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Mdramasa Papers

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Folder 2

RETURN TO ARCHIVES IN MC C3-120
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**DECLASSIFIED
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OFFICE MEMORANDUM

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MAY 08 2013

WBG ARCHIVES

TO : Records

DATE : July 21, 1970

FROM : M.H. Wiehen *MHW*STRICTLY CONFIDENTIALSUBJECT : Pakistan - Call of Mr. M.M. Ahmed on Mr. McNamara

1. On July 16, 1970, Mr. M.M. Ahmed, Deputy Chairman of the Planning Commission, Government of Pakistan, called on Mr. McNamara. Mr. M.M. Ahmed was accompanied by Messrs. Osman Ali and Sartaj Aziz. Also present were Messrs. Knapp, Cargill and Wiehen.
2. After some introductory remarks about the present political situation, Mr. M.M. Ahmed informed Mr. McNamara that the President of Pakistan was determined to devalue the Rupee within about two weeks after the provincial elections which are scheduled for October 22. The President was, however, expecting to receive substantial support from the Consortium, under the leadership of the Bank Group. He stated that under these particular circumstances a reduction in the IDA allocation for Pakistan in FY 1971 to \$50 million would be a great disappointment; it would have great significance, far beyond the absolute amount involved, in that the Bank Group would fail to set an example for the other Consortium members in providing support to the Government of Pakistan at a very critical time.
3. Mr. McNamara assured Mr. M.M. Ahmed that he fully appreciated the difficulties Pakistan was facing. He said the allocation for Pakistan had to be reduced this year because of increased demands from other areas which had received too small a share in the past. He also referred to the slow disbursement under several existing credits to Pakistan and added that this rather unsatisfactory performance had had some effect on his decision to reduce Pakistan's allocation. However, he told Mr. M.M. Ahmed that he should not be too concerned about the reduction to \$50 million. It was quite likely that, as time went by, more funds would become available (e.g. from slippage of projects in other countries), and while the total would certainly not reach the level of FY 1970 (\$77.2 million), it might well be higher than \$50 million.
4. Mr. M.M. Ahmed said he would find it extremely difficult to explain the reasons for this reduction to his President. He added that, depending on the action of other Consortium members, he might under these circumstances not be in a position to recommend a devaluation to the President of Pakistan.

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5. Mr. McNamara closed the discussion by stating that in his opinion it would be a serious mistake to draw such a conclusion from the relatively insignificant reduction of IDA lending in FY 1971 which in any case would be a temporary situation, to be followed by increased amounts of lending during the following fiscal year.

Cleared by: Mr. I.P.M. Cargill

CC: Mr. L.E. Christoffersen
Mr. G.B. Votaw

MHW/gp

*For your 3.30 pm
mtg on THURSDAY*

OFFICE MEMORANDUM

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MAY 08 2013

WBG ARCHIVES

TO: Mr. Robert S. McNamara

DATE: July 14, 1970

FROM: I.P.M. Cargill

*Shaban*CONFIDENTIALSUBJECT: Your Meeting with Mr. M. M. Ahmad - Pakistan's Deputy Chairman, Planning Commission*working on 70 m.*

1. The only topic of importance M. M. Ahmad is likely to raise with you on July 16 is the reduction of the IDA allocation for Pakistan in the current Fiscal Year to \$50 million. I have informed Osman Ali of this change and will be informing the Consortium next week.

2. In the context of an aid program equivalent to more than \$500 million gross a reduction in the IDA allocation of about \$22 million cannot appear very significant. Moreover, assuming a much larger replenishment of IDA next year, it can be expected that IDA lending to Pakistan will revert to at least the level of 1969/70 (about \$77 million) and the current year can be regarded as reflecting a temporary situation. Furthermore, both Burke Knapp and I have from time to time warned that Pakistan's share may have to be reduced below 12 1/2% of available IDA resources simply because the pressures on these resources of demands from other countries have been growing. Nonetheless, the present position will come as a surprise both to Pakistan and to the Consortium.

3. In talking about a reduction below the level of 12.5%, I had not indicated a reduction to as low as 8.5%, and our lending program for the current year was planned on the assumption that any reduction would be fairly small. Also, from the point of view of Pakistan this comes at an inopportune time. The discussions that Gunter of the Fund and I had with the Pakistan authorities last month led to a decision (which, in my opinion, it is genuinely intended to implement) for a major devaluation of the Pakistan rupee after the October elections. A major feature of the new exchange system will be a floating rate for a majority of the transactions and the Pakistan authorities are extremely nervous about their ability in the short run to maintain an orderly floating rate at levels which would be politically acceptable. They fear that the stand-by arrangements with the Fund may not be sufficient and have asked me as Chairman of the Consortium to approach the larger Consortium countries for additional support in the form of debt relief for at least one year and larger program lending. Both these ideas make a good deal of sense in this context. In these circumstances Pakistan will undoubtedly feel that a sharp cut in IDA support will weaken the Bank's position in advocating Pakistan's case.

4. In a second respect, too, the timing of this decision is unfortunate. We are about to make a very large effort to secure the Consortium's support for the East Pakistan Water and Agriculture Development Program and were expecting to recommend in the current year IDA credits for three projects and partial financing of the cost of EPWAPDA consultants in East Pakistan. As we have already committed \$23 million for West Pakistan Power Transmission and are very far advanced with a major polder project in East

*77. ✓
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1190 = 10.72*

July 14, 1970

Pakistan for which we made an engineering credit last year, the program will have to be reduced to these two projects eliminating amongst others a grain storage project which we were doing in conjunction with Sweden. It should be mentioned, too, that a small credit for the Lahore Water Supply also being financed jointly with Sweden would have to be eliminated from the current program.

5. However, these consequences of the stringent resource position must be accepted and I would have no concern if similar percentage reductions were being made in the allocations to the other two major users of IDA resources. I think I can say with confidence that since the discussions three years ago which led to the ceilings of 12 1/2% and 40% on allocations to Pakistan and India, Pakistan and the Consortium countries, especially the U.K., have accepted that in time these proportions may have to be changed but that they would be changed equally for both countries. Given the history of this case, I think that the major Consortium countries, for political reasons alone, would find themselves unable to support (if their opinion needed to be asked) a differential treatment for Pakistan.

6. A sharp cut in the IDA allocation to Pakistan may also be questioned by members of the Consortium in the context of the discussions on future amounts and terms of assistance to Pakistan which we began last February. At the review meeting of the latest CPP on February 11, we agreed that the Bank itself would not provide debt relief. You noted that whatever the Bank Group might have to do to secure agreement within the Consortium, would have to be done through IDA. I can see ourselves in a very difficult position when, in reopening these discussions later in the year, we have to say that not only we do not intend to participate directly in debt relief, but also will have less IDA resources available.

7. Of course I have only a view of a small part of this highly complicated question of IDA allocations and am not about to dispute the decision regarding Pakistan if it is final. However, at this particular junction, I think it will certainly cause us trouble in our relations both with Pakistan and the Consortium.

cc: Mr. Knapp

OFFICE MEMORANDUM

TO: Mr. Leif Christoffersen

DATE: July 9, 1970

FROM: Michael H. Wiehen *MHW*SUBJECT: PAKISTAN -- Delegation to Discuss East
Pakistan Water and Agriculture Program

1. There is at present an 8-member delegation from Pakistan in Washington to discuss a draft proposal for an action program for the East Pakistan agriculture and water development. The delegation is headed by Mr. A. Rab, Secretary, Planning Division, Government of Pakistan (successor to Qamarul Islam). Mr. Rab has asked whether there would be a possibility for him to pay a courtesy call on Mr. McNamara. He would like to bring along Mr. M. Keramat Ali, Additional Chief Secretary (Planning), Government of East Pakistan, and Mr. B. M. Abbas, Chairman, East Pakistan Water and Power Development Authority. Mr. Rab and Mr. Keramat Ali will be available in Washington all day today and tomorrow. Mr. Abbas is scheduled to leave town early tomorrow morning. I wonder whether it will be possible for you to arrange a 5-10 minute meeting with Mr. McNamara, today or tomorrow, preferably today.

2. As you know, Mr. Sadove's group has prepared a very detailed draft action program, which has been discussed with, and broadly agreed to by, the delegation from Pakistan. Before this action program can be circulated to the Consortium members, a fair amount of editing will have to be done. We are presently trying to have the new version ready for distribution to the Consortium members at the meeting of the Consortium in Paris July 23, 1970. We do not expect to have, at the forthcoming Consortium meeting, a discussion concerning any of the details of the proposed action program. Mr. Cargill will merely report to the Consortium on the progress made since the February Consortium meeting in preparing the program, and suggest that a discussion on the substance of the action program take place at another meeting to be held later in the year, say, December.

3. During this week's meetings with the Pakistan delegation, two main issues arose:

- (a) The action program will have a very substantial local expenditure component. The Government of Pakistan has already, during the last two or three years, had serious difficulties in making sufficient rupees available to carry out on-going Bank/IDA financed as well as other aid-financed projects. The still spotty information we have on the budget for FY 70/71 does not indicate a major effort by the Government to accelerate the mobilization of domestic resources. With the present budget provisions it would be extremely difficult, if not impossible, to carry out on-going projects and to take up the very substantial action program at the same time. The delegation from Pakistan realizes this, and has therefore requested that the Bank/IDA and the Consortium members finance up to 80 or 90 percent of total project costs, which

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July 9, 1970

would include a very sizable contribution to the local currency expenditures. They have also requested that projects with flood control components (which would include all the major polder projects contained in the action program) be financed by grants.

- (b) The action program does not include any of the big barrage projects (like the Ganges barrage which might cost up to \$1 billion) which are being discussed very extensively in East Pakistan and which the Government of East Pakistan, for political reasons, cannot drop from their program. We feel that though some studies on these big barrage projects may continue, no major investments should be made -- neither in preparing the detailed design nor in physical construction. The issue, in other words, which has not been resolved satisfactorily yet, is whether the Government will give sufficiently high priority to the projects included in the program to avoid spreading limited funds and manpower too thinly, to the detriment of all projects.

K
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A return to Pally

OFFICE MEMORANDUM

TO: Mr. Leif E. Christoffersen

FROM: Michael H. Wiehen *MHW.*

SUBJECT: Pakistan

DATE: October 23, 1970

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I understand that Mr. McNamara will attend the lunch given by Ambassador Hilaly for President Yahya Khan this Sunday. In view of this Mr. McNamara may wish to see the attached two papers which deal with the proposed reform of Pakistan's exchange system and import liberalization.

As you know Mr. Cargill is presently in Europe to discuss the Bank's proposal for Consortium assistance in support of the proposed exchange reform with the Governments of the U.K., France, Germany and Italy. Further talks with the U.S. and Canada will take place early next week. The other Consortium members have been requested to inform the Bank of their position by October 26.

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SECRET

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REFORM OF THE EXCHANGE SYSTEM AND IMPORT LIBERALIZATION IN PAKISTAN
- A FURTHER NOTE ON SUPPORTING ASSISTANCE -

I. THE NEED FOR SUPPORTING ASSISTANCE

1. In the earlier paper on this subject, dated September 28, 1970, a case was presented for assistance from the Consortium in support of the proposed reform of the exchange system and import liberalization in Pakistan in the amount of US\$175 million. The argument for such support was based principally on the following grounds:

- (a) The reform represents a major improvement in Pakistan's framework of economic policies. It would strengthen considerably the country's capacity for raising exchange earnings as rapidly, and for using exchange resources as efficiently, as the analysis presented in the Bank's staff paper 'External Assistance Policy Towards Pakistan - A Review of Amounts and Terms of Assistance' has shown to be essential for maintaining the momentum of development even with substantial improvements in assistance policy towards Pakistan. Although not conditional upon such support, the reform, as a major decision by the Government in a highly important field of policy, warrants the fullest possible support from the Consortium.
- (b) The effectiveness of the reform in raising the productivity of Pakistan's economy through improvements in the allocation of resources is in the short run - that is, the period of 12-18 months following the introduction of the reform - contingent upon external support. The potential for such improvements exists on a considerable scale even in the short run, largely in the form of idle capacity in the manufacturing sector. To the extent such capacity has lain idle because the present exchange and import regimes rendered it uncompetitive, the proposed reform will go far towards removing this cause of inefficiency in the use of resources. However, the reform by itself will not, in the short run, be able to remove what has been another major cause of under-utilization of industrial capacity, namely, the lack of adequate supplies of imported inputs. This is so because of the rigidities which will unavoidably operate in the short run: exchange earnings are not likely to respond immediately to higher returns from exports resulting from the reform; well over half the increase in exchange earnings expected by 1970/71 over the level of 1968/69 ^{1/} will be absorbed by the rise in external debt service obligations; the aid pipeline - roughly US\$970 million as of June 30, 1970 - consists very largely of project aid (US\$755 million, or nearly 80 percent of the total) and is therefore in a form where it cannot be used to finance those kinds of imports that are most likely to increase; and neither the undisbursed amount of non-project aid already committed - US\$ 215 million - nor the amount pledged for 1970/71 - US\$ 192 million, excluding food aid - are significantly above recent

^{1/} Present estimates indicate that exchange earnings in 1969/70 were practically unchanged from 1968/69.

historical levels and cannot, therefore, be expected to support disbursements significantly larger than the average in recent years of roughly US\$ 200 million. Thus, without additional exchange resources, there is little scope for increasing imports of industrial materials. Liberalization and the exchange reform as a whole notwithstanding, the amount of resources now in sight would make it necessary to keep such imports roughly at the annual level of about US\$ 300 million that has prevailed throughout the 1960's. In other words, it would be necessary to prevent the large potential increase in demand for industrial inputs, which undoubtedly exists as a result of the sizeable expansion of industrial capacity during the last decade, from becoming effective by means of very stringent credit restrictions, by means of a rise in the flexible market rate, or by a combination of the two. In short, failure to obtain additional resources would not by itself doom to failure the whole reform; the exchange system could still be reformed effectively and imports liberalized, but economic activity would have to be kept at a low level during the period of economic re-adjustment. In particular, it would not be possible to any significant degree during this period to make use of the large potential for increased productivity of existing capacity in the manufacturing sector.

- (c) A notional forecast of Pakistan's balance of payments for 1970/71 indicates an overall deficit in the order of US\$ 125 million, assuming the reform is introduced and the exchange rate in the flexible market kept in the range of Rs.10-11 to the US dollar. If a period of 18 months is taken as the time required by the economy to effect the most difficult part of the structural transition from the old to the new exchange and import regimes, the overall deficit in the balance of payments would increase to about US\$ 175 million. Pakistan's liquid reserves - consisting of about US\$ 210 million in official reserves and US\$ 125 million in IMF resources that would become available under the proposed stand-by agreement - would not be available for financing this basic deficit because:
- (i) they are needed to enable the authorities to cope with periods of net outflows of exchange within the period of transition which must be expected to occur because of speculation, initial build-up in inventories and seasonal factors, and which are not allowed for in the forecast deficit of US\$ 175 million.
 - (ii) total reserves, including drawing rights on the IMF, are equivalent to only four months of estimated annual payments, net of aid financing in sight. They are not sufficient to give Pakistan a comfortable liquidity position to maintain confidence in the new system - which will be essential to the establishment of an orderly flexible market - in the face of what, from time to time, could well be sizeable net outflows of exchange.

2. These considerations led the paper to argue that Pakistan needed special support from the Consortium to cover the basic deficit of US\$ 175 million forecast for the 12-18 months period following the introduction of the reform. Some questions raised and comments made on this argument at the meeting in Paris on September 28, 1970, suggest that it may be useful in preparing for the next

round of discussions on this subject to elaborate a little further on the substance of the case presented in the earlier paper, particularly the argument that financing of the basic deficit must come from the Consortium rather than from use of IMF resources and/or reserves.

3. To do so, we have to pick up the main threads of the analysis presented to the special meeting of the Consortium in February this year.^{1/} It was shown there that, even with highly effective policies in respect of the domestic mobilization and use of resources, it is the level of net transfers from abroad which will determine how much faster than population Pakistan's economy can grow. The findings of the IBRD economic mission, which presented its report to the Consortium in July, provide no grounds for taking a more optimistic view of the future; if anything, they suggest that the level of net resource transfers needed to support economic growth at an annual rate around 6% may have been underestimated, rather than exaggerated, in the study on external assistance policy.

4. The next essential point to make is that the introduction of the exchange reform will not alter the basic outlook as analyzed in the February paper and the July report. As for the outlook for earnings, it must be remembered that the present system has been managed quite effectively in maintaining incentives for export and that as a result Pakistan's achievement in increasing exchange earnings in the 1960's compares favorably with the record of most developing countries. The weak spot was in the treatment of most primary products, particularly raw cotton and jute. These should increase faster than they have in the past, when the more effective returns begin to make themselves felt. However, faster growth in primary exports will most probably be needed largely to compensate for slower expansion in bonus remittances which accounted for a very considerable part of the total increase in earnings in the latter half of the 1960's. In any event, the analysis presented in the study on external assistance policy was already on the rather optimistic assumption that Pakistan would manage to raise its exchange earnings by 9.5% a year. An exchange reform as now proposed was needed to strengthen the realism of this assumption, but it would appear unrealistic to expect that it will accelerate growth beyond the rate of 9.5% a year.^{2/}

5. The same argument applies, mutatis mutandis, to the effect of the exchange reform as now proposed on future imports and other payments. The projections in the paper on external assistance policy assume that growth of GDP at 6.5% a year will be consistent with annual increases in imports of 6.8% in the period 1970/71 - 1974/75. A fundamental reform of the exchange and import system is

^{1/} IBRD, External Assistance Policy Towards Pakistan - A Review of Amounts and Terms of Assistance; January 1970.

^{2/} In the light of the limited possibilities for stepping up East Pakistan's exports in the medium term, this rate of growth implies, inter alia, that exports from West Pakistan will grow by 12% annually. (See IBRD, The Current Economic Position and Prospects of Pakistan, July 1970; p. 121.)

needed because it does not seem possible to achieve the relationship between GDP growth and imports implied in these projections within the existing system. However, it does appear realistic to expect the reform to open up additional possibilities for reducing the dependence of the economy on net imports. 1/

6. In conclusion, the fact that the Government of Pakistan now intends to undertake a fundamental reform of the exchange system does not essentially alter the grim outlook presented in the paper on external assistance policy: unless those providing assistance to Pakistan decide to improve substantially their current external assistance policy towards that country, even rapid growth in exchange earnings and savings, combined with careful husbanding of available resources, will not give Pakistan the resources needed to support growth of GDP around 6%, as in large part such internally generated improvements would merely compensate for an absolute decline in net transfers from abroad. This, of course, is the outlook depicted in Case 1.1 in the paper on external assistance policy. 2/

7. In brief, the Government of Pakistan must decide now whether or not, in conjunction with the introduction of the exchange reform, to allow industrial and, thereby, general economic activity to expand significantly, against a background that may be summarised as follows: first, a basic, long-term outlook for Pakistan's resource and balance of payments position that is likely to be difficult even in the event of a substantial improvement in external assistance policy, and very much more so if those providing assistance to Pakistan do not act favourably; second, the strong likelihood that expansion of industrial and general economic activity in the period immediately following the reform will not, directly or indirectly, produce a significant improvement in Pakistan's resource and balance of payments position. Were it to decide, in the absence of supporting assistance from the Consortium, to make available resources for a significant expansion of industrial activity by drawing on the IMF or using up its own reserves, it would have to do so knowing that a few years hence it will have to achieve a balance of payments surplus to restore reserves. Given the basic, long-term outlook, achievement of such a surplus will, in the best of circumstances, require economic activity to be slowed down somewhat below what is in any event not likely to be very rapid expansion, but may necessitate near-stagnation in the event external assistance policy does not improve substantially in the longer run. It is difficult to see how a responsible government could, in the light of the risks involved, decide to follow such a course of action.

1/ Limitations on the possibilities of further narrowing the savings-investment gap by either accelerating the growth of saving (beyond the marginal savings rate of 18% assumed) or slowing down the expansion of investment support in this argument.

2/ IBRD, External Assistance Policy Towards Pakistan - A Review of Amounts and Terms of Assistance; January 1970; pp. 16-19.

8. Clearly, had it been possible by now to reach a firm understanding on an external assistance policy consistent with reasonably rapid economic growth in the longer term, the need for assistance from the Consortium in support of the reform would not have arisen with the same intensity. As it is, only the Consortium can provide the kind of resources that will not, to an intolerable degree, pre-empt future policy options. In other words, there is essentially no difference between the arguments presented earlier for a change in assistance policy for the longer run and those made now for special support for the exchange reform: in substance, both revolve around the question what level of economic activity and pace of development the Consortium is willing to support in Pakistan. A positive response from the Consortium now to the request for special assistance will not eliminate the need to resolve the problem of external assistance policy in the longer run. However, it would provide a little time during which to search for such a solution, while in the meantime enabling Pakistan to reap substantial benefits from the exchange reform which would otherwise be foreclosed in the short run.

II. RECOMMENDATIONS FOR ACTION

9. If it is agreed that

- (a) the exchange reform, which the Government of Pakistan now proposes to undertake, warrants the fullest possible support from the Consortium, and
- (b) US\$175 million represents a reasonable estimate of the amount of supporting assistance that would be needed to enable Pakistan to exploit to a significant extent the potential for economic improvement opened up by the reform;

then the next question is how supporting assistance in such an amount may be raised from among the members of the Consortium. The section that follows deals with this question as its principal subject. It also raises the question what might possibly be done now about increasing the value of commodity assistance to Pakistan by reducing restrictions presently placed on its use.

A. INDIVIDUAL CONTRIBUTIONS

10. For some time, the Consortium has operated without an explicit, generally accepted formula for determining individual contributions towards the total amount of assistance it is providing to Pakistan. What consensus on such a formula existed in the first half of the 1960's has since been heavily eroded, principally by two developments: first, the inability of the United States, in the context of its changing total aid program, to maintain, much less increase, the absolute amount of its commitments to Pakistan; second, the sharp rise in debt service payments to most members other than the United States which, as they were not matched - even less, exceeded - by increases in gross disbursements, have tended to erode considerably their contributions in terms of net transfers of resources. As a result, it is not possible now, by reference to well established and universally accepted practice, to make specific recommendations such as are needed for this exercise. This situation was acknowledged in the discussion in February this year about the Consortium's future assistance policy. It points to the clear and urgent need to evolve a new formula which is in line with current realities. However, it is clearly impractical in conjunction with the present exercise to attempt to propose and seek agreement on such a formula.

11. In the circumstances, any formula for determining how much each member of the Consortium should contribute towards the total of US\$175 million must perforce be fairly rough and ready. Further, we thought

that, to be acceptable for even the very limited purpose for which it is intended, such a formula must embody two, possibly conflicting, criteria: it must employ past shares of individual members in total gross assistance provided by the Consortium; it must also take cognizance of the fact that fast rising debt service payments are a major cause of Pakistan's difficult balance of payments position and outlook and that, because of the very wide difference between members in the terms of past assistance, individual members have contributed in widely varying degrees to the increase in debt service. ^{1/} We also thought it desirable to have as simple a formula as possible.

12. We concluded that debt service payments due in calendar year 1971 offered the most reasonable basis for determining individual shares in total supporting assistance. If all members had assisted Pakistan on the same terms (and for the same length of time), each country's share in debt service payments would be identical with its share in total assistance provided by the Consortium. To the extent they differ, they do so because countries have been giving their assistance on terms better or worse than the average. In other words, a formula so based meets both of the substantive criteria set out above.

13. Estimated debt service payments due from Pakistan, on debt incurred through December 31, 1969, in calendar years 1971 and 1972 are shown in Attachment I. Payments due in 1971 to bilateral creditors in the Consortium come to US\$ 140.9 million. The amount of US\$ 175 million to be raised in supporting assistance represents 125% of such payments. On this basis, individual contributions to supporting assistance are calculated as follows:

^{1/} For an analysis of differences in terms, see Attachment II.

Shares in Debt Service and Supporting Assistance
(US\$ thousands)

	<u>Debt Service</u> 1971	<u>125 Percent of</u> <u>Debt Service</u> 1/	<u>Percentage of</u> <u>Total</u>	<u>Percentage of</u> <u>Commitments</u> 2/ <u>1965/66-1969/70</u>
Belgium	782	1,000	0.6	0.6
Canada	5,225	6,500	3.7	12.9
France	8,163	10,000	5.7	4.4
Germany	36,761	45,000	25.7	13.4
Italy	11,428	14,000	8.0	5.7
Japan	23,372	29,000	16.6	10.3
Netherlands	1,901	2,500	1.4	1.2
Norway	--	500 3/	0.3	0.3
Sweden	318	500	0.3	1.2
United Kingdom	21,077	26,000	14.9	9.7
United States	<u>31,893</u>	<u>40,000</u>	<u>22.9</u>	<u>40.3</u>
TOTAL	140,920	175,000	100.0	100.0

1/ Adjusted slightly for purposes of rounding.

2/ Exclusive of food aid, and Indus/Tarbela.

3/ See note on Norway on p. 12

Source: Attachment I; for last column, IBRD, Reform of the Exchange System and Import Liberalization in Pakistan - A Note on Supporting Assistance; September 28, 1970; Table 5.

14. For comparison, the last column of the preceding table gives individual countries' shares in total gross commitments of Consortium assistance in the period 1965/66-1965/70. Where there are significant differences between the shares as shown in this and the preceding column, they indicate cases in which the terms of past assistance have differed significantly from the average: France, Germany, Italy, Japan and the United Kingdom are examples of countries whose terms have been appreciatively harder than the average, whereas in the case of Canada and the United States terms have been much softer than the average. 1/

B. THE FORMS OF INDIVIDUAL CONTRIBUTIONS

15. In the next section we offer some tentative suggestions about the ways in which individual countries may make their contributions towards the total amount of supporting assistance sought from the Consortium. However, these should not be taken as more than suggestions, because we do not know enough about possibilities and procedures in each of the member countries. Therefore, on the whole, we would much prefer to leave it to individual members to determine how they can best provide their share as indicated above.

16. However, it may be useful to make some general observations on this subject which members may want to take into account in considering how best to contribute to the effort of the Consortium as a whole:

- (a) After further consideration in the light of the discussion in Paris on September 28, 1970, we are inclined to uphold the recommendation in the earlier paper that contributions in the form of additional commodity assistance, of shifts in uncommitted pledges from project to non-project assistance, and of debt relief should be treated equally. In particular, the comment was made at the meeting in Paris that contributions made in the form of additional commodity assistance and debt relief differed in nature from a shift in pledges in that only the former made available additional resources. In principle this is, of course, a valid observation. In the circumstances likely to prevail over the 12-18 months following the introduction of the exchange reform, however, that distinction may largely disappear in practice: pledges of project aid are likely to be committed only slowly, and a partial shift to commodity assistance would provide Pakistan with resources quickly which it would otherwise receive only over a considerable period of time. Nonetheless, in deciding on the amount to be so shifted members should bear in mind that it would be undesirable to reduce aid available for project financing to a point where urgent projects, particularly in East Pakistan, would have to be postponed for lack of funds.

1/ See also Attachment II.

- (b) We should also like to urge that members, particularly those whose contributions to the joint Consortium effort are large, make the fullest possible use of the possibilities they may have for providing debt relief. This provides assistance in the form of free exchange which can most readily be used in support of the objectives of the reform. Moreover, we want to reiterate the suggestion made in the earlier paper that, if feasible, members may provide temporary debt relief by unilaterally declaring a moratorium in the appropriate amount, and leave agreement on new terms to the time when agreement is reached within the Consortium as a whole on a settlement of the issue of amounts and terms of future assistance to Pakistan, including longer term debt relief. If this is not possible, previous discussions on appropriate terms of assistance to Pakistan strongly indicate that members should reschedule on terms providing for a grant element (at 10% discount) around 60%.
- (c) Finally, for the support from the Consortium to be consistent with the requirements of Pakistan's external debt situation, members should endeavor to make available their contribution in a form in which it is readily usable in the context of a liberal import regime, and on appropriately soft terms, i.e., including a grant element (at 10% discount) around 60%.

C. SUGGESTIONS FOR INDIVIDUAL MEMBERS

17. We have the following tentative suggestions to make about the form in which individual members might provide their contributions.

- (a) Belgium - US\$ 1.0 million.

According to our information, there are no uncommitted pledges of project aid outstanding on appropriate terms and debt service obligations are almost entirely due to private creditors. In these circumstances, Belgium may want to consider making available its contribution through additional commodity assistance.

- (b) Canada - US\$ 6.5 million.

Information available to us indicates uncommitted pledges of project aid of US\$ 10.5 million. In the period January 1971 to June 1972, about US\$ 8.2 million are due in debt service payments, almost entirely on account of official export credits. Canada may want to provide both additional commodity assistance and debt relief to make up its contribution.

(c) France - US\$ 10.0 million.

Uncommitted pledges of project aid, totalling nearly US\$ 24.0 million according to our records, may offer scope for some shift towards commodity assistance, although we are not certain how much of this amount represents aid on appropriately soft terms. Debt service payments due in the period January 1971 through June 1972 come to roughly US\$ 12.1 million, almost entirely on suppliers' credits. Debt relief will probably have to make some contribution towards France's share, because otherwise a sizeable amount, in relation to historic levels, in additional commodity assistance would be needed.

(d) Germany - US\$ 45.0 million.

According to our information, US\$ 66.5 million is available in uncommitted pledges of project aid. Thus, Germany may be able to provide a considerable part of its contribution by shifting presently outstanding pledges to commodity assistance. Total debt service payments due in the period January 1971 through June 1972 at US\$ 55.4 million are large, and even payments due on Government loans - US\$ 28.9 million - are sizeable. Debt relief would therefore appear to offer substantial scope for contributing to Germany's share.

(e) Italy - US\$ 14.0 million.

Uncommitted pledges of project aid are estimated at US\$ 52.8 million, the third largest amount among the members of the Consortium. Yet, little, if any, of it may be usable for present purposes because, according to our information, it is all on very hard terms. Unless it is possible to soften these terms considerably, or to provide additional commodity assistance on appropriate terms, the bulk of Italy's contribution may have to come from relief on debt service payments which are estimated at US\$ 17.1 million in the period January 1971 through June 1972.

(f) Japan - US\$ 29.0 million.

Japan's situation appears to be quite similar to that of Germany, except that the amount of uncommitted pledges of project aid - at about US\$ 20 million - is very much smaller. A sizeable amount of debt relief - against payments of about US\$ 36.2 million due in the period January 1971 through June 1972 - is likely to be necessary to enable Japan to make up its contribution.

(g) Netherlands - US\$ 2.5 million.

In view of the relatively small size of the amount involved, the Netherlands may find it possible to provide all of their contribution in the form of additional commodity assistance. However, according to our information, there is also a small amount - US\$ 3.4 million - outstanding in uncommitted pledges for project aid of which part could perhaps be shifted to commodity financing.

(h) Norway - US\$ 0.5 million.

Because no debt service payments are due to Norway in the period covered, the formula here adopted would not require Norway to make a contribution. However, it was thought that Norway may want to contribute, nonetheless, and US\$ 0.5 million was therefore included among the contributions.

(i) Sweden - US\$ 0.5 million.

In view of the small amount involved, Sweden may want to consider raising its commodity assistance by US\$ 0.5 million.

(j) United Kingdom - US\$ 26.0 million.

If our information is correct, only US\$ 10.4 million is outstanding in uncommitted pledges for project aid, which would appear to offer little scope for a shift towards commodity contributing significantly to the share of the United Kingdom. In the circumstances, the bulk of the United Kingdom's contribution would probably have to come from additional commodity assistance and from relief on debt service payments which are estimated to total US\$ 32.3 million in the period January 1971 through June 1972, including roughly US\$ 17.7 million due on Government loans.

(k) United States - US\$ 40.0 million.

The United States has the largest amount of uncommitted pledges of project aid - US\$ 68.7 million - but the bulk consists of offers of financing by the Export-Import Bank, on terms that are not appropriately soft. The Ex-Im Bank also accounts for US\$ 14.7 million out of a total of US\$ 47.4 million due in debt service payments. Still, debt service payments due on Government loans are substantial at US\$ 26.2 million, and debt relief could perhaps form part of the United States' contribution. The bulk, however, will probably have to come from additional commodity assistance.

D. LIBERALIZATION OF COMMODITY ASSISTANCE

18. We stressed in the earlier paper the difficulties of inserting commodity assistance into an economy operating under a liberal exchange and import regime, when such assistance is subject to numerous detailed restrictions as to its use and the source of procurement as well as to complicated procedures, all of which have the effect of reducing its real value below that of freely usable exchange. We should like to reiterate our recommendation that members of the Consortium consider seriously to what extent they are able to reduce such restrictions and simplify procedures. Specifically, we should like to hear from members whether they are prepared

- (a) to shift from a positive to a negative list, i.e., allow their commodity assistance to be used for the procurement of all goods, except those specifically excluded;
- (b) to untie procurement of goods under their commodity assistance, i.e., allow Pakistan to buy such goods not only in the aid-giving country but also in other developing countries as well as in other Consortium countries that are prepared similarly to untie their commodity assistance to Pakistan.

ESTIMATED DEBT SERVICE PAYMENTS
(US\$ thousands)

	<u>Calendar Year</u>	
	<u>1971</u>	<u>1972</u>
<u>I. CONSORTIUM</u>	<u>187,922</u>	<u>198,565</u>
Amortization	107,511	118,057
Interest	80,411	80,508
(i) <u>Suppliers' Credits</u>	<u>37,756</u>	<u>36,225</u>
Amortization	27,599	27,185
Interest	10,157	9,041
(ii) <u>Financial Institutions</u>	<u>9,254</u>	<u>4,689</u>
Amortization	8,036	3,795
Interest	1,216	894
(iii) <u>Official Exp. Credits</u>	<u>24,884</u>	<u>25,915</u>
Amortization	16,394	17,992
Interest	8,491	7,923
(iv) <u>Government Loans</u>	<u>69,028</u>	<u>79,168</u>
Amortization	30,467	40,673
Interest	38,560	38,493
a. <u>Bilateral Creditors</u>	<u>140,920</u>	<u>145,997</u>
Amortization	82,496	89,645
Interest	58,424	56,351
(i) <u>Suppliers' Credits</u>	<u>37,756</u>	<u>36,225</u>
Amortization	27,599	27,185
Interest	10,157	9,041
(ii) <u>Financial Institutions</u>	<u>9,254</u>	<u>4,689</u>
Amortization	8,036	3,795
Interest	1,216	894
(iii) <u>Official Exp. Credits</u>	<u>24,884</u>	<u>25,915</u>
Amortization	16,394	17,992
Interest	8,491	7,923

		<u>Calendar Year</u>	
(iv)	<u>Government Loans</u>	<u>69,028</u>	<u>79,168</u>
	Amortization	30,467	40,673
	Interest	38,560	38,493
	<u>1. Belgium</u>	<u>782</u>	<u>753</u>
	Amortization	474	473
	Interest	308	280
	<u>A. Suppliers' Credits</u>	<u>708</u>	<u>644</u>
	Amortization	474	439
	Interest	234	206
	<u>B. Government Loans</u>	<u>74</u>	<u>108</u>
	Amortization	-	34
	Interest	74	74
	<u>2. Canada</u>	<u>5,225</u>	<u>5,875</u>
	Amortization	2,587	3,327
	Interest	2,638	2,547
	<u>A. Government Loans</u>	<u>233</u>	<u>162</u>
	Amortization	-	-
	Interest	233	162
	<u>B. Official Exp. Credits</u>	<u>4,992</u>	<u>5,713</u>
	Amortization	2,587	3,327
	Interest	2,405	2,385
	<u>3. France</u>	<u>8,163</u>	<u>7,864</u>
	Amortization	5,957	5,940
	Interest	2,206	1,924
	<u>A. Suppliers' Credits</u>	<u>8,040</u>	<u>7,747</u>
	Amortization	5,856	5,839
	Interest	2,184	1,908
	<u>B. Government Loans</u>	<u>123</u>	<u>118</u>
	Amortization	101	101
	Interest	22	16

	<u>Calendar Year</u>	
4. <u>Germany</u>	<u>36,761</u>	<u>37,308</u>
Amortization	23,672	25,059
Interest	13,089	12,249
A. <u>Suppliers' Credits</u>	<u>7,776</u>	<u>7,177</u>
Amortization	5,869	5,634
Interest	1,907	1,543
B. <u>Government Loans</u>	<u>18,618</u>	<u>20,297</u>
Amortization	9,260	10,937
Interest	9,358	9,360
C. <u>Official Exp. Credits</u>	<u>10,367</u>	<u>9,834</u>
Amortization	8,543	8,488
Interest	1,824	1,346
5. <u>Italy</u>	<u>11,428</u>	<u>11,325</u>
Amortization	8,049	8,049
Interest	3,379	3,276
A. <u>Suppliers' Credits</u>	<u>10,761</u>	<u>10,689</u>
Amortization	7,542	7,542
Interest	3,219	3,147
B. <u>Government Loans</u>	<u>667</u>	<u>636</u>
Amortization	507	507
Interest	160	129
6. <u>Japan</u>	<u>23,372</u>	<u>25,630</u>
Amortization	13,838	16,604
Interest	9,534	9,026
A. <u>Suppliers' Credits</u>	<u>2,295</u>	<u>2,217</u>
Amortization	1,612	1,612
Interest	683	605
B. <u>Government Loans</u>	<u>21,077</u>	<u>23,413</u>
Amortization	12,226	14,992
Interest	8,851	8,421

	<u>Calendar Year</u>	
	<u>1971</u>	<u>1972</u>
7. <u>Netherlands</u>	<u>1,901</u>	<u>2,201</u>
Amortization	960	1,309
Interest	941	892
A. <u>Financial Institutions</u>	<u>1,354</u>	<u>1,297</u>
Amortization	960	960
Interest	393	337
B. <u>Government Loans</u>	<u>548</u>	<u>904</u>
Amortization	-	349
Interest	548	555
8. <u>Sweden</u>	<u>318</u>	<u>530</u>
Amortization	147	356
Interest	171	174
A. <u>Suppliers' Credits</u>	<u>36</u>	<u>35</u>
Amortization	26	26
Interest	10	9
B. <u>Government Loans</u>	<u>282</u>	<u>495</u>
Amortization	121	330
Interest	161	165
9. <u>United Kingdom</u>	<u>21,077</u>	<u>22,462</u>
Amortization	12,560	13,872
Interest	8,517	8,590
A. <u>Suppliers' Credits</u>	<u>6,708</u>	<u>6,345</u>
Amortization	5,109	4,982
Interest	1,599	1,363
B. <u>Financial Institutions</u>	<u>3,018</u>	<u>3,392</u>
Amortization	2,432	2,835
Interest	585	557
C. <u>Government Loans</u>	<u>11,352</u>	<u>12,725</u>
Amortization	5,019	6,055
Interest	6,333	6,670

		<u>Calendar Year</u>	
		<u>1971</u>	<u>1972</u>
10.	<u>United States</u>	<u>31,393</u>	<u>32,049</u>
	Amortization	14,252	14,656
	Interest	17,641	17,393
	(i) <u>Suppliers' Credits</u>	<u>1,432</u>	<u>1,371</u>
	Amortization	1,111	1,111
	Interest	321	260
	(ii) <u>Financial Institutions</u>	<u>4,882</u>	<u>-0-</u>
	Amortization	4,644	-0-
	Interest	238	-0-
	(iii) <u>Official Exp. Credits</u>	<u>9,525</u>	<u>10,368</u>
	Amortization	5,264	6,177
	Interest	4,262	4,192
	(iv) <u>Government Loans</u>	<u>16,054</u>	<u>20,310</u>
	Amortization	3,233	7,368
	Interest	12,820	12,941
	b. <u>International Organizations</u>	<u>48,002</u>	<u>52,569</u>
	Amortization	25,015	28,412
	Interest	21,987	24,157
	1. <u>IBRD</u>	<u>44,589</u>	<u>49,733</u>
	Amortization	24,890	28,207
	Interest	19,699	21,526
	2. <u>IDA</u>	<u>2,412</u>	<u>2,836</u>
	Amortization	125	205
	Interest	2,288	2,631
II.	<u>NON-CONSORTIUM</u>	<u>33,544</u>	<u>33,907</u>
	Amortization	28,432	29,027
	Interest	5,112	4,880
III.	<u>TOTAL</u>	<u>221,466</u>	<u>232,472</u>
	Amortization	135,943	147,084
	Interest	85,523	85,388

Source: IBRD

TERMS OF LENDING 1/ 2/

	<u>1964/65</u>	<u>1965/66</u>	<u>1966/67</u>	<u>1967/68</u>	<u>1968/69</u>	<u>1969/70</u>	<u>Averages</u>		
							<u>Second Plan</u>	<u>Third Plan</u>	<u>All Loans</u>
<u>I. CONSORTIUM</u>									
<u>A. BILATERAL</u>									
<u>BELGIUM</u>									
Maturity	12.0	-	13.5	11.9	17.0		12.0	14.6	14.4
Grace	3.5	-	3.1	1.3	4.0		3.5	2.9	2.9
Interest	6.0	-	4.7	6.0	4.2		6.0	4.9	5.0
Grant Element	21.0	-	28.9	18.3	36.1		21.0	28.3	27.9
<u>CANADA</u>									
Maturity	-	33.5	49.5	49.5	38.4		17.2	38.1	36.0
Grace	-	7.3	10.0	10.0	7.3		3.5	7.8	7.4
Interest	-	3.7	-	-	1.8		6.0	2.4	2.8
Grant Element	-	52.3	90.9	90.9	69.5		24.6	65.0	60.8
<u>FRANCE</u>									
Maturity	12.0	11.6	12.7	10.8	12.1		12.8	12.1	10.7
Grace	2.7	0.9	1.0	0.7	1.8		2.7	1.1	1.3
Interest	5.0	5.3	5.2	5.3	5.3		5.0	5.2	5.2
Grant Element	25.0	20.9	22.3	19.6	22.8		25.9	21.7	20.5
<u>GERMANY</u>									
Maturity	18.4	16.8	18.7	21.2	23.1		17.2	19.5	18.1
Grace	4.7	4.0	5.1	5.3	7.8		4.6	5.4	4.9
Interest	4.5	5.1	4.5	3.9	3.3		5.1	4.3	4.8
Grant Element	36.1	30.4	36.7	43.3	51.6		31.5	39.0	34.6

- Continued -

	<u>1964/65</u>	<u>1965/66</u>	<u>1966/67</u>	<u>1967/68</u>	<u>1968/69</u>	<u>1969/70</u>	<u>Averages</u>		
							<u>Second Plan</u>	<u>Third Plan</u>	<u>All Loans</u>
<u>ITALY</u>									
Maturity	-	11.3	11.1	11.4	10.9		13.0	11.2	11.3
Grace	-	0.9	0.6	0.7	0.7		3.5	0.7	0.9
Interest	-	6.0	6.0	5.9	6.0		6.0	6.0	6.0
Grant Element	-	17.4	16.7	17.5	16.6		21.8	17.1	17.4
<u>JAPAN</u>									
Maturity	16.3	18.0	15.2	16.6	17.5		14.4	16.8	14.8
Grace	4.5	5.5	6.3	4.6	5.0		4.1	5.3	4.3
Interest	5.8	5.8	5.8	5.6	5.3		5.9	5.6	5.7
Grant Element	26.2	28.5	27.5	28.1	31.1		24.2	28.8	25.8
<u>NETHERLANDS</u>									
Maturity	18.5	25.1	24.1	26.0	25.5		18.5	25.2	18.5
Grace	4.6	7.3	6.9	8.0	7.5		4.6	7.4	4.9
Interest	5.6	3.6	3.3	3.0	3.0		5.6	3.2	4.6
Grant Element	28.8	49.8	51.1	55.4	54.7		28.8	52.7	36.3
<u>SWEDEN</u>									
Maturity	-	17.2	20.0	46.1	-		-	29.8	29.8
Grace	-	10.0	5.5	19.0	-		-	13.1	13.1
Interest	-	2.2	2.0	0.75	-		-	1.6	1.6
Grant Element	-	57.2	55.6	87.7	-		-	73.2	73.2
<u>UNITED KINGDOM</u>									
Maturity	17.5	26.3	20.2	18.6	16.3		21.5	20.1	18.6
Grace	4.2	7.6	5.7	4.7	3.7		5.7	5.3	5.0
Interest	6.1	-	1.8	1.9	3.0		7.2	1.8	4.8
Grant Element	24.6	78.8	57.8	53.6	42.6		20.0	57.2	34.8

- Continued -

	<u>1964/65</u>	<u>1965/66</u>	<u>1966/67</u>	<u>1967/68</u>	<u>1968/69</u>	<u>1969/70</u>	<u>Averages</u>		
							<u>Second Plan</u>	<u>Third Plan</u>	<u>All Loans</u>
<u>UNITED STATES</u>									
Maturity	39.7	38.7	35.3	35.7	40.5		37.8	36.7	36.5
Grace	10.2	10.0	8.9	10.0	10.5		9.6	9.8	9.5
Interest	2.1	2.6	3.0	3.2	3.0		1.7	3.0	2.3
Grant Element	69.9	64.9	60.0	59.0	62.3		72.0	60.6	66.8
<u>B. MULTILATERAL</u>									
<u>IBRD</u>									
Maturity	-	17.0	22.4	16.5	22.6		22.8	21.1	20.6
Grace	-	3.0	3.7	2.5	6.2		5.8	5.0	4.9
Interest	-	5.5	6.0	6.3	6.4		5.5	6.2	5.7
Grant Element	-	27.1	27.5	21.8	26.4		32.9	26.4	29.4
<u>IDA</u>									
Maturity	5.0	49.6	48.5	49.5	49.8		49.9	49.5	49.7
Grace	1.0	10.1	10.2	10.0	10.5		10.4	10.2	10.3
Interest	0.75	0.75	0.75	0.75	0.75		0.75	0.75	0.75
Grant Element	84.4	84.2	84.0	84.1	84.4		84.4	84.2	84.3
<u>TOTAL CONSORTIUM</u>									
Maturity	36.3	30.1	28.3	30.2	28.5		31.6	29.3	29.1
Grace	9.0	7.1	6.9	8.0	7.1		7.8	7.3	7.2
Interest	2.7	3.4	3.6	3.6	4.2		3.3	3.7	3.6
Grant Element	63.3	53.6	51.1	52.6	46.1		55.6	50.7	51.6

- Continued -

	<u>1964/65</u>	<u>1965/66</u>	<u>1966/67</u>	<u>1967/68</u>	<u>1968/69</u>	<u>1969/70</u>	<u>Averages</u>		
							<u>Second Plan</u>	<u>Third Plan</u>	<u>All Loans</u>
II. <u>NON-CONSORTIUM</u>									
Maturity	17.1	11.3	12.7	11.1	13.8		16.1	12.4	13.3
Grace	7.9	1.3	1.5	0.8	5.7		4.9	2.8	3.3
Interest	1.4	2.6	2.2	3.3	2.2		2.1	2.5	2.4
Grant Element	60.4	32.8	37.5	28.5	47.8		49.8	38.4	41.4
III. <u>GRAND TOTAL</u>									
Maturity	34.9	26.6	26.5	28.3	25.8		30.8	26.8	27.7
Grace	8.9	6.0	6.3	7.3	6.8		7.6	6.6	6.8
Interest	2.6	3.2	3.4	3.6	3.8		3.2	3.5	3.5
Grant Element	63.5	52.0	50.9	51.5	47.6		55.6	50.4	51.5

1/ Derived from the Bank's debt file; grants are not included.

2/ Maturity and grace period in years; interest in percent; grant element in percent, discounted at 10%.

Source: Statistical Services Division, IBRD.

16

OFFICE MEMORANDUM

SECRET

TO: Files

DATE: September 24, 1970

FROM: I.P.M. Cargill *I.P.M. Cargill*

DECLASSIFIED

SUBJECT: Annual Meeting 1970

MAY 08 2013

Mr. McNamara's Meeting with the Pakistan Delegation

WBG ARCHIVES

Present: Nawab Mozaffar Ali Khan Qizilbash, Minister of Finance
 Ghulam Ishaq Khan, Secretary to Government of Pakistan,
 Ministry of Finance
 S. Osman Ali, Executive Director, IBRD
 M. Syeduzzaman, Joint Secretary to the Government of Pakistan,
 Ministry of Finance
 Messrs. Knapp, Cargill and Kavalsky

The meeting took place at the Bella Center from 2.30 - 3.30 p.m., on
 Thursday September 24, 1970.

Exchange Rate Reform and the Level of Aid

The Nawab said that President Yahya Khan had been reluctant to postpone the election and had only done so at the request of the election commissioner for East Pakistan since the election officials and buildings had been used for relief work made necessary by the disastrous floods in August. Mr. McNamara had been under the impression that the postponement of the election would also mean a postponement of the announcement of the new exchange reform, but was informed that the President had decided to go ahead with this at the end of October pending some reassurance on the availability of additional external assistance. The Nawab said that Pakistan faced a difficult internal political situation which was not made easier by Mr. McNamara's reference in his speech to the growing inequalities between East and West Pakistan. Mr. McNamara said that he recognized that there was a new awareness on the part of the government of the need to remove these inequalities, but there was no advantage in not recognizing the fact that these inequalities existed and were growing greater. His remarks have been intended not so much as a criticism as evidence of the need for greater efforts to improve the situation.

Mr. McNamara cited three reasons why Pakistan had only been allocated \$50 million of this year's IDA funds. First, IDA had limited funds available this year in relation to the demands being made on it and the need to give additional allocations to Africa and Latin America. Last year Pakistan had received some \$5 million more than its allocation and that had in a sense been a use of this year's allocation. Secondly the deferment of the exchange reform made it difficult for the Bank to act in support of the policies being pursued. Finally there had been a constant problem of slow disbursement on projects in Pakistan. (Mr. Cargill mentioned that there had been improvement in this matter in the last six months). However,

President has seen

if action were taken to reform the exchange system and speed up disbursements, he was hopeful that funds would be available to bring total commitments to Pakistan up to \$70 million.

Ghulam Ishaq pointed out that while the \$70 million represented the normal level of assistance, Pakistan was facing a special situation. The devaluation in a setting of fundamental internal political change had led to a quest for additional aid. The first approach was of course the Fund. The standby would be conditional on restrictions on deficit financing and a balance of payments test. This limited its usefulness. They were seeking commitments of \$570 million against which only \$380 million seemed to be available. Mr. Cargill pointed out that the meeting of the Heads of Consortium Delegations in Paris on September 28th would aim at getting more non-project aid and debt relief. Mr. McNamara said that two things would have to be accepted. Firstly, IDA could not go above \$70 million for this year. IDA did not have additional money and relative to the claims on existing resources of India and Indonesia, he could not make out a case for giving more to Pakistan. Second, the Bank could not participate in debt re-scheduling. There was every indication that more and more countries would in the years ahead experience difficulty in repaying their external debt, and the credit of the Bank in the world's capital markets would be seriously affected for the worst if the Bank embarked on the course of joining with other creditors in providing such relief. Ghulam Ishaq said that he recognized these constraints. The problem was to secure additional net funds on a non-project basis. Mr. Cargill said that we had been assuming a lengthier timing but now that the decision had been taken we would move as fast as we could.

Increasing Revenues

Mr. McNamara asked about the scope for increasing revenues, especially by taxing agriculture, and for using the tax system as a means of income distribution. The Finance Minister seemed much put about by these inquiries, and his reply lacked some coherence. He claimed that taxation had already reached levels where any further increase in direct taxation would affect incentives. What with income tax and the wealth tax, a man worth Rs. 3 million would have an annual income of some Rs. 300,000 of which after tax only Rs. 50,000 would be available for him to eke out a living. The case for taxing agriculture failed to take into account the realities of the situation. Any increase would ruin the green revolution, and these proposals were based on the fallacious assumption that there was a lot of money in the rural sector. Large land holdings had been eliminated by the land reform and the small farmer, whom he depicted as working day and night in the fields with his whole family, obtains a very meager return for his efforts. Mr. McNamara asked whether land values had risen. The Finance Minister replied that this again was greatly exaggerated. His experience suggested that only land near cities in which there was heavy speculation

was being sold at inflated prices. The value of agricultural land had not appreciated. Rich people choose to buy land as the most secure form of investment but this did not increase the taxable capacity of the agricultural sector or indeed of the economy as a whole. Ghulam Ishaq pointed out that income redistribution tended to reduce the tax base. Lower profit margins led to lower tax revenues, but higher wages did not raise revenues to an equivalent degree.

Flood Control in East Pakistan

The Nawab mentioned the desire to set up a fund for flood control in East Pakistan. Mr. McNamara said that his own experience of funds had not been particularly happy but that we would certainly look into the matter.

cc: Mr. McNamara (2), Mr. Cargill, Mr. Votaw, Mr. Melmoth, Mr. Wiehen, Mr. Blobel
Mr. Knapp

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Rmn

OFFICE MEMORANDUM

TO: Files

DATE: August 12, 1971

FROM: I. P. M. Cargill

SUBJECT: PAKISTAN--Visit of Ambassador Hilaly to Mr. McNamara on February 17

Ambassador Hilaly called on Mr. McNamara on February 17 to deliver a letter from President Yahya Khan thanking Mr. McNamara for the initiative the Bank had taken in making a \$25 million IDA Credit for reconstruction in the cyclone area. The discussion was quite inconsequential, being concerned chiefly with the Ambassador's feeling that the United States could have done more to help.

cc Mr. McNamara

IPMCargill:cmc

President has seen

18

May 5, 1971

Professor Rehman Sobhan -- Member of the Economics Department of the Dacca University. One of Sheik Mujibur Rahman's closest economic advisers and editor of Forum, the intellectual organ of the Awami League and one of Pakistan's most influential journals over the past few years.

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OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
FROM: I.P.M. Cargill
SUBJECT: PAKISTAN - A Note on Discussions

DECLASSIFIED

DATE: May 14, 1971

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1. Mr. M.M. Ahmad, Economic Adviser to President Yahya Khan, accompanied by Mr. Sartaj Aziz, Joint Secretary, Planning Division, were in Washington from May 10 to 14 for discussions with the United States Government, the IMF and the Bank. Before proceeding to London, Mr. M.M. Ahmad plans to meet with the Secretary General of the United Nations on May 17 to discuss the possibility of the UN organizing an international relief effort to prevent widespread famine in East Pakistan.

2. In their discussions here the Pakistan delegation endeavored to make the following principal points:

- (a) President Yahya Khan conducted his negotiations with the Awami League in good faith. By March 22, agreement was reached on all issues of substance, political and economic, on the basis of the Awami League's "Six Points", and a joint proclamation was being drafted. At that point, Mujibur Rahman abrogated the agreement and demanded immediate independence for East Pakistan. Faced with this demand, and upon the discovery of plans for imminent armed revolt, laid out in connivance with India, Yahya had no choice but to order the army to intervene.
- (b) The first phase of the army's intervention, the restoration of law and order, was essentially completed. The army was now in the second phase of its operation, the restoration of normal conditions, and in fact economic activity and public administration were fast returning to normal, although the disruption of communications - rail, roads, waterways and telecommunications - was impeding progress. It was the judgement of the Governor of East Pakistan that foreign technical assistance personnel could resume work in urban areas on May 15 and over the whole Province on June 1.
- (c) President Yahya Khan was determined to reach a political settlement on the basis of the agreement reached with the Awami League prior to the intervention of the army. He envisaged early establishment, on the basis of an interim constitution, of an elected provincial government in East Pakistan. To this end, he intended to invite the representatives elected in December, except for a limited number of Awami League leaders considered traitors, to form a provincial legislature. Elected members of the banned Awami League would be free to establish, under another name, any party they wished. Preparatory discussions were already underway between the President and East Pakistan politicians.

- (d) Pakistan faced a very serious liquidity crisis and exchange assets were likely to be exhausted by August. Financial assistance, in appropriate form, was needed quickly if the crisis was to be averted. They were looking to the IMF for such assistance, in the context of an exchange reform.
- (e) The Government of Pakistan was aware that the suspension of debt service payments to Consortium countries was complicating their relations with the Consortium. They were therefore anxious to resume full payments, but lacked the resources to do so, save by means of an emergency drawing on the IMF.
- (f) A sharp deterioration in the economy of West Pakistan later in the year would become inevitable unless aid relations with the Consortium were normalized quickly, new commitments, essentially of commodity aid, made promptly to replenish the pipeline, and early agreement reached on debt relief on a longer term basis.

3. Separate notes are attached on the discussions of the Pakistan delegation with the United States Government, the IMF and the Bank. For obvious reasons, neither the interpretation given by the Government of Pakistan to the events leading up to the armed intervention nor the realism of their optimistic assessment of the present situation in East Pakistan and of the prospects for a genuine political settlement were discussed. Nor was there any reason to argue extensively about the Government's assessment of the country's severe economic and financial difficulties because all available information supports this view. First, it is evident that the suspension of economic activity in East Pakistan, superimposed as it was on the adverse effects of procrastination in undertaking the thorough exchange and revenue reforms, has led to crisis conditions in the external and internal financial situation: exchange assets in convertible currencies are likely to be exhausted within the next two to three months; expansionary financing of at least Rs.1,650 million will be required by the Government (as compared to Rs.600 million in the budget), at a level of public development expenditures no higher in real terms than that achieved in 1966/67. Second, West Pakistan must expect a sharp reduction in industrial activity, with all the attendant social unrest, unless the economy of East Pakistan is restored quickly, both as a market for West Pakistan's manufactures and an earner of exchange, and unless very substantial amounts of external assistance are committed soon.

4. Despite differences in emphasis, a common theme ran through all the responses given to the presentations by the Pakistan delegation. Most generally this was that, understanding for the tremendous difficulties of resolving Pakistan's problems and willingness to help notwithstanding, there was at the present time no basis on which financial assistance could be given. Pakistan's present image in the world presented very strong political constraints,

and there was no economic program to serve as the framework for external assistance. It was up to the Government of Pakistan to remove these constraints by demonstrating, in terms of concrete action, that it was capable, by following the approach indicated, of achieving a political settlement that held out the promise of restoring political stability, and of undertaking the necessary economic reforms.

5. More specifically, the discussions suggest the following scenario for normalizing relations between Pakistan and the Consortium: First, to overcome the political constraints, it would be essential that conditions conducive to restoring normal life be created in East Pakistan; that the prospect of wide-spread famine in East Pakistan be averted by appropriate arrangements with the United Nations, possibly involving UN observers stationed in East Pakistan; that sufficient progress be made towards a political settlement to demonstrate the effectiveness of the Government's approach. Second, on the economic front, it would be essential that the Government, in consultation with the IMF and the Bank, work out a reform program - involving in particular the exchange and revenue systems, with the assurance of equitable treatment for East Pakistan being one of the prime objectives of these reforms - to serve as the basis for consideration by the Consortium of external assistance.

6. Concretely, it was agreed between the Pakistan delegation and the IMF and the Bank that

- (a) a Fund mission, accompanied by Bank staff, would visit Islamabad as soon as practicable for a comprehensive review of the economic situation and discussions of an appropriate package of measures for the reform of the exchange system;
- (b) The Fund's mission would be preceded by a Bank mission, accompanied by Fund staff, to East Pakistan to assess the outlook for normalization of the economic situation and functioning of the provincial and local administration as well as the related balance of payments and fiscal outlook. Their findings are intended to assist the Fund mission in determining what an appropriate reform package would comprise and in judging the prospects for effective implementation of a package.

The Fund mission will be led by Mr. Gunter, the Bank mission probably by Mr. Cargill. Subject to confirmation by the Government of Pakistan, the mission to East Pakistan will start its work about June 1 and the Fund will begin its discussions in Islamabad around June 10. Both missions may be able to complete their work by June 18 or 19. In this case, as the India Consortium will meet in Paris on June 17 and 18 and in view of the urgent need at that time for consultations, the Bank may want to convene a meeting of heads of delegations in Paris on or about June 20.

MGBlobel:ad

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Annex I

Discussions with the United States Government

1. During its visit to Washington, the Pakistan delegation met with President Nixon, Secretary Rogers, Mr. Kissinger, Mr. Hannah (AID Administrator) and Mr. MacDonald (Assistant Administrator, AID, Near East and South Asia).

2. According to oral reports we had on these meetings, the position of the US Government as presented to the Pakistan delegation may be summarized as follows:

- (a) The Administration appreciates that Pakistan is beset by very serious political and economic problems and that the task of resolving them will be difficult. It is prepared to help financially. However, at the moment the basis, on which such help might be given, does not exist. Constraints arising out of the political process in the United States do not now allow the Administration to act. Removal of those constraints is crucial to the ability of the Administration to help. Although the Administration considers the East Pakistan problem an internal matter for the Pakistan Government to resolve, as a practical matter and if Pakistan needs help quickly, only positive steps by the Government of Pakistan, demonstrating its determination to seek a political, rather than a military, solution and significant progress towards its achievement, can clear the way.
- (b) Furthermore, the Administration would have to consider any request for financial assistance in the context of an economic program. It urged the Pakistan Government to seek the collaboration of the IMF and the Bank in the preparation of such a program, as the US Government would be guided by the advice of these institutions. Moreover, the US Government would regard any help it might be able to give as a contribution to an international aid effort within the framework of the Consortium.
- (c) More specifically:
 - (i) Mr. Hannah dealt extensively with the concern of the US Government about the prospect of widespread famine in East Pakistan. He said that in their view the United Nations was the appropriate agency for organizing an international relief effort and urged the Pakistan Government to seek arrangements with the United Nations that would assure public opinion that famine would be averted and donors that their contributions would serve their intended humanitarian purpose. He held out no hope for any discussions about other forms of aid, before this problem was resolved.

- (ii) The Pakistan delegation pressed for early conclusion of an agreement on a commodity loan of US\$70 million under this year's pledge. Mr. MacDonald turned this request down, referring to the political constraints which had been explained to the delegation earlier as well as the absence of an economic program in the context of which such a request could be considered.

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Annex II

Discussions with the IMF

1. In his discussions with Mr. Schweitzer, Mr. M.M. Ahmad once again asked the IMF to consider an emergency drawing, arguing principally that such a drawing in the order of US\$60 million would enable the Government to lift the suspension of service payments on certain external debts which was complicating the Government's relations with the Consortium countries. Mr. Schweitzer turned this request down on the grounds that the situation in Pakistan provided no basis for justifying a departure from normal Fund practices.

2. He made it clear that use of the Fund's resources could be considered only after a mission had thoroughly reviewed the economic situation and outlook in Pakistan and in the context of an acceptable economic program which the Fund was satisfied could be put into effect by the Government in all of Pakistan. Mr. Schweitzer went on to explain the need, in this context, for a comprehensive review of the situation and outlook in East Pakistan. He said that it was their intention to have the Bank take the lead in conducting this review, although Fund staff would be associated with the Bank in this mission. Similarly, the Fund's discussions in Islamabad about an appropriate exchange reform package would be held in close collaboration with the Bank. In view of Mr. M.M. Ahmad's assessment of the situation in East Pakistan, he thought the discussions in Islamabad might start about June 10. On this basis, assuming the mission reached agreement with the Government by June 20, he would probably be able by the end of June to inform the Government of Pakistan of his reaction to the proposed reform package.

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Discussions with the BankAnnex III

1. The discussions of the Pakistan delegation in the Bank centered mainly around Pakistan's relations with the Consortium, the steps the Government might take to create a climate conducive to normalization of relations with Consortium, and the role the Bank, as Chairman of the Consortium, might play in this process.
2. In his meeting with the delegation, Mr. McNamara expressed the Bank's wish to be helpful. The Bank could, in his view, help most effectively by assisting Pakistan, in close collaboration with the IMF, in preparing an economic program for presentation to the Consortium as the basis for their consideration of Pakistan's need for external assistance.
3. However, Mr. McNamara cautioned that an effective economic program, while undoubtedly a necessary condition for assistance from the Consortium, was not a sufficient condition. Indeed, as he saw the situation in Washington and other capitals, political constraints were the dominant obstacle to any donor coming forward with assistance. Irrespective of the merits of the case, this was the factual situation which the Government of Pakistan now faced. He urged the delegation during the remainder of their visit here and in Europe to try their utmost to comprehend the strength of the political constraints. Furthermore, he emphasized that only the Government of Pakistan could remove these constraints, by demonstrating, through its actions over the next several weeks, that it was seeking a political, rather than a military solution to the problems of East Pakistan, and by moving towards its achievement.
4. In this context Mr. McNamara singled out the food situation in East Pakistan as a matter of very serious concern. He saw no possibility of moving towards normalizing Pakistan's relations with the Consortium until Consortium members were assured that every possible effort was being made to avert widespread famine in East Pakistan. Mr. McNamara went on to say that President Yahya's reply to U Thant's offer of United Nations assistance was widely interpreted as being intended to keep the UN out of East Pakistan and therefore had worsened, rather than improved the general climate. He urged Mr. M.M. Ahmad in his discussions with U Thant on May 17 to pave the way for arrangements with the UN that would provide the assurance that famine would be prevented in East Pakistan.
5. As for direct relations between the Bank Group and Pakistan, the Pakistan delegation confirmed that debt service payments to the Bank Group were excluded from the 'moratorium' and would be made as usual, and that the Government had withdrawn the request, dated April 5, 1971, for relief under Section 4(c)(i) of Article IV of the Bank's Articles of Agreement. They accepted that, for the time being, no new loans or credits were being made.

OFFICE MEMORANDUM

TO: Mr. Robert McNamara
DATE: June 9, 1971

FROM: Gregory B. Votaw

SUBJECT: Your Appointment with Dr. Nurul Islam - Noon, Friday, June 11, 1971

1. I attach a c.v. for your information. I have deleted a six page list of 14 books, 34 articles and 16 international conferences.
2. Dr. Islam is presently attached to the Economic Growth Center at Yale and is writing the "Memoirs of a Miscreant" regarding his experiences prior to the tragic effects of March 25.
3. Dr. Islam was closely associated with Sheik Mujib and the Awami League. He was intimately involved in the constitutional negotiations and in all aspects of planning economic policy for the Awami League.
4. I would expect him to emphasize to you inter alia (a) the importance of relief for refugees already in India as the only immediately available non-political means of getting food and medical supplies across the border into East Pakistan and (b) the dangers of aid givers trying to prevent a collapse of economic life in West Pakistan in the absence of a political settlement within Pakistan.
5. I wish I could join your discussions, since I admire Dr. Islam and always learn from him. However, the signing of the Khanabad credit ~~is~~ has also been arranged with the Afghan Ambassador for noon Friday; ~~and~~ for ceremonial reasons I must give that priority.
6. I believe you know that Dr. Islam is on Hollis Chenery's Economic Research Advisory Committee.

** Now postponed due to loan Committee,
which I also must attend.*

President has seen

Nurul Islam

Curriculum Vitae

Date of Birth: April 1, 1929

Place of Birth: Pakistan

Marital Status: Married - two children

Academic Record

B. A. Dacca University, Pakistan, 1949 - First Place in First Class

M. A. Dacca University, Pakistan, 1950 - First Place in First Class

M. A. Harvard University, U. S. A., 1953 - Grade "Excellent" in general examination.

Ph. D. Harvard University, U. S. A., 1955 - Grade "Excellent Minus" in special examination on thesis. Special field for Ph. D. - International Economics.

Ph. D. Dissertation - "Studies in Foreign Capital and Economic Development" - published as a book in 1960 by Charles Tuttle & Co. (Tokyo and Vermont, U. S. A.). The book has run into third edition since then.

Nuffield Foundation Fellow (1958-59) in United Kingdom at

(a) London School of Economics, London, England

(b) Department of Applied Economics, Cambridge University, England

Working on problems of mathematical programming and application of programming techniques to development planning, especially in international trade field.

Rockefeller Fellow at Netherlands Economic Institute, Rotterdam, Holland, working with Professor J. Tinbergen during the last quarter of 1959. Working on the use of econometric models in development planning.

Professional Experience

1. Reader in Economics, Dacca University, Pakistan, 1955-60.
2. Professor in Economics, Dacca University, Pakistan, 1960-64.
3. Chairman of the Department of Economics, Dacca University 1962-64

4. Taught International Trade and Development Economics in the post graduate classes, Dacca University, 1955-64.
5. Director, Pakistan Institute of Development Economics, Karachi, Pakistan, 1964-71. Teaching an advanced course in International Trade and Development in the Training Programme of the Institute.
6. UNESCO Consultant in Paris, France, for three months in 1960 on the integration of the techniques of economic and educational planning.
7. Consultant to the UN/ECAFE at Bangkok, Thailand, for six months (April-October 1963) on trade and development preparing papers for the ECAFE Working Party on Trade and Development held in September 1963. Specially prepared two papers (a) Regulation and Development of Exports, and (b) Techniques of Foreign Exchange Budgeting, published in the ECAFE Bulletin, December 1963.
8. Prepared a paper under Special Service Agreement with the FAO Commodities Division on "Problems and Effects of Transition from the stage of Raw Material Production to that of Manufacturing or Processing of Raw Materials - a case study of jute," 1964.
9. Member, Expert Group on Trade Liberalization in the ECAFE Region, 1964, Bangkok, Thailand.
10. Member, UNCTAD, Committee of Experts on Trade Expansion and Economic Cooperation among Developing Countries, 1966.
11. Visiting Professor, Economic Development Institute, International Bank for Reconstruction and Development, September 1967-March 1968, Washington
12. Senior Research Associate, Economic Growth Center, Yale University, April 1968 - December 1968.
13. U. N. Visiting Professor on Economic Planning and Development, Warsaw School of Economics and Statistics, Warsaw, Poland, during first half of March 1968, at the invitation of the Warsaw School of Economics and Statistics.
14. Member, Committee of Experts on Projections of Supply and Demand of Agricultural Commodities. FAO, Rome, March 1970.
15. Visiting Lecturer, SEANZA, Central Banking Training Course, Manila, on Techniques of Plan Formulation and Implementation, at the invitation of the Central Bank of the Philippines, October 1970.

Government Assignments within Pakistan

1. Member, Prices Commission, Government of Pakistan, 1960
2. Member, Panel of Economists, Ministry of Finance,
Government of Pakistan, 1962
3. Member, Finance Commission (1st), Government of Pakistan, 1962
4. Member, Industrial Advisory Council, Government of Pakistan, 1962
5. Member, Finance Commission (2nd), Government of Pakistan, 1964
6. Member, Advisory Panel of Economists for Fourth Five-Year Plan, 1970
7. Member, Finance Committee of Government of Pakistan, 1970-71.
8. Member, Commission on Taxation, Government of Pakistan, 1971
9. Member, Expert Committee on Transfer of Resources between East
and West Pakistan, 1971

OFFICE MEMORANDUM

TO: Mr. Leif E. Christoffersen

FROM: R.A. Clarke *[Signature]*

SUBJECT: Mr. P.K. Basu

DATE: July 14, 1971

Mr. McNamara has agreed to see Mr. P.K. Basu at 6.30 p.m. on Friday July 16. As you may know, he is the son-in-law of G.L. Mehta.

Mr. Basu has been in the United States for the past month as a visiting Professor of Economics at the University of Minnesota's Summer School. A very good friend of Bill Diamond's, he has held very high positions in both the public and private sectors in India and has a very impressive record. Certainly, his experience is broad gauged and of potential interest to the Bank. He expressed keen interest in the Industrial Projects Department when it was established, but Mr. Fuchs did not have available the kind of senior position which Basu would reasonably expect. Moreover, he already had commitments outstanding to two senior Indian economists with a very similar background, who have since joined the staff. Mr. Fuchs' vacancies are extremely limited and he does not feel he should take on another Indian unless his background is quite different from that of the two Indian economists he already has. To do so would also pose other problems (limitation of travel to India and Pakistan or to other areas where knowledge of French or Spanish is essential).

In May 1971 Mr. Basu wrote Mr. Diamond referring to advertisements in India for the post of economist in the Industrial Projects Department. We did not ask India, or any other country, to prospect for this vacancy in either 1970 or 1971, although job descriptions were included in the complete list given to our recruitment contacts. Mr. Fuchs' attitude remains the same. As for other possibilities, EDI is looking for a junior industrial economist for the position of lecturer. IFC has only one economist vacancy and is seeking to fill it from within the Bank. They do not, moreover, feel that he fits their particular needs. We do not yet know whether the Economics Department (Economics of Industry Division) will provide a fit.

In addition to interviews with Mr. McNamara and Mr. Knapp, requested by Basu, we have arranged interviews with Mr. Fuchs, Mr. Mathew (in Diamond's absence) and Mr. Henderson. The fact is that openings for senior and experienced people of Mr. Basu's background are rare and we already have a number of Indians in this type of post. On the face of it Basu would be an attractive candidate for UNIDO but we do not know whether he has approached them.

cc: Mr. J. Burke Knapp

President has seen

F.G.STONE/R.A.CLARKE/vlr

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OFFICE MEMORANDUM

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MAY 09 2013

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TO: Files

DATE: July 22, 1971

FROM: Gregory B. Votaw

CONFIDENTIALSUBJECT: Mr. McNamara's Meeting with Messrs. Hamidul Huq Chowdhury and Mahmood Ali

The attached paragraphs were prepared jointly by Mr. Osman Ali and myself as a record of the meeting in Mr. McNamara's office on the afternoon of July 9, 1971.

Attachment

cc: Mr. Christoffersen (2)
Mr. Blobel
Mr. Shibusawa

GBVotaw:jw

OFFICE MEMORANDUM

TO: Mr. S. Osman Ali

DATE: August 12, 1971

FROM: I.P.M. Cargill

SUBJECT: Discussions between Mr. Chowdhry and Mr. McNamara (July 9, 1971)

1. I have read the minutes which you and Mr. Votaw prepared of these discussions. If Mr. McNamara was understood to say that we had signed the sub-projects under the Cyclone Reconstruction Credit, he was wrong. However, it would be a pity to allow this to distract us from the important and substantive point Mr. McNamara was making, namely, that in present circumstances the administration in East Pakistan does not appear to be in a position to execute projects.

2. At the moment, of course, construction work seems to be at a very low level, if not at a standstill, on account of the monsoon. However, indications are that even before the monsoon started construction work had come to a virtual halt on practically all IDA projects. Since April 1 we have disbursed about \$4.75 million on fourteen projects in East Pakistan, but except for payments to consultants disbursements have been in respect of equipment ordered, or civil works done, prior to March 71. Further, we understand that quite a lot of equipment to be delivered after April 1 had to be diverted to ports outside of East Pakistan. When we visited East Pakistan in June we were able to see that almost all work on IDA projects had come to a halt.

3. To state these facts is not criticism of the administration in East Pakistan. Given the dislocation of the transport system and the priority being rightly given to distribution of food, it would be surprising if the facts were otherwise. Since in any event very little work, if any, can proceed until the next dry season, I concluded in June, amongst other things, that there was no point in signing a sub-project agreement until we had more assurance that the work could proceed. In early July, I sent Mr. Kuriyama back to Dacca for a month and have asked him for a report on this matter which we expect shortly.

cc Mr. McNamara

IPMCargill/AHShibusawa:cmc

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CONFIDENTIAL

Mr. McNamara's Meeting with Messrs. Hamidul Huq Chowhury and Mahmood Ali
-- July 9, 1971

Messrs. Hamidul Huq Chowdhury and Mahmood Ali called on Mr. McNamara on July 9. Mr. Farooqi, of the Pakistan Embassy, accompanied them. Mr. Osman Ali (Executive Director) was also present.

Introducing Messrs. Chowdhury and Mahmood Ali, Mr. Farooqi said they had no official connection with the Government of Pakistan and were visiting several capitals as private citizens to clarify the current state of affairs in East Pakistan.

Government had taken steps to revive economic activity. When he left the country on June 15, things were slowly returning to normal - this was just a matter of time - but much remained to be done, particularly to restore communications which had been badly disrupted. Many transport vehicles had been taken across the border to India (1,500 from tea estates alone, which meant that tea could not move from field to factory), railway signalling equipment destroyed, bridges and roads damaged and boats sunk. He emphasized the urgency of the food distribution problem. Despite theft of foodgrains from government storage points, stocks were still adequate. Sugar was in ample supply but, as in the case of foodgrains, the difficulty was to move the supplies into retail markets. He then asked what the Bank was going to do for East Pakistan. In answer to a query, he confirmed that what he had in mind was emergency relief to be followed by reconstruction.

Mr. McNamara commented that he had not understood from Pakistan sources that the situation was still so bad in respect of communications. He agreed with Mr. Chowdhury that the first step was to provide emergency relief. Such relief was not handled by the Bank. It was for this reason that he had urged Mr. M. M. Ahmad to see U Thant, which, no doubt, he would have done even without that urging, to line up international assistance. He was quite sure that there would be a wide response and that equipment, like trucks and so on, could also be quite easily supplied.

Mr. Chowdhury said that, as regards reconstruction, he understood that the Government had given lists of immediate requirements to the U.N. and bilateral donors, like Germany, U.K., and the U.S.

Mr. Chowdhury went on to say that there were many projects to be undertaken in East Pakistan, and asked if there were any holdups at either end. Mr. McNamara referred to the problem of slow disbursements and said that the Bank had "a pot of money" ready for disbursement but no requests for disbursements were coming through. He cited as examples the Tubewells and the Cyclone Rehabilitation Projects. He amplified his statement by saying that where projects had been approved, the Bank stood ready to finance them. He added the assurance that the Bank was still working on project preparation and appraisal for East Pakistan.

Mr. Chowdhury said he had seen in the newspapers, and heard rumors also, that nothing much would be done because of the political situation. Mr. McNamara, in reply, said that so far as the Bank was concerned, it was prevented by its Articles from bringing in political considerations. He also thought there was some "verbal shorthand" involved here. What people in donor countries meant when they talked in these terms was that to put in capital equipment, they needed to see that this could be done physically, and that it would be used properly. In other words, the economic situation had to be right, and to achieve this might mean, in turn, politically settled conditions. He maintained that the only constraint that the Bank had was that it must be possible effectively to put capital into a stable economic milieu.

Mr. Osman Ali pointed out at this stage that he had been told by the Bank staff that a sum of \$200,000 for a livestock survey in West Pakistan was held up along with all other projects, although this one was not adversely affected by local economic conditions. Mr. McNamara said that he had no details on this particular project.

Mr. Chowdhury said that there were many problems in East Pakistan to be tackled, including the question of flooding and irrigation. He thought it would be helpful if the Bank had somebody from East Pakistan on its staff who would have a better understanding of East Pakistan's requirements. Mr. McNamara replied that the Bank had a full division working on the problems of East Pakistan and he hoped that, if normalcy could be restored, hopefully soon, some of them, primarily in the field of agricultural development, could go forward.

Mr. Chowdhury said that the Bank and others should not wait until things returned to normal or we would be caught in a vicious circle because normalcy could not be restored without aid. If full normalcy were restored by say August or September, the Bank must be in a position to act. Mr. McNamara said that he did not foresee such a vicious circle and that Pakistan could continue to draw on loans and credits committed earlier.

Mr. Chowdhury emphasized again that, while he thought the situation would quickly return to normal, recent events had created new economic problems which urgently required external assistance. Mr. McNamara said that the Bank was planning for a quick resumption of lending as soon as development prospects permitted. Bilateral aid givers also were working on the same basis, so far as he knew. Mr. Chowdhury emphasized that Pakistan was a sovereign country and would not tolerate any outside recommendations regarding a formula for political settlement. Mr. McNamara said he understood that and, as far as he knew, no outsiders had any particular formula in mind.

There was a further brief discussion of Bank Group projects which it was agreed would be reviewed in the usual way to see how disbursements could be speeded up.

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: July 8, 1971

FROM: Gregory B. Votaw *GV*SUBJECT: Pakistan: Your Meeting with Mr. Hamidul Huq Chowdhury and
Mr. Mahmood Ali

1. An appointment has been arranged for you at 2.00 p.m. on Friday, July 9, to meet Mr. Hamidul Huq Chowdhury and Mr. Mahmood Ali. The meeting has been arranged at the request of the Pakistan Embassy.
2. These gentlemen are two of some half-dozen Bengalis who are currently touring the capitals of the world as emissaries of the Government of Pakistan. The stated purpose of their mission is to give an alternative account of the situation in East Pakistan and thus correct the allegedly false and exaggerated picture that has been portrayed in the Western press.
3. Both men have had prominent political careers. Mr. Chowdhury, who is 68, was active in Bengali and Central Government (of India) affairs before 1947, and immediately after Partition became a member of the Pakistan Constituent Assembly and of the East Bengal Legislative Assembly. He held the portfolio of Finance, Commerce, and Industries in the East Bengal Cabinet from 1947-49. In the early 1950's his career was interrupted for a few years after being found guilty of various charges of corruption, but he was soon active again and was Foreign Minister in the Central Government in 1955-56. In 1958, at the start of the Ayub regime, he was barred from politics along with many other politicians. He has not sought public office since then, but has remained active in politics through association with various parties (notably the Pakistan Democratic Party^{1/}) and also through the medium of three newspapers of which he is the owner. He has also continued with his legal practice which is considered as probably the leading practice in East Pakistan.
4. Mr. Chowdhury is said to be an extremely wealthy and cultivated person, with a charming and articulate manner. He has travelled widely in his private capacity and from 1948 to 1966 he led or was a member of the Pakistan Delegations to a number of international conferences and treaties. Three of his daughters have married members of the Pakistani Foreign Service and a fourth daughter is currently attending Western College, Oxford, Ohio.
5. Mr. Mahmood Ali, who is 51, has been active in provincial politics since his student days although his primary concern has been in business. In the 1940's his politics were radical and left-wing, but since then he has

1/ The leader of this party, Mr. Nurul Amin, was one of the two non-Awami League politicians elected in East Pakistan in the recent elections.

President has seen

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moved steadily to the right while the general trend of provincial politics has been to the left. In the 1950's he was for short periods a member of the Provincial Assembly, a member of the national Constituent Assembly, and a member of the East Pakistan Cabinet. Throughout his career he has been involved in the establishment and leadership of numerous political parties, most recently the Pakistan Democratic Party of which he is the senior vice-president. Mr. Mahmood Ali was an unsuccessful candidate in the recent national elections.

6. Both Mr. Chowdhury and Mr. Mahmood Ali have lost touch with the evolution of political sentiment in East Pakistan over the last 10-15 years. The Pakistan Democratic Party with which they are closely associated is generally and not too unfairly caricatured as a "party consisting only of leaders". Neither is in any sense a Bengali nationalist, and each is known to harbor an intense personal feeling against Sheikh Mujibur Rahman. Nevertheless, Mr. Chowdhury's newspapers have followed a relatively independent line. His newspaper editorials have been consistently critical of the Awami League, but they were also critical of the Ayub Government; and over the years his paper has not failed to point out the economic disparities between East and West Pakistan. During the present crisis Mr. Chowdhury has publicly criticised the Army "excesses", though both he and Mr. Ali have strongly defended the need to bring in the Army.

7. Before coming to Washington Messrs. Chowdhury and Ali have had meetings in Paris, Bonn, Geneva, and London. I believe that, broadly speaking, their approach has been to emphasise Indian involvement in the present crisis and the danger of disintegration of Pakistan and to try to play down the refugee situation as well as the deep-seated political, economic, and cultural grievances of the Bengalis against West Pakistan. They have also argued that the Awami League is by no means the monolithic party it appears to be and that, were it not for the threat of assassination, many of the elected representatives to the National Assembly would have responded positively to President Yahya's recent appeals for cooperation from the East Wing.

8. In their meeting with you I would expect them to take much the same line. In addition they might well appeal for fresh commitments of aid to Pakistan on the arguments that a deteriorating economy in West Pakistan would have serious political repercussions and that it will be the common man in East and West Pakistan who will suffer most if development activity is curtailed. (In this connection it might be useful to point out that Pakistan has drawn at least \$80 million from the Bank Group in the last twelve months, almost as much as any other member country, and still has far more than \$200 million to draw if it would implement agreed schemes. Some discrimination!))

9. You may wish to explore the following questions at your meeting.

- (a) What in their opinion would constitute a feasible political settlement acceptable to both East and West Pakistan? What

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do they think the experts' constitution, mentioned in Yahya's recent speech^{1/}, will look like?

- (b) If an accommodation cannot be reached in the relatively near future, what do they see as the likely development of events? Will there be an intensification of guerilla activities? What will be the cost to the West Pakistan economy of a prolonged military operation in East Pakistan?
- (c) What is the nature and quantitative basis of their support in East Pakistan? In addition to their mandate from the President, to what extent do they consider themselves representatives of widely held views in East Pakistan too?

10. For your easy reference, I am attaching a copy of the report of June 26, 1971, on Mr. Cargill's recent visit to Pakistan. This copy does not incorporate editorial changes proposed by Mr. Knapp and has had no distribution. I also attach some patently biased biodata supplied by part of the Bangla Desh lobby.

Encs.

cc. Messrs. J. Burke Knapp
W. Clark
L. Christoffersen

NSSegal:ccs

1/ In brief, the President stated that the task of drawing up a constitution for the country, which should have been done by the elected National Assembly, had now been assigned by him to a "group of experts" of his own appointment. He expected that the constitution would be ready in "four months or so". This constitution would provide the framework for the National Assembly and could be amended by the Assembly according to procedures laid down in the constitution. There would be no fresh general elections. The Awami League remains banned, although representatives elected under the banner of this party who had not committed "anti-state... and anti-social activities" would be permitted to sit in the Assembly in their individual capacities. In the meantime, Martial Law will remain operative.

The general reaction to the speech in the Western world has been one of disappointment. The President has made no real concessions to the Bengalis and his tough attitude to East Pakistan apparently remains the same. Already it is reported that the Mukti Fouj (the Bengali Liberation Army) have damaged various power installations to declare their dissatisfaction with the President's intentions.

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SECRET

Mr. Robert S. McNamara

June 26, 1971

I. P. M. Cargill

PAKISTAN--Status and Prospects

I. Introduction

1. The Bank and Fund missions that jointly visited Pakistan from June 1 to 19 have now returned. They spent about ten days in East Pakistan to review the situation there. Subsequently, they moved to Islamabad for about a week to report to the Central Government on the situation in the East wing and to discuss general issues of economic policy. John Gunter of the Fund and I met with President Yahya Khan on June 15, primarily to hear what he had to say about his intentions on the political front. On the way back, I stopped in Paris for an informal meeting on June 21 with the members of the Consortium, which John Gunter also attended.

2. As you will recall, we agreed in May, following Mr. M. M. Ahmed's visit here, that the only feasible course for us to take was to give the Government of Pakistan the chance of demonstrating that its approach to dealing with the political and economic problems confronting them was workable. As we saw it, in order to make it possible for the Consortium to resume aid to Pakistan, for purposes other than relief on humanitarian grounds, it was essential for the Government:

(a) with respect to East Pakistan

(i) to create conditions conducive to restoring normal life;

(ii) to avert the prospect of widespread famine by working out arrangements with the United Nations for the provision of relief;

(iii) to show concrete evidence of progress being made towards a political settlement to mollify public opinion etc.;

(b) on the general economic front, to work out a reform program-- involving in particular the exchange and revenue systems, with the assurance of equitable treatment of East Pakistan being one of the prime objectives of these reforms--to serve as economic basis for consideration by the Consortium of external assistance.

It was the principal purpose of these missions to assess the situation in Pakistan in relation to the various obstacles as outlined above to the resumption of aid by the Consortium.

II. Findings and Conclusions

East Pakistan

3. As discussed in detail in the mission's report which is attached (Attachment I) the situation cannot possibly be described as being anywhere near normal now. Furthermore, it is difficult to discern in the present

1/ Not included.

situation any basis for rapid progress towards normality. Economic activity generally is at a very low ebb. The integrating links of the economy--commerce and the movement of goods between regions and sectors--have been severely disrupted. As a result, the economy has fallen apart into a multitude of isolated mini-economies. In the circumstances, industry, which is also suffering from the disappearance of a large part of its labor force, is at best operating at a fraction of its normal level of activity; moreover, much of what is being produced goes into stocks, and storage capacity and the plants' liquidity position will determine how long production can be kept going. Even agricultural production has been adversely affected as field activities have been disrupted; output of both rice and jute are expected to be significantly below normal levels. Following the disappearance of two British tea planters, all expatriate personnel has been recalled from the estates, and tea production, suffering in any event from the inability to move output to markets, has presumably dropped to a very low level.

4. Economic recovery will depend on the speed with which the integrating links of the economy are restored. This is in part a matter of reconstruction and rehabilitation of physical facilities. The transport network is the principal bottleneck here. Damage to bridges and complete disruption of the communication system have reduced operations of the railways, by far the largest carrier of goods, to a fraction of their former level. The vital rail link between Chittagong, the main port for imports, and Dacca and other points North are still out of commission. Critical parts of the rail network in the Eastern and Western extremes of the Provinces are highly vulnerable to insurgent activity. In the circumstances, the railways cannot be counted on to operate anywhere near normal levels for some time to come. It is difficult to see how the other modes of transport could offset the loss of railway carrying capacity. Efforts are being made to increase the fleet of coastal vessels (in present circumstances the only means of moving goods out of Chittagong), but handling capacity at either end will impose limits on the extent to which this is feasible. Country boats are still hardly to be seen. The truck fleet has been severely reduced by movement into India and commandeering by the Army; destruction of bridges and culverts impedes highway traffic. In any event, road transport is severely handicapped during the monsoon season.

5. Furthermore, if widespread famine is to be avoided, the transport system, with its much reduced carrying capacity, will have to handle movements of food grains very considerably above normal levels, because only very small quantities have been moved since early March and the Province's food deficit this year is expected to be larger than usual. In brief, it is difficult to see the transport system being able over the next several months to provide more than a very limited basis for re-integrating the economy.

6. The other area of major physical destination is market places. These, too, will have to be rebuilt if the economy is to function normally. Reconstruction itself will probably not pose insuperable problems, although little building activity usually takes place during the monsoon season. Lack of funds for rebuilding and re-stocking will probably be the main problem.

7. Apart from physical destruction, the other principal cause of the disintegration of the economy--and in the medium term the more important--is

the psychological fact of widespread fear. People are still largely absent from places where they feel physically exposed to the Army--the towns, areas around army posts, and areas along the border. Merchants are afraid to move through the countryside. In the general atmosphere of uncertainty and insecurity, banks are reluctant to provide credit. Certain fields of economic activity have suffered severely from the large-scale exodus across the border, including in particular Hindus. Although a large percentage of government employees have returned to their offices in Dacca and elsewhere, the administration is not functioning because there is very little contact between the various layers of the administration (particularly between Dacca and other parts of the Province, and between the various component parts of administration within the district); because officers in Dacca have not seen the situation in the rest of the Province and district and thana officers have not ventured out of their offices, people are afraid to have anything to do with government; and because the emphasis of the Martial Law Administration is on 'return to normalcy' so that what administration there is takes place on a plane that has little to do with reality.

8. In conclusion, even with the best of efforts, full economic recovery is many months away and progress towards success will be slow because of the physical destruction that has taken place and because the loss of production, that cannot be recouped, coupled with the withdrawal of liquidity through demonetization, will keep purchasing power much below the normal level, little as that was. However, it is also clear that what progress may otherwise be possible will be retarded severely unless the present all-pervasive fear is removed from the scene.

9. In contrast to the general situation in East Pakistan, considerable progress appears to have been made in the United Nations' negotiations with the Government of Pakistan on arrangements for the provision of relief. When I met with Mr. Ismat K. ttani in Dacca he expressed himself satisfied with the agreement he had reached in Islamabad, although he cautioned that of course much remained to be done to translate the basic agreement into workable arrangements on the ground. The Secretary General's personal representative has been in Dacca since June 7, together with representatives of UNICEF and WFP. I understand that he has recently sent to New York a program for the deployment in East Pakistan of a staff of 100. I do not know what the status of this program is, but obviously we shall have to watch further developments carefully. Separately, USAID has made available US\$1.0 million to pay for the charter of coastal vessels and crews to move food to the cyclone disaster areas, and invitations to bid have gone out. USAID is considering similar assistance for shipping food into other parts of the Province.

10. Finally, my meeting with President Yahya Khan gave me little ground for being optimistic that the Government will within the very near future undertake major new political initiatives that would be effective in overcoming the opposition in Consortium countries to new aid being given to Pakistan. My suggestion that the Central Government place a competent high level official in Dacca to serve as the head of the civil administration and insulate it against the military, was received favorably, and something along these lines may be done. However, beyond that the discussion was quite unsatisfactory. Yahya Khan reacted angrily at the slightest suggestion that improvement

in the climate for aid depended essentially on the Government's actions. He obviously listened with disbelief to my report about the situation in East Pakistan. He reiterated his intention to transfer political power to provincial assemblies in East and West Pakistan, but said nothing new, except that he would announce details, along the lines of his press conference on May 24, in a speech to the Nation on June 28. We shall have to see what that speech says, but I must confess that I am highly skeptical that anything will emerge that will begin to turn public opinion abroad. Indeed, it is quite conceivable that it will be so hedged with respect to East Pakistan that it will have the opposite effect. Beyond that, of course, loom very considerable doubts that progress towards a political solution is possible within the present context, at the Center as well as in East Pakistan.

General Issues of Economic Policy

11. Discussions on general issues of economic policy were held in Islamabad under the leadership of the Fund, although there was very close cooperation with the Bank team and the working group on fiscal policy and the budget for 1971/72 was headed by Mr. Blobel. The principal purpose of these discussions was to explore how far the Pakistani authorities were prepared to go in devising an economic reform program appropriate to present circumstances, including in particular the direct and indirect implications of the situation in East Pakistan. The hope was that it would be possible to work out a realistic program of sufficient strength to serve as the basis for preliminary discussions with the Consortium against the time when considerations other than economic ones would no longer stand in the way of bilateral aid to Pakistan, and for a Fund stand-by credit, possibly somewhat in advance of the actual resumption of aid.

12. As was to be expected, the greatest difficulty in these discussions lay in reaching a common view on the general economic context within which the economic reform program would have to be formulated. The Pakistan authorities were obviously proceeding on the assumption that in East Pakistan the economy, including foreign trade, would function normally from the second quarter of the next fiscal year beginning July 1, 1971; that West Pakistan's economy would operate at a very high level of activity because the economic situation in the East wing would no longer affect it adversely to any significant extent and that sufficient aid (including use of the Fund stand-by) would be available to meet normal needs, while all extraordinary aid requirements (for food, for rehabilitation and reconstruction in East Pakistan) would be met by additional aid. Thus, they had in mind a rather modest reform program. Their proposal of the exchange system was essentially the same as that worked out last year, although at a somewhat more depreciated official rate of exchange. As regards the budget, counting on a 10 percent increase in central tax revenues at existing rates and a 50 percent rise in provincial revenues in East Pakistan, they proposed to raise additional revenues of Rs. 750 million (equivalent to about 6 percent of total present revenue) through new revenue measures. They expected, however, despite these measures, to have about Rs. 700 million less in rupee resources available for public development expenditures, partly because the amount budgeted for defense is Rs. 400 million higher than the original estimate for 1970/71.

13. On our side, we estimated that, in the economic situation as we saw it develop over the next year, the Government would collect perhaps as much as Rs. 1,000 million less in revenues than they had projected, much of it going to reduce the resources available to East Pakistan. We therefore came to the view that substantial additional revenue measures (including reductions in subsidies, tax exemptions, etc.) would be required, both to increase the resources available to the Government, particularly in East Pakistan, and to make a significant beginning with genuine fiscal reforms. We also considered essential major modifications in the exchange reform as worked out last year, partly because the earlier proposal contained serious weaknesses, partly because since that time the economic context, in which the system would operate, had deteriorated considerably, including the prospects for external assistance other than food aid.

14. When the last members of the Bank mission left on June 18 to prepare for the Consortium meeting in Paris, the views about the contents of an appropriate reform package were still about as far apart as they could be. By the time the Fund mission left two days later, they had managed to obtain from the Government of Pakistan a draft letter of intent. Its contents, with respect to both exchange and fiscal policy, clearly indicate that the Government is not at this point prepared to undertake the kind of thorough-going reform program that would be required to pull Pakistan out of the present difficult economic situation as well as the protracted state of near-stagnation of its development effort, and that would provide a strong economic case for external assistance. As it is, the difficulties of the situation are very largely obscured by the assumption that Pakistan will receive very considerably more aid in 1971/72 than it did in recent years.

III. The Consortium Meeting

15. At the Consortium meeting I reported briefly on the situation in East Pakistan as we had found it, and Mr. Gunter presented the main features of the economic reform package contained in the draft letter of intent. The discussion that followed centered around the present position of member countries on new aid to Pakistan. Pakistan's unilateral suspension of service payments, or part of its external debt was also discussed briefly.

16. Attached is the statement by the Canadian delegation which most succinctly states the views expressed by everybody (Attachment II). Thus, the members of the Consortium were unanimous in the view that, except for food aid to East Pakistan for humanitarian purposes, they were not prepared for the present to consider providing new aid to Pakistan^{1/} because:

- (a) public and parliamentary opinion were strongly opposed to aiding Pakistan in present circumstances;
- (b) even limited resumption of aid was likely to be misinterpreted by the powers that be in Pakistan and therefore further delay the necessary reforms.

^{1/} Everybody, however is continuing to disburse against existing commitments.

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At the same time, however, it was clear that nobody looked to complete restoration of normality in East Pakistan and towards full transfer of political power to elected provincial assemblies as pre-conditions to new lending. What was essential was visible progress towards these objectives which were in accord with the Government's own announced intentions. In this connection, the delegate for the United Kingdom urged that all Consortium Governments seek every possible opportunity for making this position clear to the Government of Pakistan.

17. Some members, notably Japan and the Netherlands, asked whether some attempt should not be made now to substitute an agreed moratorium for the present unilateral suspension by Pakistan which contained serious iniquities and in its present form caused some members considerable difficulty. In the end, it was agreed that any move in this direction could be deferred to the time when it could be dealt with as part of the general question of aid to Pakistan.

18. I concluded the meeting by saying that in my view a full meeting of the Consortium in July, as originally planned, would not serve any useful purpose, but that a meeting might be possible in September/October. I said further that in the meantime we would keep the dialogue with Pakistan going and in particular would attempt to reach agreement with the Government of Pakistan on a realistic program of economic reform. This was agreed.

IV. Future Course of Action

19. In order to continue the dialogue and, if possible, achieve progress during the next two to three months, I suggest that we do the following:

- (a) In the first instance, you write to President Yahya Khan, essentially to reiterate the need on the Government's part to create conditions in Pakistan that would overcome the present, very strong opposition of public and parliamentary opinion abroad to aid being given to Pakistan. I propose that a copy of our report on East Pakistan be attached to this letter.
- (b) Simultaneously, I write to Muzaffar Ahmad, reporting on the Consortium meeting on June 21 and outlining in some detail the kind of reform program that would, in our view, be required both to deal effectively with Pakistan's economic problems and to provide a strong economic case for aid.
- (c) Over the next several weeks, we would, in close consultation with the IMF, work out in detail the economic context in which the economic reform program should be formulated and the contents of such a program. We would further refine our estimates of the amount of new aid required in order to keep West Pakistan's economy going at a reasonable level and to provide for East Pakistan's needs. Finally, we would work out a possible debt relief scheme for the full year 1971/72 that would be substituted for the present unilateral suspension of some service payments.

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- (d) Upon completion, the studies outlined under (c) would be sent to the Government of Pakistan to serve as the basis for further discussions as well as, at least in part, to the members of the Consortium for any comments they might have.

Mr. F. J. Chambers (Canada)

Thank you, Mr. Chairman. I would like to take this opportunity to thank yourself and your colleagues, in particular Mr. Gunter, for bringing us up to date on the conditions in Pakistan. I must confess that they are not as encouraging as one might have liked after your return. I am quite impressed with the amount of work which both the Fund and the Bank have done on the balance of payments and resource requirements for Pakistan as they see it at this moment. It seems quite clear that much technical progress has been made, at least on the short-term balance of payments situation. Nevertheless, I cannot help but feel that the main question is not confined to a question of meeting the technical requirements for Fund support and perhaps even for continuation of Bank support. I think the factors which will determine the action of governments at least, and I am sure of the Canadian Government, are not limited to questions of appropriate financial and fiscal measures, although this is certainly one of the conditions. The difficulties in the Sub-continent are of great concern to the Canadian public and the Canadian Government and as a result our freedom of action is not entirely unrestricted. We have divided this question, at least conceptually, into three parts. The first is the question of support for Pakistani refugees in India; the second is the question of continuing or re-establishing normal aid flows to Pakistan; and the third one is the question of relief in its purest sense for East Pakistan. I've already indicated in the meeting of the Indian Consortium what we have been willing to do for the refugees in India, and that we hope to be able to do more in due course. But as serious as the problem in India is, the question of assistance for Pakistan itself is a much more difficult one. The Canadian Government has given some considerable thought to this question, and although our position is not yet final, a number of central points seem to be emerging at this time. In the light of the difficulties in Pakistan, the Canadian Government has not yet determined the level of assistance it is prepared to make available to Pakistan in the current year. But we would be prepared to participate in the program, along with other donors, provided the following general conditions were met:

- (a) Since Canadian aid is provided only to countries which are in a position to make effective use of the funds, a clear requirement for the resumption of Canadian aid activity would be a viable and effective government, capable of providing an environment for orderly development;
- (b) To this end, efforts should be made to establish a form of government in Pakistan having the confidence of the people, and a less obvious role for the military and greater civilian participation. Since the maintenance of security and stability in East Pakistan may require some military presence, a complete withdrawal of military forces is not a necessary condition at this time, but a minimal role for the military would appear to be desirable.

(c) The Government of Pakistan should be making efforts to repatriate refugees back into East Pakistan, and the political and economic environment there must be such as to allow them to return without fear, and programs for their rehabilitation and reintegration into East Pakistan should receive a high priority. I might say, Mr. Chairman, that this is a condition on which our authorities attach a considerable degree of importance, because it would be quite impossible to have a sort of a permanent refugee problem established in that particular area.

(d) The Government of Pakistan must present a program for rehabilitation and the establishment of development that at least in broad outline will:

- i) restructure its priorities to take account of the impact on the economy of the recent troubles;
- ii) outline an appropriate division of resources for development between the two parts of Pakistan;
- iii) take serious steps to conduct economic and financial policies in a manner which would alleviate its current debt servicing problem.

(e) Finally, in a general sense, Pakistan should be seen to be acting within the community of nations in a manner which would be acceptable to the donor countries of the Consortium. Canada would only be prepared to resume aid activity in close cooperation with other Consortium members and members of the United Nations.

These are the major conditions as we see them at the moment for re-establishment of the main aid flows to Pakistan. There is still the question of emergency relief assistance to East Pakistan itself. I find it extremely difficult to define whether and at what point emergency assistance would start to affect the general pressure on resource flows in Pakistan, and thus negate the efforts of the conditions for re-establishment of the main assistance program. Nevertheless, I think the Canadian Government would want to reserve some scope for emergency assistance to East Pakistan, but it would have to be provided under effective supervision of some acceptable international organization or agency. I would like to emphasize again, Mr. Chairman, that this is still somewhat in the nature of provisional thinking. This will continue to be re-assessed and will have to be re-assessed again after this meeting, but that is by and large the way the picture appears at the moment. Thank you very much.

~~Sajid~~ / information

Dr. Sajid Hossain served the Ayub Khan regime by participating in attempts to suppress the autonomy of Bengali universities. To this end, the University Ordinance Act of 1959 was formulated. This act would have curbed academic freedom by bringing the university more tightly under control of the army. In 1969, Dr. Hossain was rewarded for his loyalty with the Vice-Chancellorship of Rajshahi University. His appointment encountered widespread opposition from the faculty and students, but their sentiments were overridden by martial law authorities.

Hamidul Huq Chowdhury has never won an election and has never had a constituency of his own. Rather, he was appointed to the Muslim League Cabinet in 1949, even though he was not a member of the Legislative Assembly. Because of corruption and misappropriation of public funds, he was the first to be dismissed under the Public Representative Offices Disqualification Act in 1951. Since then he has occupied a number of positions in legislative bodies, but not because he was popularly elected.

Kazi Din Mohammad is currently chairman of the department of Bengali at the University of Dacca. He collaborated with the Ayub regime in its campaign to suppress the Bengali language and culture in East Pakistan. The program was aimed partially at removing all courses on Tagore at universities and colleges, banning all writings and books on Tagore, and banning all songs by Tagore from the programs of Radio Pakistan. This campaign was strongly resisted in East Pakistan and was finally withdrawn because of the popular opposition it encountered. Thereafter Mr. Mohammad was ostracized by all literary and cultural societies in Dacca.

Justice Nurul Islam was a relatively undistinguished lawyer in Dacca before being appointed to the High Court of East Pakistan. His appointment came not as a result of his popularity in the East but as a result of his political support by the West. As a student he was active in local Muslim League politics. More recently he has served on the Executive Committee of the Dacca Muslim League. The Muslim League, which has its base in West Pakistan, has never had popular support in East Pakistan. It is solidly opposed to the Awami League.

Dr. Mohur Ali, professor of history at Dacca University, has the reputation of a staunch conservative. He is identified with extreme religious ideology. During his tenure as proctor at Dacca University, he served as an informer to the Ayub regime, reporting on the political activities of students and professors.

Begum Akhtar Sulaiman is the daughter of the late Bengali politician Surwardy, who founded the Awami League. She is, however, a totally unknown figure in Bengal. She has never lived in East Bengal, is married to a West Pakistani, has never been politically active, and does not speak Bengali. She was recently sent by Yahya Khan to recruit elected members of the Awami League to form a Quisling administration in East Bengal. She has failed so far.

Mahmud Ali ran as a member of the People's Democratic Party in the recent election and lost to the representative of the Awami League. Mr. Ali lost the support of his constituency in Sylhet after his attack on Maulana Bhashani and his collaboration with West Pakistani landlords, such as Nawabzada Nasrullah, of the P.D.P. In the election, he came in a poor fourth, with 15,628 votes against the winner's 53,749 votes.

Copy also from: Friends of E. Bengal 4621 Larchwood Lane, Phil. 19143, Pa.
Source: Kruppenderff - 4513 Osage Ave, Phila 19143

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OFFICE MEMORANDUM

TO: Records

DATE: October 5, 1971

FROM: Michael H. Wiehen *MHW*~~CONFIDENTIAL~~

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SUBJECT: Annual Meeting 1971: Meeting of Pakistan
Delegation with Mr. McNamara

1. A meeting of the Pakistan Delegation with Mr. McNamara took place on Wednesday, September 29, 1971, at 8:30 a.m. in the Sheraton Park Hotel. The Pakistan Delegation comprised:

Mr. S. U. Durrani, Governor, State Bank of Pakistan
Mr. Aziz Ali F. Muhammed, Adviser, Ministry of Finance
Mr. M. Syeduzzaman, Joint Secretary, Ministry of Finance
Mr. S. Osman Ali, Executive Director, IBRD
Mr. A. R. Bashir, Economic Minister, Pakistan Embassy.

Also present: Messrs. J. Burke Knapp, I.P.M. Cargill, G.B. Votaw, M.G. Blobel, D.L. Gordon, and M.H. Wiehen.

2. Mr. Durrani opened the meeting by expressing his regret that Mr. M.M. Ahmed was not able to attend the Annual Meeting as he had planned to do. Mr. McNamara asked Mr. Durrani to transmit his best wishes for a speedy recovery to Mr. M.M. Ahmed.

3. Thereafter Mr. Durrani, with reference to the Bank's June 1971 report on East Pakistan, said his Government would like to know what precautions the Bank had taken to assure that its reports would in future not be available to those for whom they were not intended. The question remained unanswered.

4. Mr. Durrani then briefly described the present political and economic situation in Pakistan, with the following major points: The general amnesty declared for participants in East Pakistan's disturbances has partially restored confidence. A new constitution was about to be announced; it would be presented to the National Assembly after the by-elections which are necessary to fill vacant seats in East Pakistan. The by-elections would now, after a brief postponement, be held in late December; and the National Assembly would convene early next year. The appointment of Dr. Malik as the head of a civilian government in East Pakistan was a big step forward.

5. Regarding the economic situation, Mr. Durrani first summarized the findings of a State Bank report on East Pakistan that was prepared last August (and of which he had earlier given copies to the Bank staff). He highlighted the situation of the jute sector; while movement of jute at all levels had been completely disrupted, the very special efforts of the Government in this field had been successful, and jute was moving again in satisfactory volumes (during July exports reached 75 percent of July 1970 levels). All commercial bank branches (except for 9 in border areas) have been reopened, special bank booths have been set up in jute collection areas, and in some regions cash would be flown in by helicopter every day if necessary. Industrial activity has reached high levels, and production was about 65 to 75 percent of normal.

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Foodgrains are reaching Chittagong in sufficient volume, and arrangements for movement up-country are well in hand. The recent monsoon floods had caused considerable damage (value of foodgrains destroyed about \$50 million, other property damage about \$60 million), about 6.5 million people had been affected by the floods, and consequently imports of foodgrains into East Pakistan would have to be increased to 2.5 million tons in FY 1972. A very large public sector program has been prepared to cope with the specific problems facing East Pakistan; about Rs. 250 million (approximately US \$50 million equivalent) would be spent this fiscal year for rehabilitation (Rs. 150 million) and for reconstruction (Rs. 100 million). About one-fourth of total development outlays would be channeled into rural works. In general, ongoing and flood control projects would have high priority.

6. In West Pakistan, the public sector is severely squeezed, and Pakistan's balance of payments problem is causing a serious constraint on the use of industrial capacity. While great success was being achieved in expanding exports, sound balance of payments management would be impossible if all debt service were to be paid in full.

7. Mr. Durrani continued that it was in this context that his Government had requested debt relief from the Consortium, and that the absolute minimum needed to overcome the present difficulties was \$90 million for the current fiscal year. He recalled that only a few years ago Pakistan had been cited as a model for sound economic development and said that, while at present no developmental progress was being made, the question was how fast Pakistan would be able to revert to its previous position. With particular regard to the informal meeting of Consortium members set for October 2, Mr. Durrani requested that the Bank play the role not of a neutral chairman, but of an active leader, initiating new assistance for Pakistan and also setting a date for a full Consortium meeting to discuss long-term debt relief and other long-range assistance.

8. Mr. McNamara replied that by calling the October 2 meeting the Bank had indeed taken considerable initiative. This was done even though Consortium members had shown no enthusiasm at all to discuss the subject of debt relief. It was not clear how far the Consortium countries were prepared to go at this time, but the first hurdle to be taken clearly was to neutralize the problems caused by Pakistan's moratorium. Mr. McNamara said that one should be quite satisfied that all Consortium members were at least prepared to attend the October 2 meeting. Mr. Cargill added that he felt several decisions taken recently by President Yahya were steps toward a political solution, and that these should be given emphasis in Pakistan's bilateral discussions with Consortium countries. Mr. McNamara concluded the discussion of this subject by reiterating that the Bank would not get involved in such political considerations, but that these matters were important for Pakistan's talks with its bilateral creditors.

9. In response to Mr. Durrani's question when the Bank/IDA would resume normal activities in Pakistan, Mr. Cargill stated that fresh commitments could hardly be made in the absence of a development plan, and that the Bank would instead concentrate first on a reactivation of the existing projects in East Pakistan. Mr. McNamara confirmed this view, citing as a particularly unfortunate example the Cyclone Reconstruction project, which had been approved by the

Executive Directors within 60 days after the cyclone, and on which now, almost nine months later, no progress had been made at all. Mr. Cargill said that a technical mission would visit East Pakistan in about 10 days to determine whether conditions allow implementation of this project to start. Mr. Osman Ali expressed the hope that this mission would lead to some action by the Bank, and not just to another mission, as he claimed had happened in the past. Mr. Durrani emphasized that this project was related to a particular purpose -- reconstruction of cyclone damage -- and that with an even longer delay the project would be less and less effective. Mr. McNamara agreed with the need for action as soon as feasible, but he said that as long as cash had to be flown to jute buyers by helicopter, the situation could not really be considered normal. Besides, he added, there were very few disbursement requests on other projects where action depended entirely on the Government authorities.

10. Mr. Aziz Ali, with reference to the immense shortage of rupees in Pakistan and the heavy flow of debt service payments to the Bank in the next few years, asked whether the Bank/IDA would consider non-project lending to Pakistan in the next year or two. Mr. McNamara replied that he would not rule this out during the entire period mentioned by Mr. Aziz Ali, but that in the present circumstances he could not recommend anything to the Executive Directors.

11. In conclusion, Mr. McNamara said that the reactivation of existing projects should get priority attention; and that other Bank activities in Pakistan would depend substantially on the progress achieved with existing projects and also on the outcome of the October 2 meeting of the Consortium.

cc: Mr. R.S. McNamara
Mr. J.B. Knapp
Mr. I.P.M. Cargill
Mr. G.B. Votaw
Mr. C.G.F.F. Melmoth
Mr. M.G. Blobel
Mr. M.H. Wiehen

MHWiehen/lgl

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: November 30, 1971

FROM: I. P. M. Cargill

MAW for IPME.

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SUBJECT: PAKISTAN - Visit of N. A. M. Raza

Pakistan's new Ambassador to the United States, Nawabzada Agha Mohammad Raza, will call on you today at 4 o'clock p.m. A brief biography is attached. Ambassador Raza may use this opportunity to raise questions on the following subjects:

East Pakistan Cyclone Reconstruction Project

2. A five-man Bank mission visited East Pakistan October 15-30 to form a judgement on whether it would be feasible to proceed with the first of the sub-projects for which agreements had been negotiated last February but which had not been signed due to the start of disturbances. The cyclone shelter sub-project had been thought to be a good case to test the implementation capacity under the disturbed circumstances, and the mission therefore spent considerable time looking into the feasibility of commencing with its implementation. The mission's report, which is being finalized now, and its recommendations have of course been overtaken by the events of last week, namely stepped up fighting and the declaration of a state of emergency. While the mission reported difficulties in travelling in the cyclone area and substantial increases in the local market cost of the materials and services required for the building of shelters, the Government gave assurances that it could deal with these difficulties. I might have been tempted, then, to recommend to you that we sign the respective sub-project agreement and let the Government prove that it can be implemented. Such a recommendation, however, would have implied minimum supervision opportunity for us as well as the Government. In view of the increased military activity there is no question that we will have to defer our decision to go ahead, even on a very limited scale.

Other Bank/IDA Operations in Pakistan

3. Under the present circumstances we should of course not make any new loans or credits. Existing projects in West Pakistan are generally making satisfactory progress; supervision missions are being carried out again in a normal manner. At this moment, a mission supervising the West Pakistan education projects is winding up its review in Islamabad, and one other staff member is in Karachi reviewing the port projects there. Projects in East Pakistan, on the other hand, are progressing at a much less satisfactory pace, if at all. Information is scarce, and we have not had - or scheduled - any supervision missions to that wing since last March. We continue to support efforts by the various project authorities to achieve

President has seen

whatever progress is possible but we will not know, until the security situation allows resumption of mission visits, the status of our projects there.

4. Disbursements under existing commitments in both wings (and debt service to the Bank Group) are continuing (in \$ million):

	DISBURSEMENTS			DEBT SERVICE -- BANK + IDA		
	<u>BANK</u>	<u>IDA</u>	<u>TOTAL</u>	<u>Principal</u>	<u>Interest</u>	<u>TOTAL</u>
<u>FY 68</u>	<u>59.3</u>	<u>63.7</u>	<u>123.0</u>	<u>16.0</u>	<u>11.4</u>	<u>27.4</u>
<u>FY 69</u>	<u>89.2</u>	<u>29.1</u>	<u>118.3</u>	<u>18.2</u>	<u>14.6</u>	<u>32.8</u>
<u>FY 70</u>	<u>66.7</u>	<u>28.0</u>	<u>94.7</u>	<u>20.8</u>	<u>18.9</u>	<u>39.7</u>
<u>FY 71</u>	<u>56.1</u>	<u>25.8</u>	<u>81.9</u>	<u>24.0</u>	<u>20.5</u>	<u>44.5</u>
1st Quarter	17.2	3.9	21.1			
2nd Quarter	10.6	4.6	15.2			
3rd Quarter	11.2	9.0	20.2			
4th Quarter	17.1	8.3	25.4			
<u>FY 72</u>	<u>28.5</u>	<u>36.6</u>	<u>65.1</u>	<u>26.0</u>	<u>24.2</u>	<u>50.2</u>
1st Quarter	9.8	9.2	19.0			
October-November Actual	2.2	4.4	6.6			
December 71-June 72 Proj.	16.5	23.0	39.5			

Of the total amount disbursed during the period April 1-November 25, 1971, about 20 percent related to East Pakistan projects (7 percent of Bank disbursements, and 30 percent of IDA disbursements). It is interesting to note that both Bank and IDA disbursements related to East Pakistan have begun to drop considerably during the last few weeks.

External Debt

5. The six-month period for which Pakistan originally deferred debt service payments on much of its external debt ended on October 31. While most of the Consortium countries appeared ready to "acquiesce tacitly" in continued deferment of part of the external debt during the remainder of Pakistan's current fiscal year (June 30), the Government of Pakistan decided that "tacit acquiesce" would not achieve their objective of replacing the default by a mutual agreement, while at the same time it would narrow their room for maneuver in bilateral negotiations. During discussions with Consortium countries in October I got the impression that all countries were interested in working out an arrangement under which the default with its discriminatory features could be replaced by a more orderly arrangement under which an amount of something between \$75 and \$90 million of debt due before June 30, 1972 would be deferred. Most countries appeared prepared to accept

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one of the formulae proposed by the Bank for a modified burden sharing, and the Bank's proposals would have allowed Pakistan to pay all those types of debt non-payment of which proved particularly embarrassing and could soon lead to a halt in disbursements.

6 Although we have very little direct information it appears that Pakistan, in early November, again approached the Consortium countries extending the "moratorium" through January 31, 1972, and hinting at bilateral talks towards a formal agreement. I expect that such bilateral talks will soon commence with Italy and Japan, the two countries where the default by Pakistan caused particularly great inconvenience. I have assured the governments of both these countries that they should not feel inhibited in their bilateral talks by the fact that the Consortium as a group at present was unable to come to a general agreement - formal or tacit - with Pakistan.

7. Ambassador Raza may also reiterate earlier requests of the Pakistan Government to deal with the present short-term moratorium as part of a long term debt rescheduling. However, since the February 1970 Consortium meeting it has been clearly understood in the Consortium - and communicated repeatedly to Pakistan - that proposals for long-term rescheduling of debt would have to be considered in the context of long-term economic development and could in any case not be undertaken until Pakistan had implemented exchange and fiscal reforms which had been agreed with the Fund. Pakistan has persistently procrastinated on this issue. Those reforms as agreed with the Fund are now out of date and new schedules will have to be worked out. There is no possibility that the Consortium will agree to any proposals for longer-term debt rescheduling without suitable reforms supported by the Fund and the Bank being implemented.

cc. Mr. Knapp

MHWiehen/ccs
November 30, 1971

ATTACHMENT

N. A. M. RAZA
PAKISTAN'S NEW AMBASSADOR TO THE U.S.
BIOGRAPHIC DATA

Nawabzada Agha Mohammad Raza, 66 years old, comes from the Qizilbash family of the Punjab. He was educated at the Bishop Cotton School in Simla and in England. He graduated from the Royal Military College in Sandhurst and was commissioned in 1927. During World War II, he was Commander of a brigade in Burma. After the war he was Director for the selection of personnel for the Armed Forces. At the time of Independence, he was appointed Senior Member for Pakistan on the Army Resolution Committee. On the establishment of Pakistan, he became Adjutant General and was responsible for the reorganization of the Pakistan Army. Ambassador Raza holds the rank of Major-General.

Raza was Pakistan's first Ambassador to the Peoples' Republic of China from 1951 to 1954. He then served as Ambassador to Iran from 1955 to 1959, and as Ambassador to France (and the Vatican) from 1960 to 1962. In August 1962 he was reappointed Ambassador to the Peoples' Republic of China and was concurrently accredited to the Mongolian Peoples' Republic. From August 1966 to January 1969 he served as Ambassador to Italy and was concurrently accredited to Malta and Albania. Since early 1969, he has been one of the Directors of Pakistan National Oil Company.

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October 9, 1970

SECRET

Mr. David L. Gordon
IERD
P.O. Box 1025
Islamabad, Pakistan

Dear Dave:

I spoke to the IMF yesterday to learn what came out of their discussions with the Pakistanis in Copenhagen in the week following the Annual Meeting. In brief, there is now an agreed draft of a letter of intent - broadly following the usual lines of such agreements, including restrictions on credit - to serve as the basis for a stand-by agreement of \$125 million. Unfortunately, the contents of this agreement are not such as to give much cause for satisfaction. Indeed, there are two aspects of the reform as now proposed which disturb me greatly. Let me explain in some detail what my problems are because I want you to talk to the Government about them.

What disturbs me most is the impact of the reform on the budget. As you know, I was quite unhappy about the Government's failure in June to take decisive action in raising additional revenues. Information prepared at our request last week by your people in Islamabad and Dacca about the current budgetary outlook broadly confirms our earlier fears, indicating that at best total public development expenditures this year will come to Rs. 660 crores, as against a gross program of Rs. 770 crores and last year's actual outlays of Rs. 620 crores. This by itself would hardly amount to giving the Fourth Plan a very auspicious start and would raise questions in my mind about the realism of the assumptions on which we are proceeding in preparing the action program for East Pakistan. I am now told by the IMF that the Pakistanis have estimated the reform of the exchange system to reduce the resources available in the budget for development by as much as Rs. 95 crores. Claims on the budget would result from various subsidies on imports of foodgrains, edible oil, fertilizer and other so-called essentials (Rs. 94 crores), net reductions in import duties (30 crores) and, of course, the sharp increase in the exchange rate for debt service payments, defense, and other Government imports and payments. These claims would be partially offset by additional revenues arising out of the reform - principally export duties and exchange taxes - but the net effect is, as I said above, estimated to be a substantial reduction in resources available for development. As far as we know, there is no intention on the part of the Government to make up for this impact by additional revenue measures; the IMF says that they tried but failed to move the negotiators on this point. As a result and provided the Pakistani estimate is reasonably accurate, we now face the prospect of a further drastic cut in the development program to, say, Rs. 565 crores. I suspect that

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not only would such a cut in development outlays fall disproportionately on East Pakistan, but also the regional composition of Government expenditures would shift in favor of West Pakistan because a very large part of the increase in non-development expenditures - defense, debt service, fertilizer subsidy - would be on behalf of the West Wing. I am not sure how the Centre expects to be able to persuade East Pakistan to swallow such further cuts, but there is no question in my mind that if the Government sticks to its present intentions, our position in arguing with the Consortium about support for the reform will be weakened considerably. Furthermore, I simply cannot see how in these circumstances we could go ahead with the action program for East Pakistan.

I am particularly upset about the outcome of the discussions on this particular point because I had thought that I had made my concern about the budgetary situation perfectly clear to John Gunter and Ishaq before I left Copenhagen. Moreover, it was quite obvious in our meeting with the heads of delegations in Paris that the Consortium shared this concern. It is impossible to guess how they would react if they had to be told that the additional resources accruing to the Government from their support - whether through additional commodity assistance or through debt relief - would merely compensate for the negative impact of the reform on the budget and thus enable the Government only to keep the development program at the present unsatisfactory level, particularly as far as East Pakistan is concerned. However, I am afraid that we would find it very difficult to get anywhere near the \$175 million that we have been talking about. Manfred made this quite clear to both John Gunter and the Pakistani negotiators when he met with them in Copenhagen after the Paris meeting.

The second major weakness is that, as the proposal stands at present, it would widen rather than narrow the difference in effective cost of imports of finished capital goods and raw materials. According to our calculations, the details of which are shown in Attachment I, the difference would increase from Rs. 1.92 to Rs. 4.30 per U.S. dollar. Considering that underpricing of investment and the large spread between the cost of capital goods and raw materials was perhaps the largest source of inefficiency in the allocation of resources in the exchange and import regime as it developed during the second half of the 1960s, I just cannot see how one can contemplate undertaking a major reform without tackling these problems.

Undoubtedly, an increase in the effective cost of imported capital goods above the level now contemplated would raise political problems. In particular, East Pakistan would certainly argue that such a move is essentially designed to frustrate their plans just at the time when they had thought they had finally won the battle for a larger share in the country's total resources. I believe we all sympathize with this concern, but I believe it also needs to be said that this problem is essentially one of transfers and of budgetary allocations. To try to deal with it through the exchange rate structure is not only highly inefficient, but also highly undesirable because of the disadvantageous position in which domestic manufacturers of capital goods would be placed as a consequence.

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I should have thought that as far as East Pakistan is concerned at whatever level one puts the effective cost of imported capital goods it is essentially an accounting price: most investment is undertaken by the public sector, and additional outlays arising out of higher duties would be matched by additional receipts; surely some way could be found around the difficulty that outlays would have to be made by the Province while the revenue would accrue to the Centre. A net shortfall in resources would only occur to the extent that, as a result of domestic manufacturers being placed in a better position to compete, capital goods are procured domestically rather than abroad. However, I would be quite surprised if this came to more than US\$30 to \$40 million a year for East Pakistan. This would be quite a substantial amount for domestic manufacturers, but the net budgetary impact should surely be manageable.

So, unless you have strong objections to the positions I have outlined, here is what I want you to do: I want you to call on the Finance Minister - who I hope will ask Ishaq and others with knowledge on the subject to attend - and explain to him that we are deeply disturbed about the way the reform seems to be shaping up in some highly important areas. Referring to Manfred's meeting with the negotiators in Copenhagen, you should point out that if what I have said above, particularly on the budgetary front, is a reasonably accurate description of the implications of the reform, we would enter into our discussions with the Consortium about supporting assistance for the reform with a very much weaker case than we thought we would be able to present and than we would regard as essential for getting anywhere near the amount for which we have asked.

Ideally, what we would want them to do is through a combination of a reduction in subsidies below the level now contemplated and additional revenue measures, to keep the public development program in real terms intact at the present level, say, Rs. 660 crores. I expect the Consortium would be prepared to go along with something less than this ideal situation but it is essential that they be assured that the Government is prepared to take such fiscal measures as will be necessary to ensure that the major part of their support will be used for increasing the development program beyond Rs. 660 crores.

I personally do not feel quite as strongly about the cost of capital goods and its implications for domestic suppliers, although I think the present proposal is foolish. However, it is also obvious that our argument vis-a-vis the Consortium that what is proposed amounts to a major reform and therefore deserves their fullest support will be weakened considerably if the reform in fact fails to resolve satisfactorily this issue of which everybody in the Consortium is only too well aware because we have hit it so hard in successive economic reports. Moreover, I know that the United States response is likely

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to be influenced by Government action in this respect. Here again it is difficult to be precise about what would be a satisfactory resolution, but I would be prepared to defend an average effective rate of Rs. 10 to the U.S. dollar, including duties, for capital goods, perhaps somewhat, but not much, less, for East Pakistan.

For your general information, I am also enclosing copies of the paper we distributed to the Consortium in Paris and of the minutes of that meeting.

Manfred and I have tentatively planned to leave Washington on October 21 for further discussions in London, Bonn, Paris and Rome on October 22 and 23. It would obviously be helpful if we could have some initial reaction from you before we leave.

One last thing: we promised to let the Government know when we would have our next round of discussions with individual members of the Consortium. Would you, therefore, please convey to them our plans as indicated above. In addition, we will meet with the Canadians and the U.S. either shortly before or after our trip to Europe. You should also tell them that in the event they are not prepared to strengthen substantially the present draft agreement along the lines indicated in this letter, we will almost certainly have to have another meeting of heads of delegations at which we would want the Pakistan Government to be represented, both to explain their position and to hear for themselves the reactions from the Consortium.

Yours sincerely,

I.P.M. Cargill
Director
South Asia Department

Attachments

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IBRD



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