CHAPTER V

RESOURCES AND FINANCING

1. The size of the Third Plan has been determined in the light of a careful evaluation of the recent experience under the Second Plan, the growth possibilities that clearly exist in various sectors of the economy, and the expenditures necessary to exploit the growth potential of the economy to the maximum. A careful assessment of the resources that can be mobilized, both domestically and from abroad, shows that the growth and investment targets are well within reach. The proposed development programme of Rs. 52,000 million can be financed with only a modest increase in the present levels of external assistance and by maintaining the marginal rate of saving realized in the Second Plan period. The main problem is to mobilize an adequate proportion of these resources for the public sector programme, the size of which is fixed at Rs. 30,000 million. Current projections of resources in the public sector indicate that, in addition to revenue surplus, and a modest resort to deficit financing, efforts will be required to transfer responsibility for financing a part of the programmes of the public corporations from the Government Budgets to the capital market. In the private sector, estimates of resource availability and the experience of the Second Plan support an investment programme of Rs. 22,000 million. The rationale of overall resource projections, the availability of resources in the public sector and the investment possibilities in the private sector, together with changes in the institutional and policy framework necessary to mobilize these resources, are discussed in the following paragraphs.

SOURCE AND USES OF NATIONAL RESOURCES

2. The experience of the Second Plan has clearly demonstrated the capacity of the economy to attain high growth rates and to generate adequate resources for this purpose. The actual increase in the GNP over the Plan period is expected to be 29 per cent compared to the target of 24 per cent. Including imports, the total availability of resources is expected to increase to a level of Rs. 52,530 million in 1964-65. This increase in national resources has enabled capital formation to more than double in 1964-65 compared to the level of 1959-60.

TABLE 1

RESOURCES AND EXPENDITURES: 1959-60 — 1969-70
(Million Rs. ; current prices)

	1959-60	1964-65	1969-70	1969-70 (1964-65=100)
A. Resources:				
Gross National Product (Factor cost)	31,439	43,365	59,400	137
Indirect Taxes net of Subsidies ...	1,266	2,175	3,365	155
Gross National Product (Market Prices)	32,705	45,540	62,765	138
Imports of Goods and Services ...	3,535	6,990	8,985	129
Total National Resources ...	36,240	52,530	71,750	137
B. Expenditures:				
Private Consumption ...	28,007	36,024	46,410	129
Public Consumption ...	2,563	4,400	6,740	153
Total Consumption ...	30,570	40,424	53,150	131
Non-Investment Development Outlay in the Plan ...	160	655	1,100	168
Plan Investment ...	2,600	6,776	11,400	169
Other Investment Expenditure* ...	400	1,375	900	65
Changes in Stocks ...	430	250	400	160
Total Domestic Expenditure ...	34,160	49,480	66,950	135
Exports of Goods and Services ...	2,080	3,050	4,800	157
Total Expenditure on National Resources	36,240	52,530	71,750	137

* Includes non-monetized investment and investment on Indus Basin Works.

This is mainly due to the success achieved in holding down the increase in consumption to less than the increase in the GNP. While the rate of increase in public consumption has been substantially above that of private consumption, this is related mainly to rising debt service liability and recurring expenditure on completed development projects. It also includes the effect of an adjustment in the pay scales of the Government employees to the rise in the cost of living in the fifties. As public consumption constitutes a small proportion of total consumption, its increase did not significantly affect total consumption.

3. The GNP at factor cost is expected to increase by about 37 per cent over the Third Plan period. The increase in the GNP in terms of market prices will in fact be larger, *i.e.*, 38 per cent. The additional resources that will thus be available to the economy during the Third Plan period will be adequate to finance an increase of more than two-thirds in the level of investment proposed in the Third Plan period, allowing at the same time consumption to rise by 31 per cent (13 per cent on a per capita basis). This is expected to be accomplished with only a modest increase in the flow of foreign resources (including the financing of the Indus Basin Works). Table 1 presents estimated 1964-65 benchmarks on the basis of the latest analysis of GNP, exports, imports, consumption and investment and projections for 1969-70.

4. The Plan expenditure (including non-investment development outlay) is expected to rise from 16.3 per cent of GNP in 1964-65 to 20.0 per cent by the end of the Third Plan period. Correspondingly the ratio of consumption expenditure is expected to decline from 88.8 per cent to 84.7 per cent of GNP. The net inflow of external resources which increased sharply during the Second Plan period from 4.8 per cent to 8.1 per cent of GNP is expected to decline to 6.7 per cent by the end of the Third Plan period. Table 2 clearly brings out the rising share of investment and the declining share of consumption in total GNP.

TABLE 2

SOURCES AND USES OF NATIONAL RESOURCES IN THE THIRD PLAN

(Percentage of G.N.P.)

	1959-60	1964-65	1969-70
A. Sources :			
Gross National Product (at Market Prices)	100.0	100.0	100.0
External Resources	4.8	8.1	6.7
Total ...	104.8	108.1	106.7
B. Plan Investment :	7.9	14.9	18.2
Non-Investment Development Outlay	0.5	1.4	1.8
Other Investment Expenditure	1.2	3.0	1.4
Changes in Stocks and exchange reserves	1.7	0.0	0.6
Consumption Expenditures	93.5	88.8	84.7
Total ...	104.8	108.1	106.7

5. The critical assumption in the Third Plan is that the economy would continue to save and reinvest roughly 22 per cent of the additional income generated during the Plan period. Table 3 indicates the marginal rates of saving over the Second and Third Plan periods.

TABLE 3

MARGINAL RATES OF SAVING IN THE SECOND AND THIRD PLAN

(Million Rs.)

	(In current prices) Second Plan	(In 1964-65 prices) Third Plan
1. Increase in GNP (Market prices)	12,835	17,225
2. Increase in investment	4,970	4,300
3. Additional external resources (over the preceding Plan level).	2,110	495
4. Additional domestic savings (2 — 3)	2,860	3,805
Marginal rate of savings (ratio of 4 to 1)	22	22

6. It is obvious from the above Table that it will be possible to raise domestic savings necessary to finance the Third Plan with the same saving effort as was experienced over the Second Plan period. In fact this would impose less sacrifice on the nation as it implies that 28 per cent of the *additional per capita income* would be required to be saved in the Third Plan compared to 31 per cent in the Second Plan period.

7. A substantial part of the required saving effort is implicit in the financing of the public-sector programme, explained in a subsequent section. Public savings increased from Rs. 30 million in 1959-60 to Rs. 1382 million in 1964-65 and are expected to rise further to nearly Rs. 3000 million by 1969-70. Marginal rate of private savings out of incomes after taxes would in fact be somewhat lower in the Third Plan compared to the Second Plan. Thus public savings which increased from a negative figure in 1959-60 to 1.7 per cent of G.N.P. in 1964-65 would rise on the basis of present projections to 4.3 per cent in 1969-70. Thus private savings would rise from 8.6 per cent to 9.6 per cent over the Third Plan period which is less than the increase from 5.9 per cent to 8.6 per cent experienced during the Second Plan.

8. The saving effort to be made in the Third Plan is based on a clear recognition of the possibility that industrial profits may tend to decline with more domestic and international competition and the initiation of a structural change in favour of more complex and longer-gestation-period capital goods industries. This trend will be intensified by policies aimed at better distribution of income and wealth in the industrial sector. Liberalization of imports will, however, permit a fuller

and more efficient use of industrial capacity and at least moderate this trend. It is estimated that with the incentives provided by the present system of taxation as much as 60 to 75 per cent of industrial profits will continue to be re-invested. Furthermore, agricultural productivity is expected to increase substantially and the private sector is increasingly investing its income in the acquisition of tube-wells, tractors, fertilizers and other means of agricultural investment. Finally, the institutional framework for mobilizing domestic savings through the capital market has improved considerably and is expected to penetrate further in rural and semi-urban areas where the bulk of the new incomes will be generated during the Third Plan. In addition a comprehensive revision of the interest-rate structure is under way to provide greater incentives for a higher rate of savings. Thus, it will be possible to mobilize domestic resources to the extent of Rs. 35,500 million during the Third Plan period by maintaining the saving effort that the country undertook for the Second Plan.

9. The requirement for external resources for the Third Plan is estimated at Rs. 16,500 million. It is difficult to say what amount of foreign assistance the country can negotiate and disburse over the next five years but at least the current trends are reassuring. Leaving aside foreign private investment (about $150 million), technical assistance (about $100 million) and PL-480 assistance for the Plan ($210 million), the level of external resources envisaged in the Third Plan implies an annual commitment of about $600 million which compares with total pledges of $520 million in 1964-65. The acceleration assumed from the current rate is thus quite modest. The proportion of foreign financing in the Third Plan is expected to decline from 34 per cent in 1964-65 to 27 per cent in 1969-70. The projections of foreign resources are discussed in detail in the next Chapter and are integrated with the projections of the country's own balance of payments.

II. FINANCING OF THE GOVERNMENT SECTOR

10. The net programme of the public sector is expected to be Rs. 30,000 million. The financing of this programme is indicated in Table 4. It is expected that about 55 per cent of the public sector development programme would be financed from domestic resources compared to 47 per cent in the Second Plan. A substantial part of increased public savings is expected to come from larger budgetary surpluses at existing tax rates and from net capital receipts. However, it would be necessary to raise roughly 10 per cent of these resources by the imposition of new taxes leaving another 5 per cent to be mobilized through deficit financing necessary to permit adequate increase in money supply to meet the needs of a growing economy. The various elements of public sector financing are discussed in the subsequent paragraphs.

TABLE 4

RESOURCES FOR THE GOVERNMENT-FINANCED SECTOR
(Million Rs.)

	Second Plan		Third Plan Projection
	Target	Revised Estimates	
Domestic Resources :			
Surplus on revenue account	1,920	2,163	8,600
Net capital receipts	1,600	1,746	2,400
Additional taxation	1,750	1,800	3,000
Deficit financing	Nil	911	1,500
Possible additional resources	—	—	1,000
	5,270	6,620	16,500
External Resources :			
Project loans (including technical assistance)	5,250	2,932	7,000
Commodity loans	3,500	3,306	5,500
P.L.-480 counterpart funds	600	1,172	1,000
	9,350	7,410	13,500
Total resources	14,620	14,030	30,000
Domestic resources as a percentage of the total	36%	47%	55%
Foreign resources as a percentage of the total	64%	53%	45%

Surplus on Revenue Account :

11. During the Second Plan period, revenue surplus has become an increasingly important source of financing the development expenditure of the Government sector. The revenue surplus is expected to increase from Rs. 30 million in 1959-60 to Rs. 1,382 million by 1964-65 including the effect of additional tax effort. This major increase in revenue surplus was made possible by a 16 per cent annual increase in revenues while the increase in non-development

expenditure is being kept within 9 per cent per annum. In fact, excluding debt servicing and recurring expenditure of the development departments, the increase in administrative expenditure has been less than six per cent per annum in the Second Plan. This also includes the effect of revision of pay-scales of Government employees towards the end of the Plan period, which is not likely to recur in the near future. The projections for the Third Plan are summarized in Table 5 below:

TABLE 5

PROJECTIONS OF REVENUE SURPLUS FROM EXISTING TAXES

(Million Rs.)

Budgetary Head	1959-60	1964-65	1969-70	Total Third Plan Period
	At 59-60 Rates	At 64-65 Rates	At 64-65 Rates	At 64-65 Rates
A. Revenue receipts:				
Customs	560	1,080	1,350	6,420
Excise duties	370	849	1,400	5,785
Sales Tax	310	750	1,028	4,550
Income and Corporation Tax	370	633	1,015	4,238
Land revenue	220	307	307	1,510
Other taxes	170	362	480	2,128
Total Taxes	2,000	3,981	5,580	24,631
Non-tax revenues	640	1,113	1,670	6,724
Total Revenue Receipts	2,640	5,094	7,250	31,355
B. Non-Development Expenditure :				
Defence	960	1,297	1,434	6,890
General Administration	880	1,126	1,320	6,462
Development Departments	460	817	1,515	5,855
Debt Services	310	472	911	3,548
Total Non-Development Expenditure	2,610	3,712	5,180	22,755
Surplus on Revenue account	30	1,382	2,070	8,600

12. On a review of the revenue receipts from major tax heads for the last twelve years (1952-53—1963-64), it appears that these receipts, even after excluding the effect of additional taxation during the period, increased quite appreciably. The increase in excise duties and sales tax on domestic products was roughly in line with the growth in domestic manufacturing sector, while income and corporation taxes moved by a higher proportion than non-agricultural income. Only in the case of import duties and sales tax on imports, did the collection of revenue improve less than in proportion to total imports, due mainly to the change in the composition of imports in favour of capital goods and raw materials on which rates of import and sales taxes are low. There is evidence in each case that this long-term measurement of the responsiveness of individual taxes to elements of growth in the economy understates the relationship observed in recent years. There is a large number of industrial units which enjoyed tax holiday and other liberal tax concessions in earlier years. Most of them will start paying taxes during the Third Plan period. Similarly in the case of import duties, there is not likely to be as steep a change in the composition of imports as was observed over the past decade. These considerations clearly point to the conclusion that the tax revenue will rise at a higher rate than is indicated by the analyses of relationship in the past. The elasticities have, however, not been corrected for recent upward trend. The elasticities of the four major taxes in relation to their determining variables are shown in the following Table.

TABLE 6

ELASTICITIES OF MAJOR TAX RECEIPTS

Tax Receipts	Determining Variables	Elasticity for Third Plan based on 1952-53—1963-64
Import Duties	Total Imports	0.7
Excise Duties	Value added in large-scale manufacturing sector.	1.0
Sales Tax:		
(a) Domestic Products	Value added in large-scale manufacturing sector.	1.0
(b) Imported Goods	Total Imports	0.4
Income and Corporation Tax	Non-agricultural Income	1.3

13. In projecting non-developmental expenditure, adequate provision has been made for strengthening the administrative machinery, particularly the development departments, for meeting defence expenditure, and the rising debt servicing

liability. The annual increase in defence and administrative expenditure is projected at two and three per cent, respectively, during the Third Plan period. The recurring expenditure of development departments will rise much faster, at about 13 per cent per annum, while debt servicing liability is projected to increase sharply at a rate of 16 per cent per annum. The latter two elements are directly related to the size of development effort, with a lag. On the completion of a project, its recurring expenditure is included in non-development outlay. Debt servicing liability is also related to the sizable increase in domestic and foreign debt during the Second Plan period.

The projected total revenue receipts on the basis of existing taxes and total non-developmental revenue expenditure are likely to result in a revenue surplus of Rs. 8,600 million over the Third Plan period.

Net Capital Receipts:

14. Net capital receipts during the Second Plan did not show as much buoyancy as revenue surplus, especially because of the substantially increased liability on account of repayment of foreign loans. Even so, these resources, along with estimated contribution from local bodies, are likely to yield Rs. 1,746 million against the Plan target of Rs. 1,600 million. The tentative projections of net capital receipts (excluding local bodies) add up to Rs. 2,400 million for the Third Plan period, as given in Table 7 below.

TABLE 7

PROJECTIONS OF NET CAPITAL RECEIPTS
(Million Rs.; 1964-65 prices)

	1964-65	1969-70	Total Third Plan
A. *Capital Receipts:*			
Small savings	130	170	770
Public borrowings (non-bank)	90	110	500
Depreciation and other reserve funds	200	270	1,245
Other receipts	170	260	1,040
Total receipts	590	810	3,555
B. *Capital Liabilities:*			
Repayment of foreign loans	83	280	905
Other liabilities	67	40	250
Total liabilities	150	320	1,155
Net Capital Receipts	440	490	2,400

Additional Taxation :

15. Additional taxation is the most important weapon that Government can use not only to raise additional resources but also to influence the direction of economic policies. This is all the more important in an economic framework where administrative controls are gradually being withdrawn and taxes and subsidies have necessarily to be used as regulatory measures. The National Economic Council has already appointed a high-level Commission on Taxation and Tariffs to review the possibilities of additional taxation in the Third Plan, to suggest ways and means for improving the efficiency of the tax collecting machinery, and to recommend the rationalization of the existing tariff structure. The first report of the Commission is expected to be available before the commencement of the Third Plan period.

TABLE 8

RATIO OF TAXES TO GNP
(Million Rs.; Current Prices)

	1959-60	1964-65	1969-70 (without additional taxation)	1969-70 (including proposed additional taxation)
Tax Revenue ...	2,000	3,981	5,580	6,480
Total Revenue ...	2,640	5,094	7,250	8,150
GNP (Market Prices) ...	32,705	45,540	62,765	62,765
Ratio of Tax Revenue to GNP ...	6%	9%	9%	10%
Ratio of Total Revenue to GNP...	8%	11%	12%	13%

16. The projections of tax revenues at current rates of taxation (as given in Table 5) show that the tax receipts will increase at about the same rate as the GNP so that unless additional taxation is imposed there is not likely to be any improvement in the present ratio of 9 per cent between tax receipts and GNP. As indicated in Table 8 above, ratio of taxes to GNP improved significantly from 6 per cent to 9 per cent over the Second Plan. Tentatively, the feasibility of raising about Rs. 3,000 million of additional resources by way of new taxes in the Third Plan is being examined. Even considering this additional taxation, the share of the GNP collected by the Government in taxes will be only 10 per cent by 1969-70. Ratio of total revenues (including non-tax revenues) to GNP has increased substantially from 8 per cent in 1959-60 to 11 per cent in 1964-65 and would improve further to 12 per cent in 1969-70 without additional tax effort and to 13 per cent with the tax effort.

17. There are several areas which need careful examination from the point of view of raising additional resources. The coverage of excise duties and sales tax can be extended and their rates rationalized further.This has to be a continuing exercise in a developing economy. Imports of consumer goods subject to high rates of *tariff* are being substituted by domestic industrial production. It is possible once the domestic industries have developed adequately, to compensate for the loss of import duty by subjecting them to excise duties and sales taxes at appropriate rates. In the case of import duties, the progressive liberalization of imports has necessitated much greater use of import tariff for regulating imports for balance of payments reasons. The process of replacing import licencing by regulatory import duties initiated towards the end of the Second Plan period would have to be carried further during the Third Plan period. Similarly the shift in the emphasis in industrial sector in favour of manufacturing capital goods domestically will require a much greater use of protective tariff. This change in tariff policy dictated both by industrial strategy and balance of payments considerations will yield substantial additional revenue over the Plan period. The need for continuing generous tax concessions to industry may also have to be reviewed. Similarly, ways and means must be devised to capture some of the increase in agricultural incomes in the form of taxes, particularly because agricultural incomes are expected to increase quite rapidly during the Third Plan period. There was some justification for not raising the burden of taxation in the agricultural sector during the fifties due to its virtual stagnation. With the high rates of growth achieved in the agricultural sector during the Second Plan period and projected for the Third Plan period, the picture has changed dramatically. Finally, considerable scope exists for improving tax collection machinery for reducing tax evasion, and expediting assessment and collection of taxes.

Deficit Financing ;

18. Economic growth generates ever-increasing demand for money and credit. In the process of satisfying this need, public sector can acquire command over some resources, after meeting the genuine credit requirements of the private sector. In formulating the Second Five-Year Plan, the estimates of deficit financing and of expansion of money supply were set fairly conservatively. In fact, no provision was made for deficit financing, and the rate of expansion of money supply was projected exactly in proportion to the planned increase in national income. This caution was justified in view of the considerable monetary overhang from the First Plan period. The rate of monetary expansion was kept very low during the first two years of the Second Plan which allowed the excess liquidity in the economy to be absorbed through the growing demand for money in the economy. In the third and fourth years of the Second Plan period, however, money supply rose rapidly, by about Rs. 950 million per annum. According to current indications, this rate is expected to be exceeded in the final year of the Plan.

Over the Second Plan period, money supply is expected to increase by roughly Rs. 3,150 million, with the deficit financing* of the level of Rs. 1,800 million. Private bank credit has expanded at a remarkably accelerated pace partly financed by the accumulation of time deposits with the banks.

19. For the Third Plan period, a modest sum of Rs. 1,500 million is tentatively suggested to be mobilized for the public sector through deficit financing. This is a deliberately conservative estimate to provide fullest room for adjusting short-term monetary policy to the economic situation which will actually prevail from year to year. On an average annual basis this amounts to reducing the rate of deficit financing to roughly half that in the last three years of the Plan.

20. The deficit financing suggested in the Plan is fully consistent with the estimated increase in the demand for money and the expansion of credit for the private sector. It has been estimated that if allowance is made for growth of the monetized sector as compared to GNP the ratio of money supply to resource flows in the monetized sector increased from 24.6 per cent to 26.2 per cent over the Second Plan period.

TABLE 9

RATIO OF MONEY SUPPLY TO RESOURCE FLOWS IN THE MONETIZED SECTOR

(Million Rupees)

	1959-60	1964-65	1969-70
Gross National Product (1964-65 market prices)	33,640	45,540	62,765
Non-Monetized Sector†	9,844	11,132	14,079
GNP in the Monetized Sector	23,796	34,408	48,686
Money Supply (end-year)	5,853	9,000	13,000/ 14,000
Ratio of Money Supply to Resource Flows	24.6%	26.2%	26.7/ 30.0

† 50 per cent of value added in agriculture in 1959-60 and 10 per cent of services. The ratio of non-monetized sector in agriculture is assumed to have come down to 47 per cent in 1964-65 and 45 per cent in 1969-70.

Even to keep this ratio virtually constant over the Third Plan period, money supply may have to rise by Rs. 4,000 million. An increase of Rs. 5,000 million would imply only an increase in the ratio of money supply to resource flows in the monetized sector in line with the Second Plan experience.

*Deficit financing is defined here to include all financial transactions in the public sector which have an expansionary influence on money supply. It does not, therefore, compare with the budgetary deficit figure used earlier.

21. With an increase in money supply of the order of Rs. 4,000 million to Rs. 5,000 million—indicating a reduction in the rate of monetary expansion compared to the latter part of the Second Plan—deficit financing of Rs. 1,500 million would leave ample scope for necessary expansion of bank credit in the private sector. In fact, deficit financing of this order would be necessary to generate sufficient primary reserves in the banking system on which credit expansion for the private sector may be based.

22. It may be pointed out that banks are required by law to maintain a liquidity ratio of 20 per cent (consisting of cash, balances with the State Bank and unencumbered Government securities). The banking system has generally maintained a higher ratio to allow for seasonal fluctuations. Allowing for the required increase in balances with the State Bank, banks may be expected to invest 15 to 20 per cent of the net increase in their deposits in Government securities. On this basis, roughly Rs. 750 to 1,000 million of resources may be obtained through sale of marketable loans to banks, leaving the balance to be obtained by borrowing from the State Bank. In case the monetary situation so warrants, a shift of bank credit from the private to the public sector can be effected by raising the liquidity ratio of the banks, reducing reliance on the State Bank.

23. It is the nature of any projection of the extent of safe limits of deficit financing that the figure adopted can only be a very tentative estimate, depending as it does on many uncertain elements of future economic developments. The Third Plan estimate of deficit financing is neither a target to be achieved nor a rigid limit that cannot be over-stepped. It is a cautious estimate of the potential on an assessment of the existing and prospective situation. A close watch must be kept on the economic situation as it actually unfolds itself through the Third Plan period, and judgements must be continuously formed on what monetary and fiscal policies will be appropriate for dealing with imbalances in the economic and monetary situation. The safe and appropriate role of deficit financing in annual budgets must be determined at the time of budget making; short-term monetary policy must continue to play an important role in keeping the economy on an even keel. A plan can merely provide the broad framework within which considerable scope for policy manipulation remains.

24. Rapid economic development during the Second Plan has been accompanied by remarkable price stability. The wholesale price index rose by only 5 per cent during the first four years, while cost of living indices showed increases ranging between 2 to 3 per cent per annum. Price stability would continue to be a basic policy objective during the Third Plan. Some rise in prices is, however, inevitable at the present stage of economic development for three reasons. First, import substitution under shelter of tariff, a basic element in the industrialization

programme must raise the prices of sheltered products. Second, some rise in agricultural prices is necessary to encourage the shift from subsistance to cash crop agriculture. Third, the need to place heavy reliance on indirect taxes to discourage consumption has some implications for domestic prices. In the course of time, increasing efficiency of production will reduce costs and prices and will offset these factors. However, for the Third Plan, some modest increase of prices is inevitable. The effort would be to keep this increase within tolerable limits.

Possible Additional Resources:

25. The above projections of revenue surplus, net capital receipts and deficit financing have been made on a conservative basis. It is possible that resource mobilization through these means may be larger, especially in terms of current prices. Additional revenue may accrue to the public sector from some of the policy measures currently under the consideration of the government, such as the substitution of foreign exchange loans to the private sector through PICIC and IDBP by a system which transfers the rupee counterpart of these loans to the public sector, revision in the pricing policy of the public corporations and greater participation by the private sector in joint ventures with the public sector. It is important to note, however, that a ceiling of Rs. 30,000 million has been set on the implementation of public sector programmes. If actual resources fall short of this ceiling or if private sector can take on some of the activities presently reserved for the public sector, the net implementation in the public sector may be correspondingly lower than currently estimated.

III. FINANCING OF THE PRIVATE SECTOR

26. The performance of the private sector in respect of fixed capital formation has exceeded the targets in the Second Plan. The Plan had estimated private investment (including non-investment development outlay in the private sector such as expenditure on fertilizers) at Rs. 8,380 million. According to the latest estimates, investment in the private sector is expected to be as a high as Rs. 11,500 million. On an annual basis, the level of private investment roughly quadrupled over the Plan period, rising from Rs. 805 million in 1959-60 to Rs. 3,180 million (estimated) in 1964-65.

27. This acceleration in private investment activity was intimately linked with the adoption of liberal economic policies recommended by the Plan and a gradual relaxation and withdrawal of direct controls on prices, distribution, imports and investment decisions. Reliance on the Investment Schedule as a tool for directing investment within the frame-work of the Plan, coupled with improved availability of key inputs like cement and steel and freer imports of raw materials evoked a highly favourable response from the private sector. Moreover, in

recent years a climate has been created in which businessmen can plan with confidence in the hope that the economy would continue to grow which is the only guarantee of long-term profitability of any venture. Finally, institutional facilities for both credit and equity finance have reached a stage of maturity where they contribute substantially to the financing of private investment.

TABLE 10

FINANCING OF THE PRIVATE SECTOR DURING THE SECOND AND THIRD PLAN

(Million Rs.)

	Original Estimates (1960-61 Prices)	Revised Estimates (Current Prices)	Third Plan (1964-65 Prices)
Loans and credits in foreign exchange	1,600	1,440	2,300
Private foreign investment	600	450	700
Private domestic savings	6,180	9,610	19,000
Total	8,380	11,500	22,000

28. Table 10 shows clearly that the larger investment programme resulted exclusively from higher domestic savings, which more than compensated for the shortfall in the availability of external resources. Present estimates of private savings are about 50 per cent above the original projections of the Second Plan. Savings mobilized by the private sector in the Second Plan can be compared with the growth of production in those sectors where savings are generated. On this basis, it is possible to project the amount of savings that would probably be forthcoming in the private sector at about Rs. 19,000 million during the Third Plan.

29. Even though foreign loans and credits to the private sector fell short of the Second Plan expectations, their level has been increasing each year. In fact, the shortfall resulted mainly from the low level at the beginning of the Second Plan, being only Rs. 40 million, but in subsequent years a steep increase is noticeable, leading to an estimated inflow of Rs. 450 million in 1964-65. For the Third Plan, an estimate of foreign loans and credits to the private sector of Rs. 2,300 million can thus be considered fairly conservative. In addition, foreign private investment is estimated for the Third Plan at Rs. 700 million, bringing the total of external resources to the private sector to Rs. 3,000 million. This expectation should be fulfilled with only a modest acceleration in the net flow of foreign resources to the private sector over the level of 1964-65. In addition it would be possible to meet additional import requirements of the private sector out of the country's own resources. Moreover, substantial expansion of basic industries projected for the Third Plan would reduce the dependence of private investment on imported inputs to some extent.

30. Primarily responsibility for financing the expansion of the private sector rests upon the domestic institutional framework. Considerable effort has already gone into building up an adequate framework of credit and financing institutions in the country. The reform of these institutions carried out at the beginning of the Second Plan period enabled them to play their part effectively in financing the acceleration of private investment during the Second Plan period. It is expected that with the experience gained in the Second Plan period, the private financing institutions notably capital market will be in a position to play a more important role in the Third Plan period. Acceleration of private investment activity in the Third Plan is estimated at roughly half the rate achieved in the Second Plan period, as the base is now higher and some of the pent-up investment demand in the industrial sector from the First Plan period has already been reflected in the acceleration during the Second Plan period.

The following Table indicates estimated contribution of various sources of financing for private investment.

TABLE 11

PRIVATE SECTOR FINANCING

(Million Rs.)

	1960-61	1964-65	1969-70
Private Investment	1457	3180	5200
Public Subscription to New Flotation	65	300	500
Foreign Private Investment	90	100	180
Foreign Loans in the Private Sector	75	500	750
Bank Credit *	461	1000	1500
Ploughing Back of Profits by Large-Scale Industry	450	750	1550
Household Savings Used for Self-financing	316	530	820

* Includes credit advanced by specialized Corporations except PICIC. The latter has largely provided foreign loans.

31. The private investment in the industrial sector, including fuels and minerals, is placed at Rs. 9,050 million in the Third Plan, roughly 40 per cent of the total private investment. Of this, about one-third may be expected to be mobilized through the market for new capital issues if the rate observed at the end of the Second Plan is maintained. A similar amount may be forthcoming through the re-investment of earnings in the industrial sector and the ploughing back of profits of existing industries. The balance may be financed by loans from the Industrial Development Bank and PICIC. A major portion of the foreign loans for the private sector will be used for industrial ventures. PICIC had sanctioned loans amounting to Rs. 1,435 million over the four-year period ending June 1964. IDBP provided Rs. 680 million over the same period. In addition adequate provision has been made for meeting working capital requirements of the industrial sector in projecting bank credit expansion for the Third Plan.

32. In the agricultural sector which would account for nearly one-fifth of the total private investment in the Third Plan, self-financing has played a major role so far. The Agricultural Development Bank had made loans amounting to Rs. 267 million by the end of December 1964. In addition, the State Bank channelled Rs. 150 million through the Co-operative Credit System for meeting short-term requirements of the agricultural sector. It is of vital importance for the success of the Third Plan, which relies heavily on growth in the agricultural sector, that a much larger flow of credit is directed to this sector. The Bank will be required to undertake an ambitious programme of branch expansion to be as near as possible to the rural areas, of particular significance will be the proposed line of credit being arranged through the World Bank. In addition to the resources placed at its disposal by the Government and supplementary finance obtained from the State Bank of Pakistan, the bank should make a concerted effort to mobilize resources on its own by accepting private deposits. As a substantial part of the new incomes is to be generated in the agricultural sector, the Agricultural Development Bank would be in the most strategic position for mobilizing resources. An attempt must also be made to revitalize the co-operative credit system and to co-ordinate these institutions and the Agricultural Development Bank into a well-integrated credit system for the agricultural sector. There is growing evidence that rural savings are increasing steadily. A large part of these savings has been diverted through the banking system to urban money market centres. The proposed expansion of agricultural credit need not prevent a continuation of the mobilization of rural and semi-urban savings through the banking system.

33. In the case of housing, the finance has so far been provided mainly by individuals out of their own savings. The house-building loans provided by the House Building Finance Corporation have supplemented these resources only marginally. Total loans disbursed by the House Building Finance Corporation during the first four years of the Second Plan amounted to Rs. 180 million. The banking system has been singularly reluctant to provide credit for house-building or against immovable property generally. This lack of credit facility has been responsible for a substantial shortfall in the private housing programme in the Second Plan. If the increase in the house-building activity in the private sector suggested in the Third Plan (2,12,500 new dwelling units compared to 50,000 in the Second Plan) is to be realized, credit facilities would have to be improved substantially. In addition to enlarging the scope of operation of the House Building Finance Corporation, it would be necessary to sponsor and encourage the setting up of specialized credit institutions in this area such as Saving and Loan Associations and Mortgage Banks.