Our modification to the policy governing sale of arms to India and Pakistan, announced on February 24, 1975, was carefully formulated to make clear our interest in minimizing the political and economic impact of U.S. arms sales. This intention is reflected in GAO's summary on page 24 of the new policy, in which, *inter alia*, it is stated that the U.S. has no interest in "resuming its pre-1965 role as a major arms supplier to the region." Requests for the purchase of U.S. weapons will be closely scrutinized from a number of angles, including the potential impact on the Pakistani economy and Pakistan's prospects for development. State's Bureau of Near Eastern and South Asian Affairs and its Bureau of Politico-Military Affairs, which jointly monitor arms requests under the new policy, are acutely aware of the need to avoid excessive military spending in the Subcontinent. Accordingly, we are committed to administer the new policy in such a way as not to stimulate an arms race in the area. (No formal requests for new weapons systems have yet been received from the Government of Pakistan, although it has requested so-called "price and availability" data on certain equipment.)

Obviously Pakistan's weapons procurements from this country are only a part of overall military spending. While the trend in recent years (as a percentage of GNP or the national budget) has been encouraging, State and AID agree with Recommendation No. 3 that Pakistan's defense spending should fully be considered in determining aid levels.

Comment on Chapter 1, GAO Report

Assuming that GAO incorporates a series of changes, updated information, and clarifications suggested in recent meetings with GAO officials, we believe that the introduction and sections on political/economic conditions and the Aid-to-Pakistan Consortium constitute a broadly accurate statement. Among the additions we considered particularly important is a strengthening of the

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section on Pakistan's external relations (page 3) to more accurately reflect the roles of the OPEC members and the USSR. We believe the modified section covering the Consortium (pp. 6-7) now represents a useful overview of the complementary roles played by the eleven Western donors.

Comment on Chapter 3:

In the first paragraph, we agree that the level of commitment by the Government of Pakistan is highly significant to the effectiveness of U.S. aid in achieving sustaining economic development. The GAO's observations in this regard may, however, cast doubt on the sincerity of past governments' efforts in seeking broad economic ends. This allegation is, perhaps, somewhat gratuitous since the question of "commitment" is more a measure of their acceptance of our perception regarding what would best improve conditions in Pakistan. Needless to say, Pakistani officials arrive at their own conclusions as to what is best for their country, as well as the political and social feasibility of given targets and approaches. Moreover, the observation that "U.S. agencies administering assistance to Pakistan have not always had this commitment" (by the Government of Pakistan) is made in hindsight; "commitments" and their mutual perception necessarily change over time and in response to changed conditions.

Regarding defense spending, the GAO report correctly identifies such expenditures as about 6 percent of GNP and 24 percent of total government spending. However, (1) there has been a decline in real terms (i.e., increases less than the amount of inflation) in recent years, including a 7 percent decrease in the just-announced FY 1976 budget, and (2) according to a recent ACDA survey, there are some 40 nations which spend at least as large a share of their GNPs on defense as Pakistan does. The comment by GAO (page 22) that "U.S. economic aid indirectly made possible a higher level of defense expenditures than the country could otherwise afford" is somewhat misleading. U.S. lending and grants are channelled to closely-monitored projects which engage scarce Pakistan resources in development; furthermore, withdrawal of this assistance would not mean that funds spent on military programs would be diverted to the AID-backed projects. ~~Likewise, the GAO comment that defense spending is larger than reported is also misleading.~~ Such data can be used for comparisons (worldwide or historically) and any statistical problems will be sorted out on a roughly consistent basis. That is, any containing errors in the data tend to be eliminated when one uses the statistics for year-to-year and country-to-country comparisons (e.g., the FY-75 to FY-76 military spending increase in Pakistan of 11.6 percent -- a likely 7 percent drop in real terms -- is accurate since the spending levels are in error by similar amounts). As noted in our response to the recommendation on arms purchases in the U.S., we will carefully monitor Pakistani requests for such weapons to minimize their impact on development.

Comment on Chapter 3 (pp. 40-49)

We agree with the GAO's analysis of the need to improve Pakistani tax revenues, though we must note that the picture is far more complex than portrayed by GAO. All developing countries rely on indirect taxes more than on income and other direct taxes; it is inherent in the development process that institutions

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develop which permit sophisticated taxes and collection mechanisms to evolve rather slowly. In this regard, Pakistani officials argue persuasively that an agricultural income tax would (1) be difficult to collect given a traditionalist rural structure, and (2) would erode support for the century-old land-revenue tax which, though subject to some abuse, is capable of producing considerable revenues. As the report comes to recognize, the side effects of indirect taxes are complex and not easily predictable. In short, Pakistan's tax structure is a subject which requires careful and in-depth study and for which few easy generalizations or recommendations can be made.

On the nationalizations undertaken by the Government of Prime Minister Bhutto, the GAO analysis tends to oversimplify the effects on investment. Excess capacity in the wake of the separation of Bangladesh also had an important role in deterring new investment. Though statistics are inadequate, the increased investment in small-scale firms appears to have at least partially offset declines in new private investment in larger-scale industries. We also suggested modifications in the GAO report to note the considerable public-sector investment in heavy industry, as well as the ambitious expansion plans being put into effect in the current budget. Finally, the Government of Pakistan's posture of welcoming foreign private investment in many fields was not mentioned in the report.

The report also studies Pakistan's serious trade gap, partially created by recent worldwide economic distortions, and mentions favorably the Government's efforts to seek new domestic energy resources, including Pakistan's large natural gas reserves. GAO's conclusions noted in Chapter 3 again raise objections to the Pakistan Government's price policies and other factors which contribute to lowered agricultural productivity -- . These conclusions in the draft report did not fully reflect the complex difficulties in reconciling policy goals in Pakistan, and tended to give the impression that the Government of Pakistan was not taking hard decisions among various desirable policy alternatives. We are hopeful that State/AID's meetings with GAO officials will result in a more thorough treatment of this aspect.

Recommendation No. 4: GAO recommends that the Administrator of AID obtain a firm commitment of support from Pakistan before providing any additional assistance for the malaria program.

Comment:

AID has assured itself of the Government of Pakistan's firm commitment of support for the malaria control program prior to authorizing a loan of \$20 million for that purpose, the first part of \$35 million to be provided over three years. The loan provisions will include "conditions precedent" which require that prior to disbursement of the loan or issuance of letters of commitment each year, the Government shall (1) provide its federal Directorate of Malaria and (through provincial governments) the provincial health departments all necessary funds

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in addition to the loan for the timely and effective carrying out of that year's portion of the program, and (2) furnish evidence of arrangements for the procurement of necessary commodities, and the distribution and utilization thereof as required for the program. Pakistan, from the beginning of the program, will be required to budget the foreign exchange costs for each year's program operations and for continuing a control program on its own after our share of the financing is completed.

The Government of Pakistan is preparing to issue invitations for bid for the FY 1976 requirement of nearly 7,000 tons of chemical pesticide. Pakistan is responsible for providing the foreign exchange to purchase the pesticide subject to reimbursement by AID under the sharing formula provided for in the loan agreement which obligates Pakistan to pay for 40% of such costs. It is estimated that Pakistan's share of the foreign exchange cost for the five-year program will be about \$27 million.

In addition to its commitment of 40 percent of foreign exchange costs on an annual basis, Pakistan has undertaken the institutional responsibility for carrying out the program, the performance of which will be jointly evaluated annually as a basis for meeting the following year's conditions precedent.

Local currency costs over five years are expected to approximate \$33.5 million equivalent. Of this amount, \$25.3 million equivalent in rupees will be met by grants of excess U.S.-owned rupees which will be provided in accordance with PL-480 Section 104 (f). According to an earlier GAO report, with which we agree, this grant of accumulated U.S.-owned rupees is, in fact, an allocation of Pakistan's own resources, and not a form of U.S. aid.

Recommendation No. 5. a): With respect to disaster relief programs, GAO recommends that the Secretary of State and Administrator of AID:

-- not use disaster relief funds for development assistance programs already justified to the Congress in the annual budget presentation for the purpose of reprogramming these funds to other countries, thus supplementing a congressionally imposed limitation on foreign assistance.

Comment:

We concur in and will implement this recommendation. We wish to point out, however, the particular circumstances concerning implementation of the \$18 million Agricultural Production Loan signed November 15, 1973, the principal purpose of which was to finance fertilizer imports to expand Pakistan's food production following the flood disaster of August 1973. GAO concluded that this loan did not support the emergency relief and rehabilitation efforts and, therefore, should have been funded with regular development assistance funds.

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When the President's Disaster Relief Coordinator visited Pakistan in early September 1973 to review the extent of the flood damage and to consider ways in which the United States might help Pakistan in the rehabilitation stage, we had only a limited ability to provide food from the United States. This reinforced the conclusion that every effort should be made by Pakistan itself to produce more food, and in examining the opportunities for food production and the ways in which we might help, it was decided to give priority to fertilizer supply. Pakistan was concerned at the time about a potential fertilizer supply problem and we judged that a quickly processed loan primarily for fertilizer would cause Pakistan to act more vigorously to commit its own resources for fertilizer purchases and to get in-country stocks of fertilizer out to the farmers in anticipation of AID financing subsequently becoming available to reimburse the Pakistan Government for such purchases to replenish fertilizer stocks. For these reasons we related the \$18 million loan to the disaster.

The rapidity of the increase in fertilizer prices, the extent of the difficulty in making fertilizer purchases and the very unfortunate action by the Punjab Government relative to taking over of fertilizer distribution were all factors we did not anticipate. We judged it advisable to hold up signing the loan while the Government of Pakistan tried to limit the damage done by the Punjab action - though under the reimbursable procedures we were following, this, of course, did not hold up Government of Pakistan procurement of fertilizer. We conclude that the existence of the loan speeded up GOP procurement action and led to important rectification of the Punjab action. While the implementation did not go as we had hoped, the funds will have been well used for the purpose of increasing production of food. Given the facts as we knew them at the time decisions were made, we believe AID acted prudently in the implementation of this loan. Moreover, the Congress acted on the disaster relief assistance to Pakistan, following a visit to Pakistan by a Congressional study team, after full consideration of the facts, including knowledge of the \$18 million fertilizer loan, and including consideration of the very questions the GAO now raises about that loan.

Recommendation No. 5. b): With respect to disaster relief programs GAO recommends that the Secretary of State and Administrator of AID:

- establish guidelines and procedures for the fixed-cost reimbursement method of aid to require that plans, specifications, and fixed amounts to be reimbursed be agreed upon between AID and the benefiting country before actual work on such projects is undertaken, and that the agreement include a provision that the foreign exchange provided be used to purchase commodities in the United States.

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Comments:

Following the flood in August-September 1973 the Government of Pakistan immediately assessed the damage and assigned priority to specific project areas in order to most effectively mobilize its resources. Pakistan's need for assistance was urgent, and the USAID Mission immediately reviewed GOP's rehabilitation plans to determine how U.S. assistance might be most effective. We concluded that the greatest benefit would accrue to the population most seriously affected by the flood from U.S. participation in the repair of rural feeder roads, the repair or replacement of schools and medical facilities destroyed or seriously damaged, and in the replacement or construction of potable water wells in flood damage areas.

A fixed cost reimbursement grant to partially finance these specific rehabilitation efforts (which involved primarily local costs for indigenous materials, labor and equipment operation) was explored with Pakistan and discussed fully with the Congress. Funds for the grant, although appropriated in December 1973, were not authorized until July 1974, the month when the \$27.5 million grant agreement with Pakistan was signed.

The grant, in keeping with principles conditionally agreed upon with Pakistan some months earlier, provided for the reimbursement of a fixed dollar amount to be determined for each project and not to exceed 70 percent of the estimated direct costs of labor, equipment, materials required for construction, construction materials, and contractor services.

Because of the urgent necessity for Pakistan to move ahead with rehabilitation and because of delay incurred in executing the grant agreement after mutual understanding had been reached on the fixed cost reimbursement procedure, Pakistan, with AID's concurrence, proceeded with the construction of certain of the rehabilitation projects after USAID/Pakistan had reviewed a sampling of designs, specifications and estimated costs. Upon completion of sub-project segments or units reimbursement is being made on the basis of AID's verification that expenditures were in accordance with agreed design and construction criteria. It should be noted, however, that this activity has proceeded much less rapidly than we had anticipated. The first request for reimbursement was received in May 1975.

We concur in the recommendation concerning guidelines and procedures for the method of fixed cost reimbursement to be followed in normal situations. Such procedures were spelled out in AID Circular A-513 dated July 17, 1974 entitled "Use of Fixed Amount Reimbursement Method for Local Cost Financing." The procedures used in financing the flood rehabilitation projects in Pakistan are consistent with these guidelines.

In its further discussion of the Pakistan Disaster Relief Program GAO recommended that future agreements involving use of the "fixed cost or fixed amount reimbursement" method include a requirement that foreign exchange provided to the benefitting country be used to purchase in the United States any commodities needed to satisfy its import requirements.

In financing local costs in disaster relief programs, we do give consideration to tying the dollars for procurement in the United States if a significant balance of payments impact is foreseen. This was not visualized as likely in connection with the flood grant to Pakistan since the United States was the largest single exporter to Pakistan, and since demand for imports from the U.S. in the form of cash purchases of food was rising. Furthermore, Pakistan suffered major foreign exchange losses in potential earnings and we believed it desirable to give Pakistan some flexibility in meeting its import bill. We would, in the future, give serious consideration to GAO's recommendation to tie free dollars a country receives under the fixed cost reimbursement system used in disaster relief programs to expenditure in the U.S.

Flood Relief and Rehabilitation Grant
(Chapter 5, pages 67, 68 and VI of the Digest)

We suggest that GAO modify and clarify its discussion on the pages referred to above concerning the \$27.5 million grant for flood relief and rehabilitation so as to take into account the following points:

a) In justifying the request for \$27.5 million for flood relief and rehabilitation, our Congressional presentation and testimony made it clear to both Houses that dollars were to be used for local costs to assist in financing reconstruction and rehabilitation of rural feeder roads, primary and secondary schools, medical facilities, and community water facilities.

b) The \$27.5 million amount for relief and rehabilitation assistance was appropriated under Title IV of the Foreign Assistance Appropriation Act of 1974, passed by the Congress in December 1973. These funds were, however, not available until passage of the Authorization Act in July 1974.

c) In the last paragraph, page 67, GAO's statement concerning its view of the broad applicability of Section 113 of the Foreign Assistance and Related Programs Appropriation Act of 1974 (which specifically prohibits the use of dollars appropriated under Title I of the Act to finance local currency costs in countries where we have U.S.-owned excess currencies), would appear to prohibit the use of the dollar appropriation by the Congress to finance local costs for relief and rehabilitation in the Pakistan disaster case. The GAO report notes that AID's General Counsel determined that Section 113 does not apply to Title IV of the Act and states further that "we do not necessarily disagree with AID General Counsel's technical legal opinion; however, we believe that the statement concerning the sense of the Congress /Section 113/ has broader application than /to/ Title I of the Act." We suggest that this statement be clarified, as it appears to be inconsistent with other statements in the report. The statement could be interpreted as implying that we should have provided U.S.-owned excess rupees in lieu of dollars, which would simply mean that we would have provided \$27.5 million less aid to Pakistan than the Congress authorized. The substitution of U.S.-owned rupees would not have provided

Pakistan with "new" resources and, in fact, would have constituted a claim against Pakistan's own resources. GAO clearly recognized this principle in its extensive study and report of 1971 entitled "Opportunities for Better Use of United States-Owned Excess Foreign Currency in India" in which GAO stated:

"The United States does not provide additional resources when it lends or grants rupees to India, as pointed out on pages 69 and 70 of this report. Thus, there is no economic benefit in terms of new resources when the United States provides the Indians with U.S.-owned foreign currency in India. A grant of U.S.-owned foreign currency is akin to an agreement whereby the United States and Indian Governments simply decide to attribute to the U.S. Government the financing of a project that actually is financed from current Indian resources."

The Congressional Research Service, Library of Congress, in its January 1974 report entitled "The Availability and Use of Local Currencies in the U.S. Foreign Aid Programs" prepared for the House Foreign Affairs Committee, commented as follows on the transfer of U.S.-owned local currency:

"Two facts noted above should be reemphasized: First, there is only one real resource transfer into the recipient's economy: the American commodity. After that transfer, the real economic benefits cease, though in many instances there might be further benefits resulting from the provision of financial resources. Second, the local currency given to the United States in exchange for the commodities is a potential claim on the real resources of the recipient. When the United States spends the local currency in the country that created it, the claims placed upon that economy will require new real resources if they are to be met. The real resources foregone by the aid recipient will not be available for domestic consumption, investment, or export."

Donation of Helicopters

The report states on page 76 that "Neither Pakistan nor AID had any specific plans for how six helicopters funded from AID's contingency fund would be used. In our opinion, this was an unnecessary use of appropriated funds."

The GAO report describes the circumstances under which the six U.S. Army helicopters, previously used in providing assistance in the disaster relief operations following Pakistan's 1973 flood, were transferred to Pakistan. In implementing the Grant Agreement of February 24, 1974 covering these helicopters, our AID Mission in Pakistan obtained explicit agreement by the Government of Pakistan regarding eligible civilian uses and internal budget procedures to assure cost recovery for these uses and, consequently, for maintenance of the aircraft. Disaster relief was the highest priority usage, and the helicopters were placed under the control of the Government's disaster relief unit.

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The decision to give priority to keeping the helicopters in a state of readiness for use in disaster relief emergencies, we believe, has proven sound. As a result of the December 28, 1974, Swat earthquake in the mountains of northern Pakistan, road access to the affected area was broken by landslides and other damage. The disaster relief aircraft and such other helicopters as Pakistan could deploy flew some 400 sorties, airlifting medical teams, clothing, field hospitals and tents to the disaster area, and bringing out seriously injured for hospitalization. We believe that the availability of these helicopters to Pakistan for possible future emergency operations such as the earthquake and the flood disaster relief programs will prove to be of humanitarian value.

In referring to the very limited use of the helicopters by other civilian agencies of the Pakistan Government, the GAO team noted at the time of its field visit late in 1974 that the various agencies had not been provided with usage criteria or informed of procedures for obtaining the aircraft and for making reimbursement therefor; and, therefore, they had not budgeted such costs. The agencies were subsequently informed of the criteria, procedures and costs, and our Mission in Pakistan expects such general usage of the helicopters to increase.

PL 480, Title I Assistance - (pages 69-72)

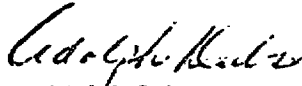
We suggest that the following statement concerning grain sorghum imported by the Pakistan Government be added to the last paragraph, page 70:

An official of the U.S. Department of Agriculture has also confirmed that the Government of Pakistan knew that only mixed (yellow and brown) sorghum was available. The Purchase Authorization requested by GOP in late November was issued on December 2, 1973. The GOP arranged purchases and shipping. One ship booked by GOP had mechanical problems and did not depart from the U.S. port until February.

Chapter 4, Population Planning and Malaria Control Programs

In accordance with our discussions with GAO's representatives we are attaching separate detailed comments on Chapter 4 of the draft report. (GAO Note)

If GAO feels it would be useful in preparation of its final report, we shall, of course, be glad to provide additional documentation which may be desired and discuss further with GAO's representatives any of the matters covered by this statement and by our separate comments on Pakistan's family planning and malaria control programs.



Adolph Dubs
Deputy Assistant Secretary
Bureau of Near East and South Asian Affairs

Attachment a/s

GAO Note: Chapter 4 of the report has been modified to reflect these detailed comments as considered applicable.

APPENDIX IV

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UNITED STATES DEPARTMENT OF AGRICULTURE
FOREIGN AGRICULTURAL SERVICE
WASHINGTON, D.C. 20250

AUG 10 1975

Mr. J. K. Fasick, Director
International Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Fasick:

Reference is made to your letter of May 16, 1975 with which you enclosed a draft of your proposed report to Congress on your review of U.S. assistance to Pakistan and requested our written comments.

The main thrust of the report is directed toward development problems and policies which are the responsibility of the Agency for International Development.

This Department is concerned with disincentives to agricultural production in Pakistan and has strongly supported AID efforts to obtain changes in Government of Pakistan policies in order to encourage farmers to increase production, especially of wheat. These policies were discussed at the Consultative Group Meeting on Pakistan in Paris in May of this year and the GOP has taken some favorable policy decisions as a result. Presumably, this was after the GAO report was drafted.

As soon as the exportation of barley by Pakistan in violation of the terms of the Title I grain sorghum sale was detected by our Agricultural Attache, this Department took the lead in working with State/AID in finding a solution to the problem and took necessary corrective action. The purchase of the grain sorghum for cash was the best course of action Pakistan could take in order to be in compliance with provisions of P.L. 480.

Sincerely,

David L. Hume
Administrator

PRINCIPAL OFFICIALS RESPONSIBLE FOR ADMINISTERING
ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of Office</u>	
	<u>From</u>	<u>To</u>
<u>DEPARTMENT OF STATE</u>		
SECRETARY OF STATE:		
Henry A. Kissinger	Sept. 1973	Present
William P. Rogers	Jan. 1969	Sept. 1973
ASSISTANT SECRETARY FOR NEAR EAST AND SOUTH ASIAN AFFAIRS:		
Alfred L. Atherton, Jr.	Mar. 1974	Present
Roger P. Davis (acting)	Feb. 1974	Mar. 1974
Joseph J. Sisco	Feb. 1969	Feb. 1974
AMBASSADOR TO PAKISTAN:		
Henry A. Byroade	Oct. 1973	Present
Sidney Sober (Charge' d'Affaires)	Apr. 1972	Oct. 1973
Joseph S. Farland	Sept. 1969	Apr. 1972
<u>AGENCY FOR INTERNATIONAL DEVELOPMENT</u>		
ADMINISTRATOR:		
Daniel Parker	Oct. 1973	Present
John A. Hannah	Apr. 1969	Sept. 1973
ASSISTANT ADMINISTRATOR FOR ASIA (note a):		
Arthur Z. Gardiner	Oct. 1975	Present
Alfred D. White (acting)	Mar. 1974	Oct. 1974
Donald G. McDonald	Sept. 1970	Mar. 1974
ASSISTANT ADMINISTRATOR FOR NEAR EAST AND SOUTH ASIA (note a):		
Robert H. Nooter	Oct. 1974	Oct. 1975
DIRECTOR, U.S. AID MISSION TO PAKISTAN:		
Joseph C. Wheeler	Aug. 1969	Present

a The Bureau for Asia was reorganized to form the Bureau for Near East and South Asia in October 1974, and effective October 12, 1975, a Bureau for Asia was again established to include country responsibility for Pakistan.