

**FOREIGN AID, DOMESTIC SAVING AND ECONOMIC
GROWTH IN RETROSPECT: THE CASE OF PAKISTAN
(1960 TO 1988)**

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DEDICATION

'This thesis is dedicated to the masses of my country, who will never see the comforts and glories of life as I have seen them, yet their generations are bound to toil, and burn their souls and hides under the killing sun, to repay the debt I am accumulating fast.'

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ABSTRACT

This study focuses on the relationships between foreign aid, domestic saving and economic growth in Pakistan between 1960 and 1988. The relationship between foreign aid and domestic saving is extensively analysed, and it is argued that there is no direct one-to-one measurable relationship between them because of unquantifiable social, political, and institutional factors. The analysis concludes that at times political rather than economic criteria were used by donors for giving aid, and that the failure to adequately emphasise economic criteria was the cause of the low rate of domestic saving in Pakistan. Statistical analysis provides positive, but not significant co-efficients of correlation between the current values of foreign aid and economic growth. Analysis of the structure of GDP shows that the major part of GDP growth consisted of expansion of services, which included an overwhelming expansion of 'unproductive' services, such as public administration and defence. These activities were largely financed by foreign aid. The study also considers the persistent balance of payments deficit and mounting debt service obligations, and it concludes that to maintain high rates of growth in future calls for strenuous mobilisation of large amounts of domestic resources for productive investment.

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INTRODUCTION

Foreign aid is an issue of much actual and perhaps even greater potential importance. This study's scope of inquiry is mainly focused on the most timely and important area of the topic, namely; the relationship between foreign aid, domestic saving and economic development, examined with the help of the data on Pakistan for the period from 1960 to 1988. Of the wide variety of issues raised in the aid debate since the 1950s this issue has received most attention in the academic literature. One of the core tenets of foreign aid theory, particularly as encapsulated in the two-gap model, is that the insertion of foreign resources via free grants, loans, and direct investment into a developing economy sets in motion a causal chain of positive influences in the following broad manner:

aid---> increase in investible resources---> increase in domestic investment---> more rapid rate of economic growth.

This approach received widespread endorsement both by the donors and the recipients, and served as the basis for practical policy decisions. The theory claimed that in the development process of the LDCs, different sorts of bottlenecks or gaps at different times can be relieved or filled with external assistance. This sets into motion a process that ends with a self-sustaining path of

development. Once the latter is achieved, it would allow the recipients to repay the donors both directly and indirectly.

Spirited and specific challenges to this approach came from many critics, supported by a great number of broad theoretical and empirical analyses. The theoretical critics have attacked many aspects of the general aid models. They have mainly emphasised the following: (i) the separation and distinction between the gaps; (ii) whether certain gaps constitute a binding constraint on potential growth; and (iii) whether optimism built into the models can be sustained. In addition, these critics drew the conclusion that governments in developing countries may relax domestic saving efforts when more foreign aid is available than otherwise. These general points have been pursued and extended by empirical analyses. For a large part of the latter, the available evidence pointed to a negative relationship between aid and domestic saving. Hence, it was argued that an increase in development aid most commonly did not result in increase in investment. The evidence was largely based on cross-sectional data, showing that there was, in addition, reason to conclude that there was a negative relationship between aid and economic growth.

Pakistan is one of the most relevant cases to study the foreign aid and economic development relationship. The country survived the 1950s only with the help of some

loans and massive amounts of grants from her anti-Communist allies. However, the absolute amount of all types of external assistance did not reach significant proportions during that decade. But since 1960, Pakistan has been one of the major recipients of the developed countries' aid. During the period 1960 to 1988, on average, its economy has exhibited impressive performance in terms of GDP growth rates. The latter, however, does not appear to be accompanied by underlying strength of the overall economic structure. Pakistan has one of the lowest rates of domestic saving amongst the LDCs. The chronic unfavourable balance of trade has kept the external sector of the country weak and vulnerable throughout the period. The increased dependence on external help is amply reflected in the persistent balance of payments difficulties of Pakistan. The country underwent large scale, multilateral restructuring of official debt in the 1970s. The exercise was avoided in the 1980s with the help of massive aid funds, and by foreign exchange in the form of wage remittances from Pakistani nationals working abroad.

This study attempts to analyse the existing literature on the foreign aid and economic development relationship. This is followed by statistical analysis to provide some evidence on the relationship between aid, saving and economic growth using the data for Pakistan. Questions about these relationships are then further

considered by a closer examination of the data on foreign aid, domestic saving, balance of payments, and economic growth. While this study does not adopt a full-blown interdisciplinary approach, political and social considerations are taken into account in the course of the analysis. This is done by dividing the whole period into several subperiods and by considering the various dimensions of domestic saving and economic growth in each subperiod separately. The subperiods approach allows us to ascertain how foreign and domestic political factors affected the various issues involved in the aid-development relationship. It is hoped that the analysis of the various dimensions of economic growth and domestic saving, e.g., public and private saving, provides a deeper insight into the problem.

This work is structurally divided into eight chapters. The theoretical and empirical bases of the study have been derived from three sources: scholarly texts and articles; the publications by the Government of Pakistan; and international publications, e.g., reports from the IMF and the World Bank. The analysis is based on the data which have been updated for Pakistan after the separation of Bangladesh in 1971.

Chapter One is mainly chronological, giving background information on Pakistan, while Chapter Two introduces the economic theories of foreign aid and economic development. Amongst them, the major emphasis is

on the assertions and criticism of the dual gap analyses.

The relationships between foreign aid, domestic saving and economic growth are examined in Chapter Three, using data on Pakistan. This is followed by analysis of the important dimensions of domestic saving in Pakistan in Chapter Four, which highlights the complexities of the apparently simple view that there is a one-to-one measurable relationship between foreign aid and domestic saving. Chapter Five attempts to explain the saving behaviour in Pakistan by considering various political, economic and social factors. It also reveals that at least a part of the poor performance of domestic resource mobilisation is related to foreign aid.

Before coming to the structure of growth in Chapter Seven, Chapter Six analyses the debt problem and the balance of payments situation of Pakistan. It is then argued in Chapter Seven that it is the appropriate structure of growth rather than its rate which matters for long-run sustainable growth when a country has accumulated large stocks of debt in the development process. Finally, Chapter Eight brings together the major threads from the whole analysis and comes to some overall conclusion. The study does not give full support to the views of the aid critics, but it concludes that the evidence from Pakistan is not as reassuring as many advocates of foreign aid have maintained. It is argued that the context (political and economic) of foreign aid matters far more than its

magnitude for the assertions of the aid-development theory
to be true.

CHAPTER: 1

FOREIGN AID TO PAKISTAN AND HER ECONOMIC PERFORMANCE (Historical Overview: 1950 to 1988)

Introduction

Pakistan will complete forty five years as an independent state on 14th August, 1992. How and how far economic assistance has affected Pakistan's economic development is the fundamental question for this study. Before coming to the analysis of the benefits and effectiveness of aid, this introductory chapter mainly proceeds in terms of the history of aid inflows to Pakistan. It also provides an overview of economic development up to the end of the period in this study.

The structure of this chapter is built around three parts. Part one attempts to highlight the geopolitical perspective of foreign aid to Pakistan. Part two provides some details of the inflow of external assistance to Pakistan, namely; source, magnitude, and composition. The final part summarises the economic performance of the country in differing policy environment since its independence.

Part: 1-1

Foreign Aid to Pakistan: Political & Economic Perspective

More than 30 years ago Friedman wrote an article, whose argument, while never forgotten, appears to have generated fresh appeal in the 1980s(1). While Friedman also discusses the effects of foreign aid on development, it is his opinion that the objectives of US foreign aid are mainly to further US interests which is of prime interest to us here. Section one of this part analyses the geopolitical motives of the major aid donors to Pakistan, while section two attempts to explain the recipient's geopolitical and economic position.

Section: 1-1-1

Donors' Motives: Geopolitical Perspective

Insofar as Pakistan produces no significant industrial raw materials and offers no considerable market for the high-technology products of the metropolitan countries, it has never enjoyed very great prominence in the strictly economic calculations of the aid donors. However, in so far as Pakistan borders on the three largest states of the world, the former USSR, China and India, as well as the strategically crucial Persian Gulf, it has always had enormous geopolitical significance for super powers in the strategy of the Cold War. In the following we attempt to provide a background of the geopolitical significance of the country.

The years 1949 and 1950 were traumatic in the history

of the Cold War. The Soviet Union exploded its first atomic weapon. Most Americans derived little reassurance from President Truman's avowal, in his announcement of the event, that "ever since atomic energy was first released by man, the eventual development of this new force by other nations was to be expected. This probability has always been taken into account by the US"(2). The Americans realised that their supremacy of power had come to an end, and they foresaw that as the years went by, the Soviet Union could affront and assail the West more boldly. While Americans were adjusting to that nascent reality, China, on whose co-operation the United States had counted for security in the Pacific, fell before the triumphant Communists, trained and armed by the Soviet Union, swooped down upon South Korea. The American position in Japan and the Philippines was threatened, and the value of their main naval and air base in Okinawa depreciated.

Hence, the power struggle for world supremacy became primarily an inter-continental struggle between the US and the former Soviet Union. Any Soviet plans to expand on the western flank were stemmed by the US with the formation of the military bloc of the North Atlantic Treaty Organisation (NATO) in 1949. The extended chain of American bases and garrisons from the Aleutian Islands to the Philippines similarly blocked the threat of expansion by Soviet Union or its ally China into the sphere of the

Pacific Ocean. In the North the series of radar detection lines across Canada were intended to serve the same function. Only the Southern flank, by its physical and political fragmentation, indicated a number of loopholes vulnerable from the interior. From west to east these loopholes are the Straits of Dardanelles and the Bosphorus, the Persian Gulf, and the Indus low-lands and the passes which connect them to Central Asia.

After the 2nd World War the Soviet Union had acquired access to the Mediterranean Sea, but the subsequent defection of Yugoslavia was a great blow to her strategy and it accentuated the critical importance of the Straits. Any possibility of effective penetration by the Soviet Union was also vitiated when Turkey and Greece joined NATO. Subsequently, the Middle East Treaty Organisation commonly known as the Baghdad Pact (and later as the Central Treaty Organisation, CENTO) was formed(3). It allied Britain with Turkey, Iraq and Iran (and later Pakistan) and was supported by the US as it was meant to serve as a military cordon along the borders of the Soviet Union in South West Asia. The Pact insulated the Persian Gulf and extended NATO's influence farther east. The fourth loophole was the Indus Valley. Here, the gap between the Soviet transport network and Pakistan's road system was only about a hundred miles. If strategic and political considerations demanded it, an aircraft over the narrow Wakhan range could quickly bring hostile forces to

the very centre of army and civil power in Pakistan, Rawalpindi. It was a very similar hypothetical threat that led the British to fortify the north-west frontier of India at the end of last century(4). Similar considerations might have caused the Americans to include Pakistan in the chain of bases allied to Western powers and extending along the southern Soviet periphery. Though airpower and ballistic missiles had greatly reduced dependence on these bases, it is doubtful if they could have been eliminated altogether. Further, the Afghan War finally proved in the 80s' that Pakistan always remained a critical area in the strategy of the Cold War. Indeed, the following substantial evidence supports this opinion.

Even before the creation of Pakistan, the US Secretary of State George Marshall (the architect of the Marshall Plan), in a memorandum to President Truman on July 17th, 1947, referring to Pakistan said, "Pakistan with a population of seventy million persons, will be the largest Muslim country in the world and will occupy one of the most strategic areas in the world"(5). Further, as early as March 1948, it had been noted in an influential American journal, "We must realise what Britain and Russia have always understood: that the Eastern Mediterranean basin and the Middle East countries bordering it are parts of one political complex. This complex now extends as far as Pakistan; and a new line from Karachi north to Kabul must enter into the calculations of Washington as it has

for many years into those of Moscow and London"(6). Soon after, in December 1948, the Truman Administration set up the Foreign Assistance Correlation Committee which consisted of senior representatives of the state and defence departments and the Economic Co-operation Administration. The Committee believed that, in the context of US's strategic plans the geographic location and terrain of a country was an important military criterion for the identification of prospective recipients of aid(7). And, in a memorandum dated March 24, 1949, the US Joint Chiefs of Staff highlighted the importance of Pakistan and Afghanistan and the Karachi-Lahore area as vital for meeting the basic strategic objectives of the region(8). Truman himself, in his report to Congress, expressed the view that "Pakistan's friendship for the West may become an important factor in giving stability to the Near East. At the same time Pakistan is a valuable ally in South Asia because of its strategic location on the Indian Ocean and its control of land passes from Central Asia"(9).

Indeed, with a population of 76 million and an army of about 200,000, Pakistan offered obvious advantages from the standpoint of regional defence in the Middle East and Southern Asia. Its troops included some of the most famous regiments of the old British Indian army; its borders included the Khyber Pass, the historic invasion route of the Indian Subcontinent. John Foster Dulles, Eisenhower's

Secretary of State believed that Islam-oriented Pakistan was psychologically best suited to oppose Communism. As he noted, the "strong spiritual faith and martial spirit of the people make them a dependable bulwark against "communism"(10), an observation which, about three decades later was to become the most effective emotional instrument to manipulate in the strategy of the Afghan War.

The critical location of Pakistan could have been exploited by her for bargaining with the Eastern and Western power blocs at one and the same time, a technique which is not uncommonly used by other states in a similar position of advantage. Pakistan could merely have waited to see which bloc offered most for her valuable 'strategic resource' but for many reasons this proved impractical. We attempt to explain some of these reasons below.

Section: 2-1-1

Pakistan's Position: Geopolitical and Economic Perspective

In India as in many other parts of Asia, the Nationalist movement for independence from British rule had started long before 1947, the year when the Indian Subcontinent eventually achieved political freedom. Indeed, the struggle here proved to be even more dramatic than in other parts of Asia, as India was a large country inhabited by people of different languages, religions, and cultures, and complicated by competing economic and political interests. Hence, the growth of Nationalism

here was accompanied by a growth of acute internal dissension among different interests and groups. This finally resolved into two separate channels defined essentially along communal lines, since it became a two party struggle between the Muslim League and the Indian National Congress. The turbulence generated by this divisive nationalism culminated in a political landslide which not only ended foreign rule but caused a deep chasm which rent the Indian Subcontinent into separate political units. While the bulk, constituting the central part of India, became independent and formed the Republic of India, the marginal areas in the east and the west of the northern plains broke away to form a separate state Pakistan(11).

Both India and Pakistan were new States, that emerged on the world map on 14th August, 1947, but in some respects 'new' was not as true for India as it was for Pakistan. India retained the old name and the old capital city. On the other hand, Pakistan was a new State in all aspects. Its newness was evident from its boundaries, its capital, its hastily improvised Government, and even by its name.

After its formation, Pakistan received nearly one-fifth of the total population and one-fourth of the land area of undivided India(12). Of the cultivated area of 218.1 million acres in undivided India, Pakistan's share was 47.3 million acres or 21.6 percent of the total.

The country's share of minerals and industries was extremely poor. Out of 15,447 industrial establishments in undivided India in 1945, only 1,505 or 9.7 per cent of the total fell to Pakistan's share(13). Moreover, the establishments going to Pakistan's share were of much smaller size relatively to those left in Indian domain. Even these establishments were mostly of a seasonal nature and included jute processing and rice mills in East Pakistan and cotton ginning factories in West Pakistan. Industries established in India that were totally absent in Pakistan included jute manufacturing, dyeing and bleaching factories and paper mills(14). The position with regard to minerals was equally poor. Pakistan inherited those parts of the Indian Subcontinent which lacked valuable, accessible, or highly concentrated minerals. Further, at independence Pakistan stood among the poorest nations of the world. According to the UN study of 1949, Pakistan occupied the fifty-seventh position among seventy countries ranked according to the per capita income of their populations, while India stood fifty-fifth in the ranking. The annual per capita income in Pakistan was estimated at US\$51, compared to US\$57 in India, and US\$1,453 in the US(15).

It will thus be noted that at her very birth, Pakistan found herself faced with formidable economic problems. But, what was more serious was the political survival of the country as a sovereign state. There is

substantial evidence that India was looking for an opportunity to overrun the newly born country, despite the fact that India was one of very few countries to which Jinnah, the leader of the Muslim League and the Founder of Pakistan, had decided to give top priority for forging good relations. Early in April 1947, during his negotiations with the last Viceroy, Lord Mountbatten, Jinnah expressed the hope that once the principle of the creation of two states in the Indian Subcontinent was agreed upon, "every one will know exactly where they were, all troubles would cease, and they would live happily ever after"(16), and that the two States would have their own defence forces as well as some form of a common central defence organisation on the basis of parity(17). Jinnah's expectation was that after the decision to divide India was taken, "all inter-communal feelings would subside and Hindustan and Pakistan would be able to come together and work out the details"(18) of joint defence.

The thinking of the Congress leaders was, however, different. They expected that a mutilated Pakistan, to which alone they were prepared to agree, was unlikely to be acceptable to the Indian Muslims, and that if such a Pakistan did come into being, it was bound to be short-lived. The Congress resolution accepting the scheme of partition clearly stated, "Geography and the mountains and the seas fashioned India as she is, and no human agency can change that shape or come in the way of her final

destiny. Economic circumstances and the insistent demands of international affairs make the unity of India still more necessary. The picture of India we have learnt to cherish will remain in our minds and hearts"(19).

After the partition, India took practical measures to substantiate the Congress resolution. For example, the Indian Government for a long time withheld Pakistan's share of cash balances, amounting to Rs. 750 million, with the clear intention of crippling the monetary and currency systems of Pakistan. In April 1948, India stopped the flow of water into the Central Doab and Dipalpur Canals, which irrigated about 1.7 million acres of land in Pakistan but were fed from India. This action had a very adverse effect on Pakistan's economy, which was then almost entirely agricultural. More significantly, India did not allow Pakistan to have her agreed share of arms and ammunition and other defence equipment(20). As a result Pakistan's defence capability was greatly weakened. While the Kashmir issue was undecided, peoples' frustration and restiveness at the impotence of the Pakistan Government was very high(21). On top of that, in February 1950 large-scale communal riots occurred in West Bengal in India, which had their reaction, though it was very weak, in former East Pakistan. In the context of these riots, the Indian Prime Minister Jawaharlal Nehru disclosed in Parliament on 23 February that he had suggested some methods to Pakistan and that, in case Pakistan did not accept them, "it may be

that we shall have to adopt other methods"(22). Indeed, the latter was not simply a shallow threat, since as soon as these riots started, India began to move her troops within easy striking distance of Pakistan. By the end of March, as a British scholar observed, "Troops had been moved, not only in Bengal but, more perturbing, in the Punjab. India's armoured division, to which no real Pakistani counterpart existed was pushed forward in a way which threatened Lahore"(23).

Another addition to the geographical vulnerability was the Afghan Government's campaign for Pakhtoonistan at its height at that time, threatening war on the western frontiers of the country(24). Understandably, Pakistan was anxious to strengthen her defences but lacked the necessary financial resources. Further, the Government of Pakistan also found itself faced with the problem of food shortage in the country arising from the failure of summer rains in 1951. Again, Pakistan did not have the financial resources to pay cash for the required quantities of wheat. Pakistan's leadership seems to have thought that the country needed economic help to cope with the food situation and to develop her resources, as well as the political and military support against possible aggression, and that such help could come only from Western countries. Hence, the Government of Pakistan simultaneously approached both the UK and the US, the two nations who were most interested in extending the girdle

of defence along the southern borders of the former Soviet Union. The Export-Import Bank of Washington provided Pakistan with its first commodity loan of US\$15 million in September 1952. On 24th February 1954, the US announced its decision to grant military aid to Pakistan under the terms of the US Military Security Act. This was later formalised by the signing of the Pak-US Defence Agreement in May 1954. Six months later Pakistan joined Britain and the US in yet another regional alliance, SEATO, The South East Asian Treaty Organisation(25). On 24th September 1955, Pakistan assumed membership of the Baghdad Pact, reconstructed as CENTO in 1959(26).

The association with America in the defence assistance agreement, and her membership in two American sponsored regional alliances assured Pakistan's security for several years. As a well-known Indian writer on military affairs noted, "India held the pistol at the head of Pakistan, until, in 1954, American alliance delivered the country from that nightmare....at least twice, if not three times, between 1947 and 1954, India intended to invade Pakistan and was deterred only by American and British remonstrances"(27).

As we will see later in part two, Pakistan also received economic aid on a large scale from the Western bloc. The contribution of the US in economic aid has been immense. Indeed, it has always been the largest source of economic assistance to Pakistan.

Finally, it can be argued that Pakistan's own interests led her to seek the extended economic and military ties with the Western bloc. These ties, however, did not strictly place Pakistan under the obligation to essentially follow the Western lead in international relations. In our opinion, Pakistan reserved her legitimate right to make her own well-considered decision. For example, early in the 1950s the Pakistan Government assured the Soviet Union that it, "did not contemplate taking any step in hostility or unfriendliness to any government or state, with which like the USSR, it has friendly relations"(28). And, as we will see later in part two, the Soviet Union was the sixth largest bilateral donor to Pakistan. Further, Pakistan has always been a very close friend and trusted ally of Communist China. Indeed, she was the third non-Communist state to accord recognition to the new Chinese Government, the announcement being made on 4 January 1950.

Part: 2-1

Foreign Aid to Pakistan: Magnitude, Source and Composition
(Pakistan: 1951 to 1988)

This part is divided into two sections. Section one lists and describes the contribution from various bilateral and multilateral sources in the total aid commitments made to Pakistan. Section two analyses the composition of the grand total of these commitments.

Section: 1-2-1

Foreign Aid Commitments: The Sources and Magnitudes

The detailed evidence concerning the total commitments of various individual donors is given in Table 1-2-1. The figures given there are the aggregate magnitudes of the gross flows of various kinds of loans and grants until the end of the last year of this study, 1988. Table 1-2-1 shows marked contrasts in the aid performance of individual donor countries and institutions. The United States appears to be the largest source of foreign aid to Pakistan, a share of 26.5 % for the period between July 1951 to June 1988. In the 1950s, over two-thirds of all economic assistance was from the US; this share fell to a little over a half in the 1960s, and it was considerably less during 1971-77(29). The relative fall in the US aid to Pakistan continued until after the Soviet invasion of Afghanistan in 1979. The Carter Administration then offered Pakistan US\$402 million in economic and military assistance. This offer was rejected on the grounds that it was not worth the price that Pakistan would have to pay in terms of its relations with the Soviet Union(30). Later, the Reagan Administration's offer of a five-year package involving US\$1,575 million defence and a six-year US\$1,625 million economic assistance was accepted by the Government of Pakistan(31). As mentioned above, the US Government's

Table: 1-2-1

Foreign Aid: Commitments
(Pakistan: July 1951 to June 1988)

(a) No. Donor Country/ Agency	(b) Absolute Value (US\$ Million)			(c) Share of Total Commitments (%)		
	(bi) Loan	(bii) Grant	(biii) Total (bi+bii)	(ci) Loan	(cii) Grant	(ciii) Total Aid
1. Consortium						
A. Bilateral						
i. Belgium	73.50	0.00	73.50	0.30	0.00	0.22
ii. Canada	860.90	474.40	1335.30	3.38	6.12	4.07
iii. France	890.50	0.00	890.50	3.50	0.00	2.62
iv. Germany	1550.00	75.20	1625.20	6.10	0.98	4.81
v. Italy	546.10	0.00	546.10	2.15	0.00	1.62
vi. Japan	1842.00	448.00	2290.00	7.27	5.78	6.90
vii. Netherlan- ds	257.30	141.60	398.90	1.01	1.83	1.22
viii. New Zeala- nd	0.00	29.00	29.00	0.00	0.38	0.10
ix. Norway	7.00	159.00	166.00	0.03	2.05	0.54
x. Sweden	9.30	77.60	86.90	0.04	1.01	0.29
xi. Switzerla- nd	95.2	38.00	133.20	0.37	0.50	0.41
xii. U.K.	1224.30	525.20	1749.50	4.79	6.79	5.29
xiii. U.S.A.	5448.90	3225.80	8674.70	21.47	41.64	26.54
A. Sub-total (i-xiii)	12805.00	5193.80	17999.30	50.34	67.08	54.60

Table: 1-2-1 Continued.....

(a) No. Donor Country/ Agency	(b) Absolute Value (US\$ Million)			(c) Share of Total Commitments (%)		
	(bi) Loan	(bii) Grant	(biii) Total (bi+bii)	(ci) Loan	(cii) Grant	(ciii) Total Aid
B. Multilate- ral						
i. I.B.R.D.	3012.00	0.00	3012.00	11.84	0.00	8.80
ii. I.F.C.	244.00	0.00	244.00	0.96	0.00	0.72
iii. I.D.A.	3065.16	0.00	3065.16	12.05	0.00	9.02
iv. A.D.B.	1399.50	0.00	1399.50	5.50	0.00	4.22
v. I.F.A.D.	141.68	0.00	141.68	0.56	0.00	0.42
vi. U.N.D.P.	0.00	162.00	162.00	0.00	2.09	0.53
vii. Ford Foun- dation	0.00	40.10	40.10	0.00	0.52	0.13
viii. F.A.C.	0.00	71.50	71.50	0.00	0.93	0.24
ix. E.E.C.	0.00	188.00	188.00	0.00	2.42	0.61
x. Relief su- pplies and Cash Gran- ts From Various Countries	0.00	6.20	6.20	0.00	0.08	0.02
xi. U.N. and Special Agencies	0.00	209.00	209.00	0.00	2.70	0.68
xii. U.N Emerg- ency Fund	0.00	17.00	17.00	0.00	0.22	0.06
xiii. W.F.P.	0.00	5.90	5.90	0.00	0.08	0.02
B. Sub-total (i-xiii)	7862.00	699.70	7724.10	30.89	9.04	25.33
1. Total (A+B)	20667.00	5893.50	26560.50	81.23	76.12	79.85

Table: 1-2-1 Continued.....

(a) No. Donor Country/ Agency	(b) Absolute Value (US\$ Million)			(c) Share of Total Commitments (%)		
	(bi) Loan	(bii) Grant	(biii) Total (bi+bii)	(ci) Loan	(cii) Grant	(ciii) Total Aid
2. Non-Consortium						
A. Bilateral						
i. Austria	4.20	0.00	4.20	0.02	0.00	0.01
ii. Australia	11.60	56.30	67.90	0.05	0.72	0.22
iii. Bulgaria	3.30	0.00	3.30	0.02	0.00	0.01
iv. China	565.44	107.40	672.84	2.22	1.40	2.01
v. Czechoslovakia	116.70	0.00	116.70	0.46	0.00	0.34
vi. Denmark	54.63	0.00	54.63	0.22	0.00	0.16
vii. G.D.R. ^P	6.00	0.00	6.00	0.03	0.00	0.01
viii. Hungary	1.80	0.00	1.80	0.01	0.00	0.01
ix. Poland	5.20	0.00	5.20	0.02	0.00	0.01
x. Romania	13.50	0.00	13.50	0.06	0.00	0.04
xi. Singapore	1.20	0.00	1.20	0.01	0.00	0.01
xii. Spain	1.70	0.00	1.70	0.01	0.00	0.01
xiii. U.S.S.R. ^P	1150.60	0.00	1150.60	4.52	0.00	3.40
xiv. Yugoslavia ^P	45.10	0.00	45.10	0.18	0.00	0.13
A. Sub-total (i-xiv)	1980.97	163.70	2144.67	7.81	2.12	6.38
B. Multilateral						
i. I.M.F.	326.07	0.00	326.07	1.28	0.00	0.96
ii. Relief Assistance For Afghan Refugees	0.00	1536.00	1536.00	0.00	19.80	4.98
B. Sub-total (i-ii)	326.07	1536.00	1862.07	1.28	19.80	5.93
2. Total (A+B)	2307.04	1699.70	4006.74	9.10	21.92	11.99

Table: 1-2-1 Continued.....

(a) No. Donor Country/ Agency	(b) Absolute Value (US\$ Million)			(c) Share of Total Commitments (%)		
	(bi) Loan	(bii) Grant	(biii) Total (bi+bii)	(ci) Loan	(cii) Grant	(ciii) Total Aid
3. Islamic Countries/ Agencies						
A. Bilateral						
i. Abu Dhabi	198.60	0.00	198.60	0.78	0.00	0.58
ii. Iran	221.38	7.70	229.08	0.87	0.10	0.68
iii. Iraq	646.52	0.00	646.52	2.54	0.00	1.90
iv. Kuwait	250.16	0.00	250.16	0.98	0.00	0.74
v. Libya	89.16	0.00	89.16	0.35	0.00	0.26
vi. Qatar	16.80	10.00	26.80	0.07	0.13	0.09
vii. Saudi Ara- bia	649.08	80.00	729.08	0.08	1.03	2.17
viii. U.A.E.	0.00	56.00	56.00	0.00	0.73	0.18
A. Sub-total (i-viii)	2071.70	153.70	2225.40	8.10	1.99	6.60
B. Multilate- ral						
i. I.D.B.	149.37	0.00	149.37	0.59	0.00	0.44
ii. O.P.E.C.	243.90	0.00	243.90	0.96	0.00	0.72
B. Sub-total (i-ii)	393.27	0.00	393.27	1.55	0.00	1.16
3. Total (A+B)	2464.90	153.70	2618.67	9.70	1.99	7.86
1-3. Total (1+2+3)	25439	7747	33186	100	100	100

Source:: 'Pakistan Economic Survey', 1988-89, Statistical Supplement, pp. 181-189.

P The G.D.R. existed until October 1990, before it was reunified with the Republic of West Germany. The U.S.S.R. ceased to exist after the formation of Commonwealth of Russia in December 1991. Yugoslavia was dismembered into independent states in 1992.

motive behind this new initiative was political. The principal aim at that time was to give Pakistan confidence in its security, its continued development, and its conventional military forces to enable it to stand up to Soviet pressure from Afghanistan.

The International Development Association's commitment under the Consortium agreement for the period July 1951 to June 1988 was US\$3,065.16 million, or 9.01 % of total commitments, making it the second largest source of aid to Pakistan by virtue of commitments. Similarly, the commitment of the World Bank during this period was US\$3,012 million, or 8.79 % of the total, which in terms of commitments makes it the third largest donor.

Japan's total commitment under the Consortium agreement for the Period July 1951 to June 1988 was US\$2,290 million or 6.89 % of the total, making it the fourth largest donor of aid in terms of commitments. Although the area comprising Pakistan was a part of a former major British colony, Britain, with her total commitments of US\$1,749.5 million or 5.2 % of the total, ranks only as the third largest bilateral donor after the US and Japan. The reason behind this was that Britain emerged from the 2nd World War weaker and burdened with financial obligations. Germany's total commitment under the Consortium agreement during the period was US\$1,625 million or 4.8 % of the total, placing it fourth in the list of bilateral donors to Pakistan. Canada's total

commitment to Pakistan under the Consortium agreement for the Period was US\$1,335 million, or 4% of the total. She is ranked fifth in the list of bilateral donors of aid to Pakistan by the size of her commitment. The former Soviet Union was the largest supplier of aid funds amongst the former Communist Bloc countries. Her total commitment during the period was US\$1,151 million or 3.4 % of the total, making it the sixth largest bilateral donor.

Pakistan is tied by religion, geography, and politics to the oil producing states of the Middle East. The 1970s marked a new era in the flow of assistance to Pakistan from oil-producing Muslim countries. This assistance came in the wake of the first oil price hike of the 1970s. Most of the assistance from Islamic countries is in the form of loans. These loans are at a low rate of interest but carry a few years grace period and relatively short repayment periods.

Section: 2-2-1

Foreign Aid Commitments: Composition

Foreign aid is known to have many dimensions, and the aggregate volume tells little about the effect of aid until we know its composition. By June 1988, Pakistan had received a little over US\$33 billions of nominal aid flows. These inflows are composed of both grants and loans given in a number of different forms and with a variety of conditions on the use of resources and repayment. For the period in Table 1-2-1 as a whole, roughly 23% of the total

inflow was in the form of grants while the rest consisted of different forms of loans. Thus, only a part of the assistance given to Pakistan is actually in the form of outright grants. Further, there have been notable shifts in the composition of grants and loans between different periods. Table 2-2-1 lists the composition of the nominal inflow of all external assistance in four subperiods. As we will see later in this study, the subperiods have been devised in line with the shifts in the Pakistan Government's economic policy.

At first sight, the periodic record of different forms of aid flows to Pakistan, as given in Table 2-2-1, is very revealing. The fact that the figures have been compiled from a single source makes them particularly significant in indicating basic trends. The later chapters of this study will explore the implications of these relative shares for the development of Pakistan's economy. Here, only a brief description of the table is intended.

During 1951-58, out of the total external assistance 61% was in the form of grants while the rest was composed of loans. In the next period, 1958-69, grants declined to 33 percent while the volume of loans increased to 67 percent. It is perhaps indelicate but not totally unfair to suggest that grants decreased once Pakistan's alignment with the West, its acceptance of US military aid and its membership in SEATO and CENTO were assured. The suspicion

Table: 2-2-1

**Composition of Foreign Aid
(Pakistan: 1951-88)^P**

(a) No. Period	(b) Percentage Share				
	(bi) Total Inflow	(bii) Grants	(biii) Loans	(biv) Project Aid	(bv) Non-pro- Aid
1. 1951-58	2.50	61.00	39.00	54.00	46.00
2. 1958-69	16.5	33.00	67.00	54.00	46.00
3. 1969-78	22.00	12.00	88.00	54.00	46.00
4. 1978-88	60.00	23.00	77.00	72.00	28.00
1-4. 1950-88	100.00	23.00	77.00	65.00	35.00

Source: (i) For [bi-biii], Pakistan Economic Survey, 1988-89, Statistical Supplement, pp. 183-91; (ii) for [biv-bv], Appendix, Table 1-A.

^P Foreign aid commitments.

is further reinforced by the aid figures for the later two periods. In the third period, 1969-78, the amount of grants fell to the lowest level of 12 percent of the total while the amount of loans jumped to the highest level of 88 Percent of the total inflow for this period. The last period, 1978-88, witnessed a favourable change in the composition of the loans and grants, the proportion being 23 and 77 percent respectively.

The composition of total assistance with respect to project and non-project assistance, is also different for different periods. The percentage of project assistance remained high throughout the period. It was at its highest during 1978-88, the last decade of analysis in this study. In the literature, there is disagreement on the relative effectiveness of plan (non-project) and project aid. The result is to raise a number of interesting questions to which there are no entirely satisfactory answers, but rather alternative assumptions of different plausibility concerning the effects of project and non-project aid(32). Singer holds that, "the argument that project aid is good because it forces the receiving country to come up with concrete projects finds its counterpart in the argument that planning aid is good because it forces the receiving country to come up with sound plans and think about the necessary interrelation of its projects and its total development policies"(33). In his opinion, where the projects to which the aid is tied have been tailored to

meet the needs of aid donor rather than those of the recipient country, there is the added risk that the latter's own money will be tied up in the projects which might not rank high in her development priorities(34). However, even where the donors are ready to finance the 'high priority' projects which the recipient otherwise would have undertaken with his own money, the problem of aid fungibility still needs to be addressed. In these cases the aid given by the donors enables the recipient to release his money from 'high priority' projects in order to finance the projects which the donors might not have approved. This could mean that the donors of aid tie their funds to the projects which they have studied minutely and have satisfied themselves that the aid financed projects are technically sound and economically right, while in reality their funds may go into the projects which they may know nothing about, which they have not studied and which may be neither technically sound nor economically right, nor generally the kind of thing that the donors would want to support.

We do not have relevant data available for Pakistan to analyse the question of fungibility of project aid. Nonetheless, later in this study, we will return to project aid in the context of inter-sectoral allocation of aid funds.

Part: 3-1

Economic History: Policy and Performance (Pakistan: 1950-88)

This part attempts to summarise the economic history of Pakistan until the last year of this study. The aim here is limited only to drawing a perspective by identifying major trends in the economic policy and performance. It is useful to divide the whole period into five reasonably distinct periods of differing policy environment. Table 3-3-1 lists the annual average growth rate of major economic indicators for each of the period. The sluggish performance of the first subperiod, 1951 to 1958, is largely blamed on the limited resources, large population, and a public policy with overemphasis on development of manufacturing industry in preference to agriculture. During this period the newly independent country based its political system on the British parliamentary form of government. But without previous experience of working together as a unit, the whole decade turned out to be a jumble of political instability, including six different governments, some of which survived for only a short period. In the economic sphere, Pakistan had no ready-made blueprint or plan for the management of the country at the time of independence. The Government of Pakistan however, lost little time in establishing a Development Board early in 1948, which was required to prepare a programme for future economic

development. Three years later the Board was replaced by a Planning Commission and an Economic Council. The Medium-term planning was introduced into the country with the launching of a five-year development plan to cover the period from 1955 to 1960. But, the achievements of the First Plan turned out to be disappointing because, "the planning machinery at that time was not equipped to handle development efficiently"(35). However, there was an added factor of the stress caused by the excessive emphasis that came to be laid on industrialisation to the extent of the neglect of the agricultural sector(36).

The easily recognisable bias of economic policy in favour of the rapid expansion of the manufacturing sector can partly be explained in terms of Singer's views favouring a growth strategy which should rely on the expansion of manufacturing industries, as the latter was reckoned to have the greatest "spread effects" for growth(37). Another popular thesis at the time was the strategy recommended by Prebisch in favour of the initial expansion of exclusive consumer goods industries through import substitution as an "engine of growth"(38). But more important in Pakistan's case, was the government's earnest desire to overcome the country's industrial backwardness. These theories, however, might have been responsible for providing the government with scientific rationalisation to pursue the industrialisation strategy more vigorously.

Table: 3-3-1

Major Economic Indicators
(Pakistan: 1950-88)^P

(a) No. Period	(b) Gross National Product				(c) GNP Per Capita	(d) Popula- tion
	(bi) Aggre- gate	(bii) Agricu- lture	(biii) Manufac- turing	(biv) Servi- ces		
1. 1950-58	3.15	1.63	8.86	3.81	0.69	2.46
2. 1958-69	5.77	4.09	8.60	6.68	3.00	2.77
3. 1969-71	5.79	3.67	8.80	6.71	2.85	2.94
4. 1971-77	4.98	2.37	3.34	6.39	1.77	3.21
5. 1977-88	6.68	4.00	8.96	7.44	3.60	3.08
1-5. 1950-88	5.36	3.21	7.94	6.25	2.48	2.88

Source:: Appendix, Table 2-A.

^P All figures are annual average percentage growth rates. Column (b) and (c) are calculated at Pakistan's constant factor cost of 1959-60.

Further, the Korean War-induced commodity boom raised the world prices of cotton and jute dramatically, and Pakistan's earnings from her primary exports permitted a rapid building of reserves. The reserve accumulation of the early 1950s, along with the overvalued exchange rate caused by Pakistan's decision not to devalue her currency in 1949(39), permitted an expansionist policy regime(40). The industrialisation drive was also supported by commercial and fiscal policy. The relevant mix of these policies helped manufacturers to buy all inputs below their opportunity costs, and to sell their output in protected markets.

The most damaging fiscal instrument of the period turned out to be the heavy indirect taxation of agriculture through compulsory procurement(41). While industry was racing ahead, agriculture was not growing enough even to take account of the needs of the growing population. The reasons for agricultural stagnation of this period are quite understandable; as there were high rates of investment and growth in the urban economy, in industry, power, and related activities, there was probably disinvestment in agriculture. With agricultural production lagging behind population growth, the surplus available for towns declined. And the rising food deficits began to absorb an increasing share of foreign exchange resources in a country whose factor endowment granted it a comparative advantage in agriculture. Further, the

stagnation of agriculture also meant inadequate production of export crops, while despite the depletion of resources accumulated during the Korean boom, the import demand was still rising. This resulted in increasing balance of payments difficulties.

Some of the main aspects of the period are shown in Table 3-3-1. An analysis of the component sectors of the economy shows that the slow growth in GNP during this period was caused primarily by a failure in the important sector of agriculture (the growth of agriculture at about 1.6 percent per year during this period was substantially below the rate of population growth). The marginal growth rate of the per capita income indicates that government economic policies, taken as a whole during this period, did not succeed in producing sustained economic growth, for reasons that are now familiar to development economists; while import-substituting industries were stimulated, exports were discouraged and despite the "highest priority" given to agriculture, resources devoted to it increased slowly. Hence, the relatively high growth of the industrial sector did not result in a rise in per capita income as long as agricultural production grew more slowly than population.

The coup of October 1958, inaugurated the regime of Ayub Khan, the second subperiod from 1958 to 1969. The new Government made economic policy, a 'central concern' since it had justified its take-over largely in terms of

economic mismanagement by previous Governments. This period, covering most of the decade of the sixties, is truly a pivotal period in the economic history of Pakistan. The Military Government led to the establishment of direct links with the Western bloc. These links brought a large amount of foreign aid and solved the foreign exchange problem. Further, during this period the overall framework of development was outlined in Five-Year Plans. World-over an economic plan had become the characteristic vehicle of development policy. Indeed, the decade of 60s' was the golden age of the economic planner, a plan was the indispensable passport to foreign aid, the touchstone of rationality and domestic efficiency. Economic planning provided the required discipline for a stable economic environment. It was further aided by pragmatic changes in monetary, fiscal, and commercial disciplines. Procurement of food stuffs at prescribed prices and rationing had been given up, and a large section of imports had been placed on a "free list" to enhance the competitive environment for domestic manufacturers. Credit patterns had been so adjusted as to attract investment in priority industries and areas. The agricultural sector was also given greater importance during this period. Indeed, the overall strategy of Ayub's regime is recognisable as the consensus development economics of the era. It borrowed, if a bit eclectically, from Harrod and Domar, Scitovsky, Rosenstein-Rodan, Hirschman, Lewis, Ranis and Fei,

Prebisch, Singer, Nurkse, Kaldor and others whose work was influential in that period. But the part of the strategy which provoked much criticism can, in effect, be related back to the most influential debate of the day, i.e., the conflict between 'growth' and 'equity'. There were those who believed that the transformation of economies from a primitive subsistence state into industrial societies, within a basically capitalist framework, should be accompanied in the early stages by widening disparities in the distribution of income. The "Lewis Model"(42) postulated that the level of saving in a society depended on the functional distribution of income rather than the level of income. His model suggested that income must be distributed in favour of the class that saves and invests (the capitalists class) in order to ensure capital accumulation and growth. Following the Lewis model there was Kuznet's work(43), showing that in many of the present developed countries, the extent of inequality decreased in the later stages of development, and he found the degree of inequality much greater in the past in the developed countries of the day. The work of Kravis(44) also showed that during the growth process, the degree of inequality first increases within countries and then declines. It was perhaps this theoretical foundation along with the empirical findings that during this period made the economic architects in Pakistan believe that the conflict between "growth and equity" objectives should be solved as

a matter of policy, otherwise conflicting controls might defeat both objectives. Their policies, consciously and explicitly, favoured the strategy of "growth through inequality". The 2nd Five Year Plan (1960-65) warned that, "it will be necessary to tolerate some initial growth in income inequality to reach high levels of saving and investment"(45). This echoed Haq's argument that developing countries can "shelve to distant future" any aspirations for reducing inequality. Haq, then Planning Minister, believed that the inequality of income distribution was acceptable because poor people consumed most of their money, while the rich saved and invested it(46). Indeed, Haq's opinion was the mirror image of the Harvard model associated with the works of Papanek(47). Two further ingredients strengthened the strategy, viz, the infusion of massive foreign aid, and the attempt to end stagnation and increase output and productivity in the agricultural sector by 'green revolution'.

Any analysis of the distributional implications of public policy in Pakistan, however, is beyond the scope of this study. But it is important to mention that there is no real evidence of that inequality contributed to the growth process during this period. In particular, as we will explore in subsequent chapters, the rate of private saving was rather low during the 1960s. Nonetheless, there is little doubt that the more sober policy measures accompanied by a relative breakthrough in foreign aid

flows, did yield their potential fruits in Pakistan during this subperiod. As seen from Table 3-3-1 all sectors grew faster, achieving respectable annual average rates. Although the manufacturing sector registered a small decline in the growth rate, this fall is statistical rather than real in that the denominator in the 1950s was smaller due to the meagre industrial base of Pakistan at the time of independence (see, Appendix, Table 2-A).

The most significant event of 60s' was the war with India in 1965. In spite of a temporary setback in the immediate aftermath of the war, the economy maintained its growth momentum. Nonetheless, apart from the merit of economic management, the real success of the 1960s was the 'green revolution' which led to a spurt in agricultural output. The detailed story of this period is well-documented, yet the social worth of the economic achievements of these years still remains controversial. As mentioned earlier, the model of economic development adopted in that period was to consciously promote inequalities as a necessary precondition for successful economic growth. But, whatever its weaknesses, the period at least must be given the credit of providing Pakistan with a stable Government and a measure of continuity and coherence in economic policies.

The third subperiod, 1969 to 1971, started with the disturbances that followed the fall of Ayub Khan and the general criticism of his regime's policies. The rapidly

changing political situation in the country made planning largely irrelevant. General Yahya Khan's three years interim rule from March 1969 to December 1971, became occupied with political and military matters. There was civil war in the Eastern wing followed by the war with India, and finally, with the dismemberment of East Pakistan a 'new Pakistan' came into being. Despite these setbacks, the growth rates given in Table 3-3-1, show that the growth momentum of the preceding subperiod was largely maintained. But, in general this period was plagued by political instability, which makes it hard to discern any coherent economic policy.

The fourth subperiod, 1971 to 1977, marked a major turning point in Pakistan's economic history. It started with the reign of Zulfikar Ali Bhutto, the leader of the Pakistan People's Party (PPP), a party, which for the first time in Pakistan's history was strong enough to hold power firmly. Most elements of the PPP mandate were a reflection of 'leftist' views. The proclaimed aim of the Government's policy was to create a 'socialist pattern' of society by non-revolutionary methods. The rhetoric of this policy was essentially the uplift of backward classes and abolition of privilege. Soon after the assumption of power many actions were taken to implement the new strategy, namely, the nationalisation of a number of manufacturing units, insurance companies, and all scheduled banks. The government also announced land reforms in

agriculture(48).

The Fourth Five Year Plan (1970-75), was drawn up in the framework of an undivided Pakistan. But the separation of Bangladesh in 1971 rendered it infructuous and inapplicable to the resulting situation. In the changed circumstances medium-term planning was given up. Instead, the government introduced the system of an Annual Development Programme (ADP), and annual plans became the principal instruments for designing development programmes.

The growth rates of major sectors as given in Table 3-3-1, though moderate, were accompanied by rising rates of inflation during this period, with the sharpest increase being recorded in the prices of the main staples(49). The average growth of the economy under the PPP, was 4.98% per year. This was a reasonably high average growth rate especially in view of the uncertainties produced by the dismemberment of the country and the institutional reforms of the Government. Most of the growth, however, was accounted for by the services sector. Agriculture grew at a rate less than the growth of population, leading to a decline in per capita agricultural production. The average growth rate of the manufacturing sector was markedly lower than that of any other subperiod. The high inflation rates and the poor performance of the commodity producing sectors were accounted for partly by exogenous factors. The first oil

price rise of the 1970s, for example, greatly increased the import bill and resulted in escalated balance of payments difficulties. Further, there were droughts and floods in two out of the six years of PPP rule. Nonetheless, there is little doubt that some of the public policy measures were directly responsible for the emerging economic difficulties. For example, there were short-term production losses due to erratic implementation of land reforms. Similarly, the growth of manufacturing was affected by industrial reforms. Increased government spending was another endogenous factor which fuelled inflation. Budget data on Pakistan's revenue and expenditure for these years suggest that the current account deficit worsened in real terms, necessitating a rapid increase in government's borrowing.

On the social front, the economic policies of the PPP Government and those of previous regimes revealed more continuity than change. The structural change introduced by the 'socialist pattern' was marginal, and showed that no basic or far-reaching transformation of the economic structure was envisaged. Later in the text, we will discuss in detail the economic difficulties which nationalisation gave rise to. Here it suffices to say that, although the PPP Government took serious action to implement its visionary strategy, the results can hardly be described as plausible. Basically Bhutto's policies, whatever their rhetoric, disappointed, because little was

done to help those at the bottom of society. It was reflected in the rising costs of living for the masses, whose relative poverty grew throughout the period. For the great majority of people it was a period of declining living standards and heightened social insecurity.

In the closing days of the PPP regime, the Pakistan economy was characterised by: an over ambitious economic and social development programme whose cost far exceeded the available resources; a conspicuous public sector which was largely inefficient; an industrial structure unsuitable to Pakistan's endowment(50); and a price structure that promised no solution to Pakistan's emerging stagnation. In July 1977, a military coup overthrew the Parliamentary Government, for the second time in the short history of the country.

The toppling of the PPP regime marked once again an easily identifiable turning point in the rhetoric of economic policy in Pakistan. The new Government under the military rule of General Muhammad Zia-Ul-Haq, soon turned out to be determined to prolong and legitimise its totalitarian regime under various pretexts. The rhetoric of economic policy changed substantially in favour of the private sector. The Medium-term planning was reintroduced with the launching of the 5th Five Year Plan in 1978. Economic growth, as shown in Table 3-3-1, registered the highest average rate during this period. There is evidence of recovery in virtually all sectors of the economy, and

especially so in comparison with the situation that prevailed in the subperiod that preceded.

Indeed, the improved management of the economy was only one of several factors which resulted in high growth rates. There were some evidently significant exogenous factors to help the military Government in providing economic legitimacy to its rule. First, the spectacular inflow of remittances from the oil Kingdoms greatly relieved the pressure on the country's balance of payments. Secondly, and most importantly, was the favourable change in the international situation which was created after the Soviet invasion of Afghanistan. The latter provided the Government with the chance to bargain its 'strategic resource' from a position of strength, for the first time since Pakistan's alliance with the Western block. As is clear in Table 2-2-1, the nominal inflow of aid during these years was 60% of the total since 1951 (later in this study, we will analyse the implications for the economy of these two external factors at greater length). Weather was another favourable factor; an excellent weather cycle, ensuring consistent and sufficient water supplies, made a critical contribution to the improved performance of the agricultural sector. Further, many of the long gestation projects which were undertaken during the preceding regime started operation during this period. This increased the average growth rate of the manufacturing sector back to the high levels of the

1950s and 1960s.

The Government seemed to be moving towards a policy mix in which the price mechanism was being restored to a more central role. However, the interest of the Government in privatisation largely stemmed from the growing prominence given to the need for major reforms in government policy in LDCs, by both bilateral and multilateral agencies. As a condition of continued funding, borrowing countries are increasingly being required to implement certain basic reforms in the economic system. In particular, LDCs Governments have been urged to allow the private sector to enjoy a greater role in their economies.

The most conspicuous feature in the economic record of Zia's Government was a move towards the Islamisation of the economy. The idea of economic activity as administration of resources on behalf of God is a central feature of all three of the Semitic religions. The early chapters of the Bible embody this approach to economic life. Similarly, within Islam economic resources are regarded as belonging ultimately to God and economic activity is an aspect of the exercise of the stewardship of these resources extended to man. The Islamisation process involves a basic transformation of the entire economy and intra-social relationships in conformity with the tenets of Islam. This was nowhere more evident than in the attempt to abolish the rate of interest. The religious

conception of economic activity dates back to a paradigm originating in Greek philosophy. The primary concern for a stable social order led Plato to express a general opposition to the practice of interest payment on loans. He believed that the existence of obligations to pay interest could bear a moral threat to the maintenance of peace and social solidarity in society. This belief was based on the occurrence of military conflict in the Greek city states due to defaults on debt(51). Aristotle opposed interest since he saw money's role as that of facilitating exchange. To use it for another purpose was a distortion of its character as a social institution(52). Similar restrictions on interest were placed by all the three Semitic religions. The Jews permitted interest on trade with foreigners but forbade interest charges to fellow countrymen. St. Thomas's reformulation of the doctrine of usury provided the intellectual foundations with which canonists and theologians supported the prohibition of interest(53). Finally, the fundamental Islamic tenets explicitly and emphatically prohibit riba (usury).

The rhetoric of the 'Islamisation' process of Zia's Government was to provide social justice in every walk of life by following Islamic principles. However, in reality it never extended beyond some dogmatic measures. Indeed, the 'Islamisation' was used largely to cash in on the religious emotions of large sections of the population, partly to legitimise the prolonged military rule and

partly to manipulate public opinion in favour of Afghan resistance. These arrangements suited the US at that time, in the perspective of Secretary Dulles's observation quoted in part one.

Finally, one of the common characteristic of all the Governments in Pakistan, was the reliance on foreign aid. In some accounting senses the receipt of aid must increase resources in the recipient country. However, it cannot be inferred from this that it leads the country towards sustained growth. This can be determined only after considering the factors influencing economic development, the repercussion of aid on policies, institutions, and the allocation of resources in the recipient country. The following chapters of this study are devoted to the analysis of interrelationship between foreign aid and economic development in Pakistan.

Notes

1. See, Milton Friedman, "Foreign Economic Aid: Means and Objectives", Yale Review, Vol. 47, 1958, pp. 24-38.
2. Quoted in, Herbert Feis, "Foreign Aid and Foreign Policy" Macmillan & Co Ltd. London, 1964, P. 152.
3. Iraq withdrew from the organisation in 1958, after the revolution in that country.
4. See, A. Tayyeb, "Pakistan: A Political Geography", OUP, London, 1966, P. 220.

5. See, Memorandum to President Harry S. Truman, Papers of Harry S. Truman Library, Independence Missouri. Also, quoted in Noor A. Hussain, "Pakistan-US Security Relations: Arm Sales, Bases, and Nuclear Issues", Published in Leo E. Rose and Noor A. Hussain (ed.), United States-Pakistan Relations", University of California, Berkeley, 1985, P. 2.

6. See, "The Atlantic Monthly", Boston, March 1948, P. 15.

7. Noor A. Hussain, op. cit.

8. Ibid.

9. See, the "First Report to the Congress on the Mutual Security Programme", Washington, 1952, pp. 29-30.

10. See, 'The New York Times' 2nd June, 1953.

11. See, (i) B. K Sayeed, "Pakistan: The Formative Phase", Pakistan Publishing House Karachi, 1960; (ii) B. R Ambedkar, "Pakistan or Partition of India", Reprints of 1945 Edition AMS Press.

12. The total area of Indian Subcontinent is 1,504,721 square miles, out of which Pakistan's share was 365,529 square miles. The population of united India was 384 million; Pakistan's share became to be 70.1 million, see First Five Year Plan, Vol. 1. Government of Pakistan, Karachi, May 1956.

13. See, B. M. Bhatia, "Pakistan's Economic Development 1948-1978: The Failure of a Strategy", Vikas Publishing

House, India, 1979, P. 28.

14. Ibid.

15. See, "National and Per Capita Income of Seventy Countries", UN Statistical Office, Department of Economic Affairs, Statistical Press Series; E. NO. 1, New York, 1950, Table 1, pp. 14-16.

16. See, the "Mountbatten Papers, India Office Records, London, File No. 191.

17. Ibid.

18. Ibid.

19. See, Latif A. Sherwani (ed.), "Pakistan Resolution to Pakistan", Karachi, 1969, pp. 247-9.

20. For instance, of the 249 armoured vehicles allotted to Pakistan, not one was delivered, and of the 160, 000 tons of the ordnance stores, only 23, 225 tons were delivered. See, Fazal Mugeem, "The Story of the Pakistan Army, Lahore, 1963, P. 40.

21. Disputed state of Kashmir is a mountain-girt and land locked area of 48,470 square miles in the extreme north of the Indian Subcontinent. According to the 1941 census, it had a population of 4.02 million. At partition, two dominant religious communities, Muslims and Hindus, formed 77 percent and 20.7 percent of the population respectively. Kashmir was one of those princely states whose fate was left undecided at the time of partition. Historical events had put the Kashmir under an autocratic Hindu ruler, whose personal preference was naturally

accession to India. While the pro-Pakistani sentiments were strong in the majority of population. Pakistan had also somehow taken for granted that Kashmir would accede to it rather than to India. By October 1947, there was a widespread rebellion in the state, giving Pakistan control over a large slice of strategic mountains area in northern Kashmir. On 27th October 1947, Indian troops entered into Kashmir (after India had obtained from the Hindu ruler the instrument of the accession of the state to India). The border conflict between India and Pakistan continued until January 1st, 1948, when India referred the problem to United Nations. Ever since all the efforts of the UN have not been successful in finding a solution to the problem of Kashmir. See, Alastair Lamb, "Crisis in Kashmir: 1947-66", Routledge and Kegan Paul, London, 1966.

22. Quoted in Latif L Sherwani, "Pakistan, China and America, Council for Pakistan Studies, Karachi, 1980.

23. See, Ian Stephens, "Horned Moon", London, 1953, P. 33.

24. The dispute between Pakistan and Afghanistan is about the acceptance of Durand Line, a boundary demarcation between Afghanistan and what was the British India established in 1893, after the second Anglo-Afghan War. Pakistan recognises the Durand Line as an established international border, various Afghan regimes generally have not, and they harbour claims on some border area of Pakistan. Since the partition of India and Pakistan, Afghanistan has proposed some form of self determination

for "Pakhtoonistan", the traditional homeland of the Pathans, its areas are presently located partly in both Pakistan and Afghanistan. See, "Report of a Staff Study Mission to Pakistan and India", to the Committee on Foreign Affairs, United States House of Representatives, US Government printing office, Nov; 20th, 1981. P. 9.

25. SEATO replaced ANZUS, Collective Security Organisation established in 1951 by Australia, New Zealand, and the US. SEATO was a collective defence system analogous to NATO. It was established in 1954 by Australia, France, New Zealand, Pakistan, The Philippines, Thailand, UK and the US. After the Vietnam War it was phased-out by 1977 and its non-military aspects were assumed by the Association of South-East Asian Nations (ASEAN), a regional alliance formed in Bangkok in 1967 with the membership of Indonesia, Malaysia, The Philippines, Singapore, Thailand, and from 1981 Burnei.

26. CENTO replaced the Baghdad Pact in 1959, as Iraq withdrew from the Pact. It collapsed when the withdrawal of Iran, Pakistan and Turkey left the UK as the only member in 1979.

27. See, Nirad C. Chaudhuri, "The Continent of Circe, London, 1965, P. 244.

28. See, Denise Folliot (ed.), "Documents on International Affairs", London, 1956, P. 268.

29. See, Noor A. Hussain op. cit.

30. See, Arshad Zaman, "Economic Relations Between

- Pakistan and the US", In Leo. E. Rose (ed.), op. cit., pp. 56-7.
31. Ibid. pp. 53-4.
32. For a detailed discussion see, H. W. Singer, "External Aid: For Plans or Projects?", Economic Journal, Vol. 75, 1965, pp. 539-45.
33. Ibid. P. 545.
34. Ibid. P. 539.
35. See, Government of Pakistan, "Economy of Pakistan: 1948-68", Ministry of Finance, Islamabad, 1970, P. 263.
36. For a detailed analysis of the merit and the instruments of the industrialisation policy of these years see, John H. Power, "Industrialisation in Pakistan: A Case of Frustrated Take-Off", Reprint Series in Pakistan Economics: No. 1, Pakistan Institute of Development Economics, Islamabad.
37. See, H. W. Singer, "Distribution of Gains Between Investing and Borrowing Countries", American Economic Review, Vol. 40, May 1950, pp. 473-85.
38. See, Raul Prebisch, "Economic Development Of Latin America", Economic Commission for Latin America, (ECLA), UN, Dept; of Economic Affairs, New York, 1950.
39. In the beginning of the period, Pakistan was, in the Sterling area. In September 1949, the Pound Sterling was devalued vis-a-vis the US Dollar, with a large number of currencies, including those of sterling area, following suit. Pakistan decided to maintain the US Dollar parity of

its Rupee, in effect bringing about a substantial appreciation in its exchange value vis-a-vis the Pound Sterling and the currencies that had devalued with it. However, as the balance of payments problems worsened later on with the depletion of the resources accumulated during the Korean boom, the government was forced to make a 30% devaluation of the rupee/dollar exchange rate in July 1955. See, Gustav Ranis, "Government and Economic Development", New Haven and London: Yale University press, 1971, chap., titled "Devaluation in Developing Countries".

40. Although in theory it is devaluation which helps the expansion, but in Pakistan in the 1950s the reserve accumulation of the Korean War boom along with the favourable mix of fiscal and trade policy made the overvalued exchange rate conducive for expansion.

41. For details of fiscal incentives, see Andrus and Mohammed, "Trade, Finance and Development in Pakistan", OUP, London, 1966.

42. See, W. A. Lewis, "Economic Development With Unlimited Supply of Labour", Manchester School, Vol. 22. May, 1954.

43. See, S. Kuznets, "Economic Growth and Income Inequality", American Economic Review, March 1955.

44. See, I. M. Kravis, "International Differences in the Distribution of Income", Review of Economics and Statistics, 1960.

45. See, "Second Five Year Plan, 1960-65", Government of Pakistan, Islamabad, 1960.
46. See, M. Haq, "The Strategy of Economic Planning", OUP, Karachi, 1966.
47. See, F. G. Papanek, "Pakistan's Development: Social Goals and Private Incentives", Harvard University Press, 1967.
48. The ceiling of individual holdings was lowered to 150 irrigated and 300 unirrigated acres. See, Jamil Rashid And Hassan Gardezi, "Independent Pakistan: Its Political Economy", Published in Hassan Gardezi and Jamil Rashid (ed.), "Pakistan: The Roots of Dictatorship", Zed Press, London, 1983. pp. 11-12.
49. See, Aijaz Ahmed, "Democracy and Dictatorship", published in "The Roots Of Dictatorship" op. cit., P. 115.
50. The Bhutto regime inaugurated capital intensive projects with a high import content. The most conspicuous example is the Pakistan Steel Mills. The Plan for making Pakistan self-sufficient in steel were first formulated in the 50s' when with the Pakistan Industrial Development Corporation (PIDC) suggested a project based on the Kalabagh iron ore deposits. The project was debated for more than a decade and was finally abandoned during the 60s' on the basis of Kalabagh ore known to be of inferior quality. But the Bhutto Government decided to go ahead with the plan on the bases of Pakistan becoming "economically independent", and the Government obtained

credit for over \$525 million from the former Soviet Union for the purchase of machinery and technology to construct the plant.

51. See, B. Gordon, "Economic Analysis Before Adam Smith", Macmillan Press LTD. London, 1975, P. 49-50.

52. See, Eric Roll, "History of Economic Thought", Faber and Faber LTD. London, 1961, P. 33.

53. See, Alexander Gray , "The Development of Economic Doctrine", Longmans, Green and Co LTd. London, 1957, P. 54-59.

CHAPTER: 2

FOREIGN AID AND ECONOMIC DEVELOPMENT: THEORY AND CRITIQUE

Introduction

Foreign economic aid to developing countries is generally traced back to the colonial links between Western Imperial powers and their overseas territories. In the preceding chapter, we have attempted to link US aid to the Truman Doctrine of the late 1940s. Nevertheless, whatever its precise origins, aid began to be an important facet of international relations in the 1950s. The attention of economists and development analysts to the phenomenon grew with the rapid expansion of aid funds. This chapter reviews a fairly large body of existing literature on the issue of foreign aid. Part one examines the theoretical justification for aid. Part two describes the theoretical critique of aid theory, and, finally, Part three presents a critique based on empirical findings.

Part: 1-2

Foreign Economic Aid: Theoretical Justification

The early literature on foreign aid and economic development was dominated by a largely optimistic vision of the prospects of LDCs. It was generally felt that, under most relevant circumstances, aid and other capital flows to developing countries would induce an expansion of economic activity and output in these countries. Indeed, conventional aid theory has its origins in Keynesian economics and, in particular, in the theories of economic growth that writers in the Keynesian tradition applied to industrialised economies. But, before we start reviewing the contributions of various aid theorists, one important point must be noted. Keynes' own theory hardly discussed the question of dynamic growth, the particular problems of poor countries or the role of foreign aid in the process of achieving high levels of growth or development. It is, however, the challenge that Keynes made to key assumptions of neo-classical theory(1) and which led him to recommend a particular form of state intervention which provides the basis for arguing that the early literature on aid was influenced by Keynesian analysis. With this exposition, we present the theoretical justification for foreign economic aid to the LDCs in the following two sections. Section one provides an overview of the early theories, while section two describes the subsequent development of the thesis as economic theoretical models, the dual gap

analyses.

Section: 1-1-2

Pioneer Work

The pioneer literature on the theory of aid and development, even if naive and weakened by overstrict assumptions, provided a framework maintained by many subsequent analysts. One of the few early works that account for the effects of capital inflows on developing economies is Kalecki's model on the problems of development finance(2). He shows the advantages of importing capital for the rapid development of a country. In his model the process of development tends to strain the balance of payments by raising the requirements for import of capital goods as a result of higher investment, for industrial raw materials because of growing industrial production, and for food if home production lags behind demand. The function of aid is to relieve the shortage of foreign exchange to meet these requirements.

Rosenstein-Rodan was also amongst the pioneer economists who provided theoretical justification for giving economic aid(3). He specified the purpose of aid to developing countries as being to accelerate their economic development to a point where a satisfactory rate of growth can be achieved on a self-sustaining basis. But he equally emphasised that the principal element in the transition to self-sustaining growth must be the effort that the citizens of the recipient countries themselves

make to bring it about'(4), adding that 'capital aid should be offered wherever there is reasonable assurance that it will be effectively used'(5). Thus, while Rosenstein-Rodan provides an explanation for the role of aid in the development process, and goes to considerable lengths to specify the quantities of aid required on a country-by-country basis, he is equally concerned to point out that there are major constraints inhibiting the successful injection of capital aid to accelerate the pace of economic development. Indeed, if these inhibiting factors predominate, his theoretical perspective would lead to a rejection of the view that more aid will mean more development. Finally, it should be noted that he also rejects the provision of aid specifically to raise the income levels in poor countries. Aid, he argues, "should continue not until a certain level of income is reached in underdeveloped countries but only until those countries can mobilise a level of capital formation sufficient for self-sustaining growth"(6).

In the early 1960s, Rostow provided an economic explanation for the role of aid in accelerating the pace of development in the LDCs(7). It is interesting to note that his lasting place in the creation of aid theory lies not so much in the analytical rigour with which he spelt out the relationship between foreign aid and economic development, nor in the acclaim that his ideas received in economic circles, but rather because the terminology and

general concepts he used have become an integral and influential part of the conventional view of LDCs' development. Amongst the terms he coined the most commonly used is the 'take-off'. It is in increasing the investment rate to accelerate the process of economic growth and achieve take-off that Rostow gives a critical role to economic aid. Within the Harrod-Domar paradigm, the investment rate of the developing countries is raised by injections of foreign capital, so augmenting the domestic saving rate without reducing the level of domestic consumption. While aid is not absolutely necessary to raise the level of investment, it speeds up the historical process of reaching the stage of self-sustaining growth. At this point, it is important to note that Rostow, although one of the first to make explicit reference to contemporary Keynesian growth theory and to incorporate these ideas into the economic analysis of providing aid, did not consider the latter as simply to be directed at achieving higher levels of economic growth. On the contrary, in his paradigm aid is to be used, primarily and essentially, to address social constraints which inhibit structural transformation. In 1957 Rostow, with Millikan, while summarising his view of the economic role of aid in development wrote that the developing countries need capital "to establish the preconditions of growth and to make sure during the second stage that growth is maintained until they reach a point where they can be

reasonably sure of maintaining it out of their own increasing output"(8).

One of the most common features of the pioneer literature providing theoretical justification for aid is the emphasis on a positive relationship between foreign aid and the economic development of the recipient. But the dual gap models which emerged in the early 1960s formulated the philosophical justification and analytical bases together in a computable dynamic framework.

Section: 2-1-2

Dual Gap Models

Insofar as the gap models broaden the analysis into a general three-phased thesis of development, they predominantly reflect the idea of development as an evolutionary and repetitive process according to the Rostovian Paradigm. Also, the general analytical framework of these models is crucially based on the Harrod-Domar structure of growth models with its emphasis on the crucial role of the rate of accumulation. But, to the extent that gap theory combines the former philosophical and analytical framework with explicit considerations of the structural rigidities present in the LDCs economies, it is essentially innovative.

The central idea of this theory is that a country will typically pass through a skill-limited phase, where its absorptive capacity is small. Over time, however, a saving constraint is said to follow which, in turn, leads

to a phase where inflexibility in the domestic production process will result in a trade gap.

A substantial part of the work on the gap models has been carried out by Chenery and associates(9). In its concise, normative form the analysis asserts that: (a), external resources can be used by underdeveloped countries as a basis for a significant acceleration of investment and growth; (b), the maintenance of higher growth rates requires substantial changes in the structure of production and trade; (c), external capital can perform a critical role in both resource mobilisation and structural transformation; and (d), the need for concessionary aid declines once these structural changes are well underway(10).

Most two-gap models are "Keynesian" in spirit and rely on fixed 'technical' relationships and on stable savings and import propensities. Chenery's major argument on the existence of the two gaps is familiar. Emphasis is given to a 'structural' argument, i.e., in any given time period a developing economy can neither increase its exports nor decrease its imports without imposing underutilisation of resources. Exports earnings for the bulk of products are largely determined by foreign demand conditions and "a rapid increase in exports typically requires the development of new export products which is limited by productive capacity as well as organisational and institutional factors"(11). Thus, assumptions are made

of a lack of substitutability between imports and domestic resources, fixed factor proportions, and rigid relationships between imports and investment and between imports and output. Analysis then is mostly concentrated on a saving-investment gap and an import-export gap. A target rate of growth is postulated and a capital-output ratio is accepted as a datum. A specific saving rate is then derived as necessary to achieve the targeted rate of growth. Similarly, a fixed relationship between imports and growth of output is postulated from which one may derive the level and rate of the required growth of imports. A saving gap appears when the domestic saving rate is below the level necessary to permit the investment required to achieve the targeted rate of growth of output, while imports are adequate. Aid covers the saving gap, and permits the achievement of the target. A trade gap appears, however, if with adequate saving the flow of imports is below the required level. Here aid breaks the import bottleneck and permits targets to be reached. In this latter case, the key assumption is that the country is unable to transform its potential saving into exports. Growth is said to be investment-limited when the domestic resource gap is dominant, and trade-limited when the foreign exchange gap is bigger. The ex-post identity of the two gaps is an accounting identity(12). Ex-ante, however, they do not have to be equal(13).

Since the two gaps are not additive, foreign capital

inflows will bridge the dominant gap and the other will be automatically covered. When the domestic resource gap is dominant, it can be narrowed through the increase in saving as a result of an increase in national income by more than the increase in investment. For this the marginal propensity to save should exceed the average propensity. However, the self-sustained growth which the dual gap models postulate (that is the need for further concessionary assistance is ceased), is achieved only if the Incremental Capital Output Ratio [ICOR](14) is lower than the marginal propensity to save. Then it follows quite clearly that the larger the saving-investment gap, the less likely this condition can be satisfied, because the more the marginal saving must exceed the average in order to eventually close the gap.

Alternatively, when the foreign exchange gap is dominant, it becomes less limiting provided either that exports grow at a faster rate than national income and/or that the import-investment coefficient falls indicating that more capital goods are being produced domestically, i.e., the marginal import ratio must be below the initial average ratio.

Chenery and Strout even spoke of the inflow of external resources as a separate factor of production, the effective use of which makes possible a rapid and sustained development(15). They held that foreign capital has properties quite different from domestic resources,

and the mixing of the two opens up new opportunities to the receiving country that could not be provided by a simple increase of national income. For a developing country the inflow of foreign capital was said to be significant in raising the productivity of a given amount of labour as well as for allowing a larger labour force to be employed. They held further that the function of foreign capital was not only to help countries break their vicious circles of poverty but also, once the growth process has started, to sustain it by making the process as fast and continuous as possible. Moreover, an increase in income, saving and investment which the inflow of foreign capital makes possible, was believed to shorten the time the recipient country would otherwise take to achieve self-sustaining growth by stepping up the rate of domestic capital formation to a level which could then be maintained without the need for any further foreign capital.

Chenery, in a reply to Bruton(16), called the gap analyses "a by-product of attempts to determine the actual policy alternatives facing underdeveloped countries"(17). But most of the gap models do not make any specific assumptions as to what economic policy tools are at the disposal of the governments of the capital receiving countries. Those which do generally fail to specify exactly how capital inflows affect the use of these tools. It is implicitly assumed that some combination of policy

measures can always ensure that the additional resources obtained in this way are allocated entirely to investment without any "leakage" into consumption. The government's overriding policy goal is regarded almost as axiomatic. Furthermore, another characteristic of these models is their omission of domestic financial variables such as money, credit, prices and interest rates.

Finally, due to the controversy over its many features, the early growth-oriented literature was rated by many critics as curiously naive. Yet it remained essentially unchallenged for a long time. Indeed, the two gap analysis gained wide currency when it first appeared, and it was extensively employed over the 60s' in the evaluation of the impact of aid programmes. Until the mid 60s' there seemed to be a great degree of consensus among economists that a very important factor in determining the causes of economic progress in developing countries is the availability of external resources to finance domestic investment. Furthermore, they presented the former so optimistically and as predictably beneficial that all less developed countries were urged to solicit and accept aid as rapidly as they could absorb it. But as time and experience brought about changes in the perceptions of economic development in the second half of the 1960s and at the beginning of the 1970s, the validity of the assumptions of these models was disputed by many critics. Subsequently, the foundations of thinking on foreign aid

and economic development were shaken. The literature evolved as an antithesis seems to have the general outlook of a combination of the structuralist paradigm and of the modern theories of international dependency. The critics generally varied from those who exposed the theoretical weaknesses of the theory of aid and development to those who rejected the analyses on theoretical as well as empirical grounds. The views of the critics are discussed in the following two parts of this chapter. It must, however, be remembered that though the 1960s proved in retrospect the decade when most work was done by economists in the development of the theory of foreign aid, it was the two-gap analyses which received most attention, particularly from those concerned to test its validity in the real world. Therefore, for the empirical part of the critique of the theory of aid and development, this study will focus on the relationships between foreign aid, domestic saving and economic growth, as postulated by the architects of gap models.

Part: 2-2

Foreign Economic Aid: Theoretical Critique

This part ranges from the narrowly-focused debate about the existence of the two gaps to those criticisms of foreign aid which are seen by some as more fundamental issues. The analysis is divided into three distinct sections. Section one describes the views of critics about

the foreign exchange gap of the two-gap models while section two summarises the critique of the radical writers on the Left. Finally, section three presents the opinion of the critics on the Right.

Section: 1-2-2

Foreign Exchange Gap

Fei and Ranis were the first to criticise the gap models for "indefinitive behavioural assumptions" and unresolved identification problems(18). However, the first challenge from a neo-classical perspective to the Keynesian basis for aid intervention came from Bruton. He examined the factors which determine the gaps and questioned the effectiveness of aid in closing the dominant gap. He maintained that the trade limit is unlikely to occur in a well managed economy and that basing aid policy on this hypothesis provides the wrong incentives to developing countries(19).

Myint also strongly criticised the trade limit of the two gap models. One of his criticisms is the familiar one that countries such as Puerto Rico and Hong Kong (the most recent examples of the sort are Taiwan, South Korea and Thailand), have all been able to achieve remarkable rates of export growth. In his opinion, these examples show that small countries can escape the foreign exchange scarcity trap. Myint also points out that, historically, the bulk of the total value of investment consists of domestic goods for such things as

construction, agricultural capital, roads, and so on. He argues that these useful activities can be expanded, even if foreign exchange is scarce(20).

Griffin based much of his later empirical analysis on the proposition that 'ultimately there can only be one constraint on investment, viz. saving'. Thus, he rejected the two-gap proposition that foreign exchange can be an independent constraint on development. He provided a theoretical model which shows that for a less developed country, it is quite rational to consume more than before as it receives foreign capital. Assuming that neither consumption nor saving is an "inferior" good, one would expect the resources provided through foreign aid to be allocated between consumption and investment in such a way that the opportunity cost of current consumption is exactly equal to the satisfaction obtained from consuming one additional item. Thus, the net effect of foreign aid would be to increase consumption on the pretext that there is a trade limit inhibiting growth(21). Similar arguments were developed by Joshi who emphasised the range of objectives and policies open to most LDCs which have a bearing on both foreign exchange and saving requirements. Over time, he argued, the distinction between the two gaps becomes irrelevant(22).

Little visualises four conditions that are necessary for a foreign exchange gap to exist: first, it must be impossible to increase export receipts because foreign

demand has unit elasticity (or there is a kink in the demand curve); second, the import bill cannot include any payment for final consumption goods; third, the import content of current domestic production cannot be reduced; and fourth, investment cannot be made more labour-intensive without reducing its social yield. He maintains that given time to make adjustments, it is doubtful whether any country has ever been in such a position as the above. He argues that in the very short run all countries experience such situations, since import saving or export expansion always takes time. Little believes that giving aid on the basis of projected foreign exchange deficits is not a 'good' idea, because it inhibits policy adjustments in favour of increasing exports and increasing labour intensity(23).

Findlay was also of the opinion that the foreign exchange gap theories, with their emphasis on the inflexibility of the production and demand structures in developing countries, had paid too little attention to the role of domestic policies in generating inflexibility. He showed that once the suitability of domestic and imported capital goods was admitted, as well as the possibility of expanding export earnings even though with worsening terms of trade, the appropriate allocation of domestic output or savings between exports and domestic investment followed the well-known principle of optimum allocation of resources(24).

Bhagwati disputed the two-gap theory in its attempt to provide a rationale of foreign aid in terms of its role in filling the exchange gap. In his opinion, the theory might have the unintended result of reducing the efforts of poor countries to correct domestic distortions in cost/price structures. In analysing this phenomenon, he provided country studies where an over-valued currency and a licensing policy provided imported capital goods to domestic manufacturing industry at the official exchange rate. In most cases, he shows, the policy overwhelmingly encouraged the adoption of capital-intensive techniques and projects. What was more disturbing, was that it led to the underutilisation of capital stock. Hence, in the process developing countries became increasingly dependent on imported raw materials to feed their domestic industries and import needs tended to increase(25).

We now shift our attention away from the debate on the gap theory to those criticisms of foreign aid which are seen by many as more fundamental issues. The latter types of criticisms share a common framework, with varying strength, which widens the issue of aid effectiveness beyond technical macroeconomic and quantifiable relationships associated with 'growth theory' to a consideration of unquantifiable relationships that attempt to capture the patterns of poverty and distribution and, relatedly, social and political aspects of the development process.

Section: 2-2-2

Critics From the Left

The radical critics from the Left maintain, that even the obvious additions made by aid to national saving, foreign exchange, and economic growth, hardly have any worth unless aid does lead to recognisable benefits in economic development. Particularly highlighted are the effects on poverty alleviation and income and asset distribution. These critics can be grouped into two distinct, although related, categories: the institutional pessimists, and the structural theorists(26). The former focus their attention on recipient governments and, for a variety of reasons, conclude that the interplay of power and economic interests prevents them from utilising the aid provided in a manner conducive to poverty alleviation in these countries.

Mende, in a rigorous critique, pin-points the deficiencies of the state in developing countries and the fundamental requirement of mobilising mass support as the key to meaningful development. He views foreign aid as a diversion from the main task at hand(27). Lappe and her colleagues agree with Mende's pessimistic conclusions about the state and extend this to a discussion of uneven power relations within recipient countries(28).

However, the most influential among the institutional pessimists are Seers and Myrdal. Their criticisms of aid are based on two negative assessments of recipient states.

They assert, first, that much aid is frittered away through corruption and, secondly and more substantially, that the aim of LDCs' rulers is not to relieve poverty, rather the contrary, to make sure that the incomes of the masses are kept low and social services are retarded(29).

The most complete account of the structural theorists is found in the writings of Jalee(30), Hayter(31), Wood(32), and Carty and Smith(33). They agree with the institutional pessimists that state structures and recipient governments are a major impediment to aid effectiveness but their analysis is both wider, usually international in scope, and historical. For them, aid is part of a structural relationship between rich and poor countries which has evolved over time to underdevelop the latter. They believe that the objectives of the developed countries are primarily and overwhelmingly to use the poor countries to further their own economic interests. The former are able to achieve these objectives by allying themselves with the dominant economic groups in the recipient countries. These groups strengthen their own economic power by furthering the links already established between themselves and the rich countries. Insofar as aid is a part of this wider and dominant relationship between the two groups of countries, it is incapable of addressing and alleviating the poverty of the developing world in a systematic and effective way.

Nonetheless, it is not the assertions of the Leftist

critics that foreign aid has a negative impact on the poor in recipient countries that concern us here. Of primary interest is the theoretical perspective underlying their assertions. It is important to recognise that, in general, the Leftist critics have failed to elaborate in sufficient detail the precise theory of development they are utilising to derive their negative conclusions. It is within this context that we now intend to view the contribution of the critics on the Right in the following.

Section: 3-2-2

Critics From the Right

The Rightist perspective of foreign aid is rooted in neo-classical economic theory. Rightists assert that intervention through aid frustrates or, in its most radical form, impedes the development process. At the centre of their critique is optimism about the efficacy of the market, and the overriding benefits of a non-distorted price system and private enterprise achieving sustained and accelerated development on their own. The debate has been largely developed by economists such as Friedman, Bauer, and Krauss.

In Friedman's opinion, government-to-government aid would normally be wasted and also it would discourage the recipient government maintaining an environment favourable to private enterprise(34). However, the most fierce critic on the Right is Bauer. One of the main arguments he advanced is that the inflow of aid may be

linked to policies which serve to reduce private investment and even encourage the flight of capital(35). Indeed, he rejected the idea of a saving gap in LDCs, as he was confident that the low level of output per capita in less developed countries is not caused by the lack of domestic saving but by the existence of certain attitudes, customs and institutions which are not favourable to growth. Thus, even if foreign aid is provided, says Bauer, it would not raise their rate of growth, and in fact "would so adversely affect the basic ingredients of growth as to retard economic growth in the less developed nations"(36).

Krauss highlights the distorting effects of government intervention in recipient economies. He holds that foreign aid which involves a transfer of income between governments necessarily increases the role and influence of the recipient governments in the domestic economic sphere and, thus, accentuates the impediments to economic progress by hindering dynamic and competitive market expansion(37).

To the extent that aid is perceived as part of the problem impeding the achievement of faster growth and development, there is agreement between the Left and the Right. Nonetheless, one fundamental difference between the two schools may be noted: while the Leftist critics attacked all capital imports including foreign private investment, Rightist opinion was critical only of the

aid-in-grant programme because it is this, they believe, which keeps the recipient governments from liberalising laws governing foreign private investment.

Finally, the theoretical critique of aid evolved side-by-side with the waning enthusiasm for aid to less developed countries resulting from empirical observation. We now turn our attention to the critique of foreign aid based on empirical findings.

Part: 3-2

Foreign Aid: Empirical Critique

Empirical work on foreign aid was largely motivated by a hypothesis advanced by Haavelmo, who in the mid-1960s first raised the question of the relationship between domestic saving and capital inflow. His argument implied the existence of a negative relationship between the two variables. He argued that domestic saving could be negative if the inflows of foreign capital are large and that, if capital inflows do reduce the level of domestic saving, little will be added to capital formation. The effect on the rate of growth is then open to question(38). Haavelmo's hypothesis was followed by a series of empirical studies that were carried out to establish the relationship between foreign aid, domestic saving and economic growth. In this part an attempt is made to describe the empirical studies. Section one looks at the early highly pessimistic findings and section two describes the analyses that arrived at some reconciliatory

conclusions.

Section: 1-3-2

Early Pessimistic Findings

Haavelmo's hypothesis was first tested by Rehman, who investigated the relationship between the saving ratio (S_t/Y_t) and the capital inflow ratio (H_t/Y_t) within a linear regression model(39). Rehman arrived at the following estimated equation(40):

$$S(t)/Y(t) = 0.1427 - 0.2473 H(t)/Y(t) \\ (2.5680)$$

Where $H(t)/Y(t)$ is the foreign capital taken as a proportion of national income and the figure in parentheses is a t-statistic.

While Chenery and Strout in their basic model assumed the recipient country to be "unwilling or unable to increase aid merely to increase consumption" and they believed the recipient governments to have "no incentive to increase aid by reducing saving"(41), Rehman's statistically significant negative result led him to conclude that foreign capital is quite likely to be used not only for augmenting investment but also as a substitute for domestic saving. From this conclusion he advanced the behaviouristic hypothesis that "the governments in developing countries may voluntarily relax domestic saving efforts when more foreign aid is available than otherwise"(42). Aside from this, he argued, the possibility also exists that some proportion of the

foreign capital inflow may be devoted to uses which have a small impact on economic growth. For example, the part of aid which goes to finance expansion of the public administration and the defence sectors adds more to aggregate demand than to aggregate supply.

In order to support the thesis that aid inhibits growth, Griffin and Enos conducted an empirical analysis(43). By regressing the average growth rate of twelve Latin American countries on the ratios of aid to GNP for the period 1957-64, they found that the coefficient of regression was negative. Their estimated equation reads as follows(44):

$$Y = 42.97 - 6.78(A/Y); R^2 = .13$$

where, A/Y= ratio of foreign aid to GNP.

With data for 32 countries for the three-year period from 1962-64, they also obtained an inverse relationship between foreign capital inflow and domestic saving. Their results were more striking than those of Rehman. Their estimated equation is(45):

$$S = 0.11 - 0.73(f); R^2 = 0.54$$

(6.6)

where, f is foreign capital and the figure in parentheses is a t-statistic.

Griffin and Enos pointed out the routes whereby foreign capital inflow ultimately leads to a reduction in the rate of growth in GNP. First, direct investment may tend to reduce the supply of local entrepreneurship and

saving by pre-empting the most profitable opportunities through special tax and import privileges. Second, this inflow raises the ICOR because some foreign capital inflow (mostly public loans) is channelled into activities that either are not directly productive or have long gestation periods. The strong linkage between public loans and social overhead capital might result in a higher ICOR and perhaps in a lower rate of increase in national income(46).

Among the early aid empiricists, Thomas E. Weisskopf and Kaj Areskoug are two other well-known names. The former gave persuasive theoretical reasons and empirical evidence to assert that an inflow of foreign capital should have a negative impact on domestic intentions to save(47). He took time-series data for seventeen countries for a period of at least seven years to estimate the overall ex-ante saving function. The results were as follows(48):

$$S = a + 0.183Y - 0.227F + 0.176E$$

(65.9) (-5.3) (4.6)

where, F is foreign capital inflow and E is export earnings. The figures in parentheses are t-statistics.

According to his estimates, the impact of F on S was highly significant and approximately 23% of net foreign capital substituted for domestic saving. He, however, concluded that the negative impact of foreign capital inflow on domestic saving applies to ex-ante saving but not necessarily to ex-post saving, and "only in situations

characterised by a binding saving constraint and a slack trade constraint is the relationship between foreign capital and ex-post saving described by the ex-ante saving function"(49). Nonetheless, his test, designed to distinguish among alternative binding constraints, suggested that the saving constraint has more often been binding than the trade constraint(50).

The analysis made by Areskoug also targeted the deficiency of the two gap models in that they cannot explain the use of foreign capital for consumption purposes. He developed the hypothesis that broad policy shifts occur with capital inflows. He then examined the validity of the hypothesis through tests on annual data on 20 countries for the period 1948-68. The analysis he carried out helped to identify four main types of policy responses; an upward exchange rate shift, trade liberalisation, increase in government expenditure, and an expansion of bank credit(51). Thus, he concluded that by design or accident a large proportion of the capital receipts in the developing countries are utilised for consumption.

Following the work of Areskoug on economic policy responses to foreign aid, Heller constructed a model focusing on the several categories of public expenditure and of domestic and foreign revenues. His findings suggested that aid not only increased investment, but simultaneously facilitated a reduction in the level of

domestic taxes and borrowing. He found a much stronger bias toward an increase in public consumption and, indirectly through tax reductions, in private consumption(52).

While the early pessimistic empiricist analysis was still gaining momentum as well as widespread acceptance among academics of both developed and underdeveloped countries, some economists simultaneously started to question its methodology and findings since they found the latter suggestive rather than conclusive.

Section: 2-3-2

Later Reconciliatory Work

The empirical evidence of a negative relationship between domestic saving and capital inflow based on cross-section analysis was opened to serious questions by many critics. They argued that the statistical relationship as revealed by simple regression analysis does not tell us the direction of causation. Another main criticism was that cross-section analysis deals with a large group of countries which differ from each other with regard to size, openness, factor endowments, institutional background, and stage of development attained. These differences, they believe, can hardly be treated as random errors, and thus cross-section studies tend strongly to mis-specification.

Not being convinced by Rehman's findings, Gupta decided to run a regression for data on 50 countries,

including the 31 countries of Rehman's sample(53). Gupta's results contradicted Rehman's findings as the former found a positive, though statistically insignificant, relationship between the saving rate and capital imports(54). Gupta also carried out another test based on the same set of data, classifying all 50 countries on the basis of per-capita income level and forming three groups with per capita GNP of US\$124, US\$125-249, and US\$250-675, respectively. He then separately estimated the same domestic saving function for each group and found more revealing and consistent results than those for all the countries together(55). He thus concluded that the foreign capital inflows "instead of leading toward slackening of domestic saving efforts may actually intensify them"(56).

Kennedy and Thirlwall argued that a reduction in domestic saving would not necessarily result from an increase in foreign capital inflows, and even if it did, it should not lead to a rejection of capital imports if consumption is desirable or productive(57).

Stewart pointed out that even if foreign capital inflows finance projects with relatively high ICORs, it does not necessarily follow that the overall impact on the development effort should be negative. This would require the further assumption, she argued, that the non-aid effort is adversely affected to offset the rise in income due to capital imports. Otherwise, the impact of foreign

aid on future levels of income would still be positive(58).

Eshag supported Stewart's argument by concentrating on one of the implicit assumptions which is necessary for Griffin's conclusions to hold, namely, that the elasticities of supply of labour and of goods and services in LDCs are zero. Then by retaining the two-gap models' assumption of a dominant foreign exchange constraint and relaxing the assumption of zero supply elasticities (because of the unutilised redundant labour in most of the LDCs, and idle land and equipment), he argued that domestic saving will be expected to increase as a result of a foreign capital influx. This is because some idle domestic resources will now be used with the foreign resources for new investment projects(59).

Issawi advanced another counter-argument that it is not morally, politically or economically wrong or harmful for poor countries to raise their consumption levels, "even granting that it would have been better if they had used more for investment and less for consumption"(60). His most fundamental contention concerned, however, the regression equations showing an inverse correlation between aid and economic growth. He argued that in view of the complexity of the factors involved, such correlations are simply meaningless for "correlation does not indicate causation"(61).

Following Issawi's reasoning, Kellman maintained

that the causality might run from growth to aid rather than from aid to growth(62). In other words, aid might be flowing to the countries where growth is faltering and the domestic saving rate is insufficient to achieve the target amount of investment. To reinforce his point Kellman regressed growth in both national and per capita national income of forty countries on effective multilateral aid(63). His findings substantiated his suggestion that the strong negative relationship between aid and growth found by the early pessimists was partly due to an accidental choice of sample. In Kellman's larger sample, the coefficient, while still negative, was much lower than that of the smaller sample used by the former authors. Indeed, income per capita was slightly positively related to effective aid levels(64).

Papanek was next to disagree with the conclusions and methodology of the early pessimists(65). Indeed, the analysis he carried out made him agree with the criterion of "need" rather than "performance" in the actual disbursement of aid. Further, he disputed the 'behavioural hypothesis' developed by Rehman and endorsed by Griffin and Enos. He suggested that the negative statistical relationship between saving and foreign inflows found in the analyses of these authors can be in part the result of an "accounting convention" and not the result of a behavioural relationship(66). He was dissatisfied with the specification of econometric models,

and he distrusted the data used to generate the results. His contention was that the early pessimists used the term 'aid' to cover all capital inflows, including a reduction in foreign exchange reserves. Papanek doubted if the regressions run by these authors can prove anything in a causal sense about a negative relationship between foreign inflows and domestic saving and growth rates. He held that both low saving and growth are caused by a poor and deteriorating economic and/or political situation rather than by high inflows. He cites among the former 'exogenous' factors; political and military disturbances, terms of trade, weather and other shocks, and historically low or high saving propensities(67). To substantiate his point he took data from a sample of 34 countries for the 1950s and 51 countries for the 1960s. His examination of countries with high and low saving rates confirmed the significance of his argument(68). He attributed the negative correlation that he found between grant aid and domestic saving, to the causation explained in the foregoing. The correlation of foreign private investment and other foreign inflows with saving was not significant in his findings(69), which further confirmed his doubts about the argument that domestic saving respond negatively to the size of total foreign inflows. He then concluded that, "unless it is argued that the saving effort of less developed countries is reduced only when foreign resources come in the form of aid, not in other forms, our findings

lend no support to the case that saving respond inversely to foreign resource inflows"(70). Here he seems to share the views of the Rightist theoretical critics of aid who favoured all types of foreign resource inflows other than aid in grant(71). But insofar as his analysis found a substantially positive correlation between grant aid and growth, the two views cannot be treated as analogous(72).

It is interesting to note that Chenery, the architect of two-gap models, himself described the undesirable scenario of the negative correlation between domestic and foreign saving and ineffectiveness of the latter in raising the growth rate. Even before the early pessimists he noted, while speaking of Latin America, that "aid has been a substitute for saving, not an addition to investment. The saving rate has decreased and there has been no increase in the overall rate of growth of the gross national product"(73). But he suggested in later work, with Carter, that causality is the other way round. In their empirical observations for the 1960s the number of countries that had raised their saving rate as a result of the aid supported growth process generally far exceeded the cases in which diversion to consumption was demonstrated. Contrary to the logic of early pessimists, they concluded that "successful development has led to increased supply of external capital, whereas unsuccessful development has usually led to a reduction in the aid supplied"(74).

Gulati also disputed the view of the early pessimists about saving behaviour. As mentioned earlier, the latter reasoned that so long as the output-capital ratio is greater than the interest rate on foreign borrowing, it will be in the interest of a country to borrow as much as possible and substitute foreign for domestic saving. Gulati argued that the country's demand for foreign funds is not elastic in the first place. Secondly, even given the fact that foreign resources are available, the country does not necessarily start increasing consumption. As for the domestic saving effort, Gulati made a point of highlighting untapped domestic resources in the LDCs which either because of the laxity of the tax system or because of the relatively low domestic interest rate, do not show up in domestic saving since they "get invested directly by the small businessmen and farmers in land improvement, irrigation channels, housing, and so on"(75). In that he seems to draw on Bose's analysis where it is argued that "investment opportunities strongly influence rural household saving in economies in which financial institutions are very underdeveloped. In such conditions, saving and investment decisions are taken by the same household"(76). Bose argued that in view of the poor compilation of statistical information in most of the LDCs it could be taken for granted that these investments scarcely appear in the investment stream of national income accounts.

As for the empirical relationship between aid and growth, Gulati obtained significantly positive correlation between growth and capital imports of all kinds for a sample of 38 LDCs for the 1960s. His estimated regression equation is:

$$\begin{aligned} \ddot{Y} &= 0.80 + 0.26AKI + 0.30S \\ &\quad (2.95) \quad (3.27) \\ R^2 &= 0.24 \end{aligned}$$

where \ddot{Y} is the rate of growth of GDP, AKI is the ratio of all capital inflows to GDP, and S is the ratio of domestic savings to GDP.

Balogh, writing at the same time as Gulati, presented an extreme, yet convincing view that as the data considered by first phase and second phase authors came from the 1960s or earlier, it was difficult to suggest that the relationships analysed for that period still hold good or whether, he suggested, "they have collapsed under the stress of the world energy crisis"(78).

Mosley, taking into account the point raised by Balogh, conducted his analysis using 1970s' data(79). He found that the overall positive effect of aid on growth which Papanek observed for the 1960s had in large part vanished. What was apparent, taking the sample as a whole, was a weak and insignificant but negative correlation between aid and growth(80). However, his results indicated that for the thirty poorest countries out of his sample of 83, aid was positively correlated with growth and significantly so if it is lagged five years(81). In work

with Hudson, Mosley reworked Papanek's 1960s' data. Their results show that aid was not a significant influence on growth either in the 1960s or in the 1970s. Their conclusion is that "aid in the aggregate has no demonstrable effect on economic growth of recipient countries in either period"(82). Thus, they throw into doubt Papanek's positive view of the aid-growth relationship in the 1960s. Yet, the factor that moves Mosley closer to the two-gap school is his observation that "comparing the experience of the 1970s with that of the 1960s, a number of countries which grew fast and received high concessional aid inflows during the earlier decade continued to grow fast during the 1970s even though their intake of concessional aid had by then become negligible"(83).

Finally, at the theoretical level, there are a variety of scenarios one can outline from the works described in this chapter. However, we cannot make a priori judgement about the nature of the contribution that aid might have made to domestic saving and economic growth in Pakistan without assessing the relevant data. The subsequent chapters of this study are devoted to this task.

Foot Notes

1. There are, argued Keynes, three basic but profoundly deficient assumptions that laissez-faire theory makes: that economies are stable, that economies left to themselves tend towards a full employment level of output, and that, as a result, there is no case for government intervention to ensure stability and to promote full employment.

2. See, Michal Kalecki, "The Problem of Financing Development", Indian Economic Review, February, 1955, Vol. 2, No. 3, pp. 1-22.

3. See, W.W. Rostow, (i)"The Take-off into Self-sustained Growth", Economic Journal, March 1956, pp 25-44, (ii)"The Stages of Economic Growth: A Non-communist Manifesto Cambridge University Press, 1961.

4. See, Milikan and Rostow, "A Proposal: Key to an Effective Foreign Policy", New York: Harper, 1957, P. 49.

5. See, Rosenstein-Rodan P., "International Aid For Underdeveloped countries", Review of Economics and Statistics, May 1961, pp. 107-38.

6. Ibid; P. 107.

7. Ibid.

8. Ibid.

9. See the following:

(i) H.B. Chenery and M. Bruno, "Development Alternatives in an Open Economy: The case of Israel", Economic Journal,

March 1962, pp. 79-103, (ii) _____ and I. Adelman, "Foreign Aid and Economic Development: The Case of Greece", Review of Economics and Statistics, February 1966, (iii) _____ and A. MacEwan, "Optimal Patterns of growth and Aid: The Case of Pakistan", Pakistan Development Review, Summer, 1966, (iv) _____ and A.M Strout, "Foreign Assistance and Economic Development", American Economic Review, Vol. 56, no. 4, September, 1966, pp. 679-733, (v) _____ and P. Eckstein, "Development Alternatives For Latin America", Journal of Political Economy, 78, July/August 1970 (supplement), pp. 966-1006.

10. See, H.B Chenery and Nicholas G. Carter, "Foreign Assistance and Development Performance: 1960-1970", American Economic Review, No. 2, 1973, P. 459.

11. See, Chenery and Strout, op. cit., PP 689-90.

12. The ex-post or accounting identity of two resource gaps is an elementary formal proposition and can be demonstrated as follows:

$$Y + M - C + I + X \quad (I)$$

$$\text{or } Y - C + I + X - M$$

$$\text{and } Y = C + S \quad (II)$$

From (I) and (II) it can be seen that C is common to both sides of the equation and equation can be rearranged as:

$$I = S + M - X \quad (III)$$

This indicates that $M - X$ is the excess of imports of goods and services over exports, or the deficit (or surplus) on the current account of the country's balance

of payments. This must be identical with the net capital inflow (F), defined to include any net change in the external reserves of the economy. Thus:

$$M - X - F \quad (IV)$$

When (IV) is rearranged we have:

$$I - S - M - X - F$$

13. Ex-ante, looking forward, the resource gaps may differ because, in the long-run, those who make the decisions about saving, investing, importing and exporting are not always the same people and they are not all affected by the same factors. The situation can be illustrated by the following set of equations:

$$Y_t = Y_0(1 + r^{\bar{}})^t$$

$$I_t = r^{\bar{}} / \dot{U} (Y_t)$$

$$S_t = S_0 + s^{\bar{}} (Y_t - Y_0)$$

$$M_t = M_0 + m^{\bar{}} (Y_t - Y_0)$$

$$X_t = X_0(1 + x)^t$$

Where $r^{\bar{}}$ = target growth rate; \dot{U} = incremental output/capital ratio; $r^{\bar{}} / \dot{U}$ = required investment rate; $s^{\bar{}}$ = marginal domestic saving rate; $m^{\bar{}}$ = minimum marginal propensity to import; x = maximum anticipated rate of growth of exports which is assumed to be exogenously determined; and Y_t , I_t , S_t , M_t and X_t are absolute levels of income, investment, domestic saving, imports and exports respectively. The ex-ante gap is measured either by $I_t - S_t$ or $M_t - X_t$ and these are both a function of the growth rate ($r^{\bar{}}$), given the initial values of income,

saving, exports and imports and the exogenously determined rate of growth of exports (x).

14. The Incremental Capital Output Ratio implies the number of additional units of capital that are required to produce an additional unit of output, since similar units of capital may produce substantially different levels of output according to the efficiency with which they are employed.

15. See, Chenery and Strout, *op. cit.*, P. 679.

16. See, Henry J. Bruton, "The Two-gap Approach to Aid and Development: Comment", *American Economic Review*, Vol. 59, 1969 (2), pp. 439-446.

17. See, H.B. Chenery, "The Two-gap Approach to Aid and Development: A Reply to Bruton" *American Economic Review*, Vol; 59, 1969 (2), P. 446.

18. See, J. H. Fei and G. Ranis, "Foreign Assistance and Economic Development: Comment", *American Economic Review*, September, 1968, pp. 897-912.

19. See, Bruton, *op. cit.*,

20. See, Hla Myint, "International Trade and the Developing Countries", in P. A. Samuelson (ed.), "International Economic Relations", 1969.

21. See, K.B. Griffin "Foreign Capital Domestic Savings And economic Development", *Bulletin of the Oxford University Institute of Economics and Statistics*, 30, May, 1970, pp. 99-112.

22. See, V.R. Joshi, "Savings and Foreign Exchange Constraints", in Paul Streeten, (ed.), "Unfashionable Economics", Widenfeld and Nicholson, 1970, pp. 111-133.
23. See, Ian M. D. Little, "Economic Development: Theory, Policy, and International Relations", Basic Books, New York, 1982, pp. 148-9.
24. See, Ronald Findlay, "Some Theoretical Notes on the Trade Growth Nexus", in Gustav Ranis (ed.), "The Gap Between Rich and Poor Nations, MacMillan, 1972, London, pp. 270-80.
25. See, Jadish N. Bhagwati, "Trade Policies For Development", in Gustav Ranis (ed.), op. cit. pp. 245-69.
26. The term 'structuralism' is used in this study to embrace all groupings that include structural elements in their theoretical writings, and should not be interpreted narrowly as a consideration of only those theories that more narrowly are referred to as structuralist.
27. See. T. Mende, "From Aid to Reconciliation: Lessons of a Failure, Harrap, London, 1973.
28. See, F. M. Lappe, J. Collins, and D. Kinley, "Aid as Obstacle: Twenty Questions About Our Foreign Aid and the Hungry" Institute for Food and Development Policy, San Francisco, 1980.
29. See, D. Seers, and G. Myrdal, "The Withering of Aid, The Guardian, 2 July, 1982.
30. See, P. Jalee, "The Pillage of the Third World", Monthly Review Press, New York, 1968.

31. See, (i) T. Hayter, "Aid as Imperialism", Penguin, London, 1971, (ii)_____and C. Watson, "Aid: Rhetoric and Reality, Pluto, London, 1985.
32. See, R. E. Wood, "Foreign Aid and the Capitalist State in Underdeveloped Society", Politics and Society, Vol. 10, No. 1, 1980.
33. See, R. Carty and V. Smith, "Perpetuating Poverty__The Political Economy of Canadian Foreign Aid", Between the Lines, Toronto, 1981.
34. See, M. Friedman, "Foreign Economic Aid: Means and Objectives", Yale Review, No. 47, June 1958, pp. 501-16.
35. See, P. T. Bauer, "UNCTAD and Arica", Africa Spectrum, September, 1967, pp. 26-31.
36. _____ "Dissent on Development: Studies and Debates in Development Economics", Cambridge, Harvard University Press, 1972, P. 100.
37. See, M. Krauss, "Development Without Aid" McGraw Hill, New York, 1983.
38. See, T. Haavelmo , "Comments On W. Leontief's `The Rates of Long-run Economic Growth And Capital Transfers From Developed to Underdeveloped Areas'", Study Week On The Econometric Approach to Development Planning, Pontificiae Academic Scientiarum Scripta Varia, Amsterdam; North-Holland Publishing Company, 1965.
39. See, (i) M.A. Rahman, "The Welfare Economics of Foreign Aid", Pakistan Development Review, Vol. 7, no. 2, Summer, 1967, (ii)_____, "Foreign Capital and Domestic

Saving: A Test of Haavelmo's Hypothesis With Cross Country Data", Review of Economics and Statistics, 50, February 1968, pp. 137-38.

40. See, Rahman (1968), op. cit., P. 138.

41. See, Chenery and Strout, op. cit., pp 686-87.

42. See, Rahman(1967), op. cit., P. 317.

43. K.B. Griffin and J.L. Enos "Foreign Assistance: Objectives And Consequences" Economic Development And Cultural Change, Vol. 18, no. 3, April, 1970, pp. 313-27.

44. Ibid; P. 320.

45. Ibid.

46. Ibid.

47. T.E. Weisskopf, (i) "An Econometric Test of Alternative Constraints on The Growth of Underdeveloped Countries", Review of Economics and Statistics, Vol. 54, No. 1, February, 1972, (ii) "The Impact of Foreign Capital Inflows On Domestic Savings In Underdeveloped Countries" Journal of International Economics, Vol. 2, 1972, pp. 25-38.

48. See Weisskopf, The Impact of Foreign Capital Inflows, op. cit., P. 36.

49. Ibid.

50. See, Weisskopf, An Econometric Test of Alternative Constraints, op. cit.

51. K. Areskoug "Foreign Capital Utilisation And Economic Policies In Developing Countries, The Review of Economics And Statistics, Vol. 55, 1973, pp. 182-89.

52. P.S. Heller "A Model of Public Fiscal Behaviour In developing countries: Aid, Investment, and Taxation", *American Economic Review*, June, 1975.
53. K.L Gupta, "Foreign Capital and Domestic Savings: A Test of Haavelmo's Hypotheses With Cross-Country Data: A Comment", *The Review of Economics and Statistics*, May, 1970, pp. 214-16.
54. Ibid. P. 215.
55. Ibid.
56. Ibid.
57. See, Kennedy and A. P. Thirwall, "Foreign Capital, Domestic Savings and Economic Development: Comment", *Oxford Bulletin*, May, 1971, pp. 135-38.
58. See, F. Stewart, "Foreign Capital, Domestic Savings and Economic Development: Comment", *Oxford Bulletin*, May, 1971, pp. 138-49.
59. See, E. Eshag, "Foreign Capital, Domestic Savings and Economic Development: Comment", *Oxford Bulletin*, May, 1971, pp. 149-55.
60. See, Charles Issawi, "Foreign Assistance Objectives and Consequences: Comment", *Economic Development and Cultural Change*, October, 1971, No. 20, pp. 142-44.
61. Ibid; P. 44
62. See, Mitchell Kellman, "Foreign Assistance Objectives and Consequences: Comment", *Economic Development and Cultural Change*, October, 1971, No. 20, pp. 144-47.
63. Kellman used the multilateral aid as a regressor

because presumably it is a better measure for the cases where aid is directed according to some need criteria. See, Kellman *op. cit.*, P. 145.

64. *Ibid*; P. 146.

65. See, (i) Gustav F. Papanek, "The Effect of Aid and Other Resource Transfers On Savings and Growth in Less Developed Countries", *Economic Journal*, September, 1972, 82, pp. 934-50, (ii) "The Effect of Aid and Other Resource Transfers on Savings and Growth in Less Developed Countries: An Interchange", *Economic Journal*, September, 1973, pp. 870-74.

66. He argued that given the assumption which underlies all the empirical work, that saving equals investment minus foreign inflows, as long as the effect of an additional unit of foreign resources on investment is less than one, its effect on saving will appear to be negative. See Papanek (1972), *op. cit.*, P. 936.

67. *Ibid*; P. 939.

68. *Ibid*; P. 937.

69. See, Papanek (1973), *op. cit.*

70. See, (i) P. T. Bauer, *op. cit.*, (ii) Milton Friedman, *op. cit.*

71. See, Papanek (1972), *op. cit.*, P. 937.

72. See, Papanek (1973), *op. cit.*

73. See, H. B. Chenery, "Trade Aid and Economic Development" in S. H. Robock and I. M. Soloman (ed.), "International Development", Dobbs Ferry, N. Y., Oceana

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74. See, H. B. Chenery and Nicholas G. Carter, "Foreign Assistance and Development Performance: 1960-1970", American Economic Review, No. 2, 1973, P. 459.

75. Umesh C. Gulati, (i) "Foreign Investment and Domestic Saving: A Comment", The South African Journal of Economics, 44.4, 1976, pp. 442-445, (ii) "Foreign Aid, Saving and Growth: Some Further Evidence", Indian Economic Journal, 24 (7), Oct; Dec; 1976, pp. 153-60, (iii) "Effects of Capital Imports on Saving and Growth in Less Developed Countries", Economic Inquiry, Vol. 16, October, 1978, pp. 563-69.

76. See, S.R. Bose, The Strategy of Agricultural Development in Bangladesh", in E.A.G. Robinson and K.B. Griffin, (ed.), "The Economic Development of Bangladesh Within a Socialist Framework", John Wiley and Sons, New York, 1974.

77. See, Gulati, Foreign Aid, Saving and Growth, op. cit., P. 156.

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79. See, Paul Mosley, "Aid, Saving and Growth Revisited", Oxford Bulletin of Economics and Statistics, Vol. 42, no. 2, May, 1980.

80. Ibid; Table 1, P. 81.

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83. Ibid.

CHAPTER: 3

FOREIGN AID, DOMESTIC SAVING AND ECONOMIC GROWTH:

STATISTICAL ANALYSIS (Pakistan: 1960 to 1988)

Introduction

The essential feature of all foreign aid is the transfer of resources from the country granting the aid to the country receiving it. However, the effect on the recipient's economy of the utilisation of these additional resources cannot be determined a priori. The major aim of this chapter is to provide some quantitative evidence on the relationship between foreign aid, domestic saving and economic growth for Pakistan. We use time series data on each of these three variables to measure the extent and direction of relationships.

The chapter has been divided into three parts. Part one contains the hypotheses, methodology and the description of the data. Part two explores the correlation between aid and several other explanatory variables with Pakistan's saving rate, while part three attempts to analyse and explain the regression findings in terms of the effect of aid on economic growth.

Part: 1-3

The Framework of Analysis

This part is sub-divided into three sections. Section one sets the hypotheses being tested. Section two explains the methodology employed, and section three describes the data used for the regression models.

Section: 1-1-3

The Hypotheses

We intend to examine the impact of annual changes in net economic assistance receipt on changes in two indicators of economic development, domestic saving and economic growth. However, we also intend to examine the effect of some distinct types of foreign capital inflow separately. This seems necessary because different forms of capital inflow are very often of different nature and are used in different ways. Although it is not inappropriate to treat all capital inflow as a single homogeneous element in a statistical analysis, yet one cannot logically expect grants to affect domestic saving and economic growth in the same manner as other types of foreign capital inflow, such as foreign direct investment. By dividing foreign capital inflow into three distinct categories, foreign direct investment(1), grants(2) and loans(3), the analysis is also carried out in terms of their separate effects on the economy.

In this analysis, along with economic assistance, we also examine the impact on our dependent variables, of

annual changes in foreign exchange earnings via home remittances. The latter is a very important exogenous factor in any analysis carried out on data for Pakistan. The most significant economic development in the country between the later half of the 1970s and the first half of the 1980s has been the phenomenal growth of these earnings, mainly from the Middle East. As we will later explore in this study, remittances financed during these years an overwhelmingly large part of the trade deficit.

Our first hypothesis is that the levels of domestic saving and economic growth in Pakistan are inversely related to the levels of the inflow of foreign assistance. The second hypothesis is that different sources of foreign assistance may differ in their impact on domestic saving and economic growth.

Section: 2-1-3

Methodology

We are using single equation models for both domestic saving and GNP, formulated in the following manner(4).

$$Y = X\beta + \mu$$

Where Y is the $(n,1)$ vector of observations on the dependent variable, X is the (n,k) matrix of the n observations on the k explanatory variables, β is the $(k,1)$ vector of coefficients and μ is the $(n,1)$ vector of disturbances. The X matrix includes all the variables thought to be relevant to the model for Y . Further, as a requirement of single equation models, we treat the causal

relationship between X and Y as uni-directional, from X to Y.

To eliminate year-specific effects, we have introduced in our growth equations a set of year dummy variables by defining variables, D1, D2, and D3, for war and civil war, radical change in government policy, and weather respectively.

Further, in all the equations we have tried to include as many explanatory variables as possible, i.e., we adopt the "general to specific" search method. In practice, this amounts to specifying a general model consistent with economic theory. However, the form of the general model we have selected is limited due to the restrictions of the single equation models, degrees of freedom, data availability, and the multi-collinearity problem. We intend to estimate both restricted and unrestricted versions of the model for each dependent variable. The restricted version is formed under the restriction that the effect of foreign aid could only be measured when all aid is treated as an aggregate homogeneous inflow. This restriction is removed in the unrestricted version where aid is divided into three distinct forms in order to measure their separate effects. Also, we will generally impose straight-forward exclusion restrictions on our models. These restrictions are conducted on the basis of dropping those variables for which the t-statistic is less than one. The resultant

model is then subjected to evaluation. The models are estimated by using the econometric package DATAFIT.

Section: 3-1-3

The Data

As mentioned earlier, the explanatory variables in each model are chosen on the basis of their relative importance as postulated by economic theory, data availability, and the limitations of single equation models. The unit of measure is Pakistan's rupee. All the domestic variables are measured in constant market prices of Pakistan with 1959-60 as the base year. For international transactions we find no consensus in the literature regarding the choice of deflator. Given that the choice is largely arbitrary, we use throughout this study the GDP deflator of industrial countries for all international flows. The index has been calculated by using the average inflation rate of these countries as given in the Year Book of the 'International Financial Statistics' published by the International Monetary Fund (see, Appendix, Table 4-A). The other indices which could have been relevant are either that based on the average inflation rate of the developing countries or the world inflation rate. The problem with using the former is that the inflation rate in most of the Latin American countries is exceptionally high. In countries like Bolivia and Peru it runs in thousands of percent. Many of the African countries also face the problem of high rates of

inflation. The generally (and in some cases exceptionally) high rates of these countries are bound to increase the average for developing countries. The same problem is present while using the world inflation rate, albeit to a lesser extent. Further, more than half of Pakistan's imports come from industrial countries and about half of her exports are destined for the latter(5). Exports to the South American countries are less than one percent of the total, while the corresponding figure for imports is about one percent(6). The most important trading partners after the developed countries are the members of the OIC (Organisation of Islamic Conference) which account for about one fifth of Pakistan's total exports and about one fourth of her imports(7). Given that the country's major imports from the OIC consist of oil, the choice of industrial countries' GDP deflator is the more relevant.

All variables, except those of foreign capital inflow, are taken from the Pakistan Economic Survey for 1988-89 published by the Government of Pakistan. The foreign capital variables are taken from the International Monetary Fund, Balance of Payments Year Book (see, Appendix, Table 4-A). The transactions in the IMF source are recorded in rupee, US dollar and SDRs terms from 1960 to 1964, 1965 to 1971, and 1972 to 1988, respectively. The rupee and SDRs values are first converted into dollars, using the corresponding yearly exchange rates which are taken from the International Financial Statistics of the

IMF. The dollar values are then deflated by the GDP deflator of the industrial countries, with 1959-60 as the base year. And, in order to make them consistent with domestic variables, all inflows of foreign capital are converted into Pakistan's rupee using the official exchange rate for each year. Finally, although we have made our best effort to make our data as consistent as possible, it is always difficult for the statistical results, based on secondary data for developing countries, to be kept immune from data-related shortcomings.

Part: 2-3

Foreign Capital Inflow and Domestic Saving

Our purpose in this part is to collect evidence and examine whether Pakistan's case corroborates or contradicts Haavelmo's(8) hypothesis of an inverse relationship between domestic saving efforts and the inflow of foreign capital. This part consists of two sections. Section one first defines the saving model, and later it lists the results of the final regression analysis out of various regressions carried out on domestic saving as a dependent variable. Section two attempts to provide the relevant description of the results obtained.

Section: 1-2-3

Saving Model

For the statistical measurement of the relationship, we define the following two single equation saving equations.

Restricted Form Equation (1.3)

$$S_t/Y_t = \beta_0 + \beta_1 F_t/Y_t + \beta_2 REM_t/Y_t + \beta_3 RRI_t + \beta_4 PCI_t + \beta_5 S_{t-1}/Y_{t-1} + \mu$$

Unrestricted Form Equation (2.3)

$$S_t/Y_t = \beta_0 + \beta_1 FDI_t/Y_t + \beta_2 GRT_t/Y_t + \beta_3 CRE_t/Y_t + \beta_4 REM_t/Y_t + \beta_5 RRI_t + \beta_6 PCI_t + \beta_7 S_{t-1}/Y_{t-1} + \mu$$

where,

S_t = Domestic saving.

Y_t = Gross National Product.

F_t = All foreign assistance.

REM_t = Home remittances.

RRI_t = Real rate of Interest.

PCI_t = Growth rate of per capita income.

FdI_t = Foreign direct investment.

GRT_t = Foreign grants.

CRE_t = Foreign loans.

μ = Stochastic error term.

The addition of a lagged value of the dependent variable (S_{t-1}) is attributable to Brown(9), who assumed that people usually change their behaviour slowly and previous consumption affects current consumption and, hence, the level of domestic saving.

Our saving model also attempts to quantify the effects of foreign exchange earnings via home remittances on domestic saving levels for the reasons already mentioned in the foregoing.

We have complete data for 29 years, 1960 to 1988, and a total of 6 and 8 regressors for equations (1.3) and (2.3) respectively. A degree of freedom is lost in taking a lag, leaving 22 and 20 degrees of freedom respectively.

Using the method ordinary least squares to estimate our equations, we start with all the explanatory variables. Some preliminary regressions were run in order to determine which variables should be included in the final regression equation. By repeatedly employing alternative sets of explanatory variables in turn, we thus obtain our final estimated equations. Table 1-2-3 lists the estimated coefficients of relationships, explained in the following section.

Section: 2-2-3

Saving Model: Description of Results

Table 1-2-3 (a) lists the coefficients of all but two variables (REM_t , RRI_t) on the right hand side of our restricted form saving equation. The results render our first hypothesis only partially acceptable for the saving model, since the estimated coefficient on the foreign aid variable in equation (1.3) has a negative sign which is not significant at 95% level of confidence.

Table: 1-2-3

Estimated Regression Coefficients
Dependent Variable Domestic Saving
(Pakistan: 1960 to 1988)

(a)			
Equation (1.3)			
Regressor	Coefficient	t-Statistics	
i). Intercept	4.636	2.639*	
ii). F_t/Y_t	-0.097	-1.187	
iii). PCI_t	0.339	2.716*	
iv). SAV_{t-1}/Y_{t-1}	0.572	4.165*	
R-Squared	F-statistic	DW-statistic	CHI-SQ
0.472	7.15	1.38	2.855

(b)			
Equation (2.3)			
Regressor	Coefficient	t-Statistics	
i). Intercept	5.422	3.167*	
ii). FDI_t/Y_t	-2.029	-1.183*	
iii). CRE_t/Y_t	-0.348	-1.985*	
iv). PCI_t	0.348	2.982*	
v). SAV_{t-1}/Y_{t-1}	0.593	4.506*	
R-Squared	F-statistic	DW-statistic	CHI-SQ
0.544	6.866	1.407	1.760

F test of restrictions= 0.78

* Significant at 5% level.

Only four independent variables (FDI_t , CRE_t , PCI_t , and SAV_{t-1}) are retained in our final estimated unrestricted saving equation (2.3). The rest are dropped as the t-statistics for their estimated coefficients were less than one. Two out of three variables of foreign aid, i.e., foreign direct investment and loans turn out to be significant at 5% level. The independent variable for grants is dropped from the regression. However, the sign on its coefficient was positive, but the size was only 0.023 with a t-statistic of 0.200. The results of equation (2.3) render our first hypothesis acceptable for our saving model, i.e., a negative relationship between foreign aid and domestic saving is found. We also accept the second hypothesis, i.e., different types of foreign aid have different effects on domestic saving. First, the results show that the aid in outright grants has no measured effect on domestic saving. This result does not conform with the views of the Rightist critics of aid as described in the preceding chapter(10). Second, both foreign direct investment and loans are inversely correlated with domestic saving. The size of the coefficient on FDI is much larger, implying that a one percent of GNP increase in FDI, causes average saving to decline by a little over two percent(11). Our results show that every additional percent of foreign loans, as a proportion of national income, results in a decline of only about 1/3 per cent of average saving, and vice versa.

The negative impact of these variables is more than doubled in the long run because given the size and sign of the coefficient on the lagged dependent variable, the current year effect of FDI and loans is much smaller on domestic saving than is their long run effect. The long run solution of equation (2.3) is given in the following:

$$SAV_t = 13.617 - 4.986FDI_t - 0.855CRE_t + 0.856PCI_t$$

The relatively strong explanatory power of the unrestricted estimated equation (2.3) is indicative, of the importance of the domestic saving and aid relationship, as more than fifty percent of the variations in domestic saving are explained by the retained variables.

Our estimated coefficients of the relationship between domestic saving and foreign aid largely conform to the empirical work on the subject which listed a negative relationship between the two variables. Table 2-2-3 compares our estimated coefficients of the saving model with the estimates of some of the important studies discussed in the previous chapter.

Most of the authors listed in Table 2-2-3 are careful not to base their arguments exclusively on the statistical evidence, since they admit that the signs of the regression coefficients could have various interpretations. The size of the negative coefficient obtained by Griffin and Enos is very high, and as

Table: 2-2-3

Dependent Variable Domestic Saving or Investment
Estimated Coefficients For Resource Inflows
 (Comparative Magnitudes and Signs[12])

NO. Author	Total Observations	Coefficient
i). Rehman	31*	-0.25#
ii). Areskoug	22 [^]	0.40::
iii). Griffin & Enos	32*	-0.73#
iv). Chenery	16 [^]	0.64# to -1.15
v). Chenery	90*	-0.49#
vi). Chenery	90*	0.11::
vii). Weisskopf	38 [^]	-0.23#
viii). Papanek	85*	-1.00#
ix). Mosley	83*	-0.11#

* Cross sectional analysis.

[^] Time series analysis.

Coefficient for domestic saving.

- 12 out of 16 countries show a negative relationship.

:: Coefficient for investment (since saving in all calculations is defined as investment minus foreign inflows, a 0.40 increase in investment is equivalent to a 0.60 decrease in saving and vice versa).

mentioned earlier in Chapter two, Griffin lists a number of routes by which capital imports might lead to a reduction in domestic saving(13). Not all of these are convincing. Perhaps the most convincing of these relates to taxation and expenditure decisions. In the gap models the implicit assumption is that the government is prevented from achieving the saving ratio it desires by its inability to tax as much as it would like. The government will therefore prefer all extra resources available from the capital inflow to go to saving. But one does not have to believe in dual-gap analysis in order to justify the proposition that the provision of foreign exchange can make possible an increase in output and, thus, generate increased domestic saving without any specific act of thrift on the part of the community. The inference, therefore, is that the tax constraint which prevented the government from imposing an optimum saving ratio in the first place will also make it inevitable that some of the extra resources from the capital inflow go to consumption. Later in this study we will attempt to analyse this and some other aspects of the relationship between foreign aid and domestic saving in some length.

Part: 3-3

Foreign Capital Inflow and Economic Growth
(Pakistan: 1960 to 1988)

This part attempts to provide an estimate of the effect of the foreign capital inflow on the growth

performance of the national product of Pakistan. We define the growth models and list the results of the final estimated equation in section one, while section two attempts to describe the results.

Section: 1-3-3

Growth Model

We intend to estimate the following restricted and unrestricted versions of a single equation growth model:

Restricted Form Equation (3.3)

$$\ddot{Y} = \beta_0 + \beta_1 Ft/Y_t + \beta_2 REM_t/Y_t + D_1 + D_2 + D_3 + \mu$$

Unrestricted Form Equation (4.3)

$$\ddot{Y} = \beta_0 + \beta_1 FDI_t/Y_t + \beta_2 GRT_t/Y_t + \beta_3 CRE_t/Y_t + \beta_4 REM_t/Y_t + D_1 + D_2 + D_3 + \mu$$

where,

\ddot{Y} = Growth rate of GNP

D_1 = Dummy variable for wars and civil war.

D_2 = Dummy variable for radical change in government policy.

D_3 = Dummy variable for weather (average annual growth rate of agriculture over the period is 3.4 percent: $D_3 = 0$ if the growth rate ≤ 3.40)

We have run various regressions on our growth equation again using the ordinary least squares method of analysis. The results obtained are listed in Table 3-3-3. Interestingly, the results are quite instructive regarding the relationship between foreign capital inflow and economic growth in Pakistan.

Table: 3-3-3

Estimated Regression Coefficients
Dependent Variable Gross National Product
(Pakistan: 1960 to 1988)

(a) Equation (3.3)			
Regressor	Coefficient	t-Statistics	
i). Intercept	4.286	4.137*	
ii). F_{t-1}/Y_{t-1}	0.318	2.475*	
iii). REM_t/Y_t	0.131	1.531	
iv). D_3	-1.200	-1.473	
R-Squared	F-statistic	DW-statistic	CHI-SQ
0.255	2.734	2.154	0.285

(a) Equation (4.3)			
Regressor	Coefficient	t-Statistics	
i). Intercept	3.935	3.489*	
ii). CRE_{t-1}/Y_{t-1}	0.524	1.918*	
iii). GRT_{t-1}/Y_{t-1}	0.225	1.292	
iv). REM_t/Y_t	0.139	1.609	
v). D_3	-1.258	-1.533	
R-Squared	F-statistics	DW-statistics	CHI-SQ
0.279	2.226	2.194	0.384

F test of restrictions= 0.79

* Significant at five percent level.

Section: 2-3-3

Growth Model: Description of Results

Our estimated results for the growth equation do not suggest support for the conclusions of aid critics in general, and particularly of Griffin and Enos. The latter argued that foreign capital inflows ultimately could lead to a reduction in the rate of growth in GNP.

Table 3-3-3 shows that our final regression equations do not include coefficients on the contemporaneous values of any of the foreign aid variables, because the estimated coefficients of the current values of all these variables produced t-statistics which were less than one. However, except for foreign direct investment, none of the variables carried a negative sign on the estimated coefficients.

There is a convincing argument in the literature that to measure the effect of foreign aid on economic growth in the same year as the aid enters the recipient economy would be likely to underestimate seriously the effect of these flows(14). In order to judge this argument we have applied a minimum period of one year for the impact of foreign assistance to be felt. The one year lagged independent variable for the total inflow of all types of foreign aid (F_{t-1}), in equation (3.3), produces a significant and positive estimated coefficient of correlation. However, its size is small and implies that for the growth rate to increase by one percent in the next

year the foreign assistance should increase by 3 percent of GNP in the current year. The results that we have obtained for the lagged foreign aid variables in the unrestricted form equation (4.3) lend some support to the estimates of equation (3.3), since the lagged independent variable of foreign loans (CRE_{t-1}) turns out to be significant at 5 per cent level with a positive sign on the estimated coefficient. Aid in grant (GRT_{t-1}) also exhibits a positive effect on economic growth after one year of actual disbursement, but its estimated coefficient is not significant. Further, the effect of foreign loans on the dependent variable is more than double the effect of aid in grants. An increase of one percent of loans as a proportion of GNP increases the growth rate by about a half of one percent, while for the growth rate to increase by one percent the aid in grant would have to increase by about five percent of GNP. Given the results listed in Table 3-3-3, we reject our first hypothesis for the growth model as we do not observe a negative relationship between foreign aid and economic growth in Pakistan. However, we accept the second hypothesis also in this case, i.e, different forms of foreign aid have different impact on growth.

The R^2 of our estimated growth model exhibits a weak explanatory power, its size is only about 26 percent and 28 percent for equation (3.3) and equation (4.3) respectively.

Our estimates tend to contradict the conclusions of aid critics. Yet, so far as the effectiveness of aid in increasing the GNP growth rate is concerned, the results we have obtained remain essentially of a low profile and particularly so, in view of the optimism voiced by the architects of gap models. Also, our estimated positive coefficients on foreign aid variables are strictly subject to Bauer's criteria for the evaluation of the effectiveness of aid, i.e, it can be determined only after considering the factors behind economic development, and the repercussions of aid on policies and institutions and on the allocation of resources in the recipient countries(15). Indeed, for any meaningful analysis of the effects of foreign aid, the fundamental question is what international and domestic real resource shifts accompany international transactions, an issue that depends on the reactions of policy makers and private investors and consumers to these transactions. In developing countries the government sector is generally a major recipient of foreign capital, and its economic policies must be influenced by the varying supply of foreign aid capital. If the nature of this influence could be ascertained, the question of how foreign capital receipts are utilised might no longer seem so puzzling. For Pakistan, we will attempt to explore these important facets later in this study.

In order to compare our results with work already

Table: 4-3-3

Dependent Variable Gross National Product
Estimated Coefficients For Resource Inflows
 (Comparative Magnitudes and Signs[16])

NO.	Author	Total Observations	Coefficient
i).	Griffin	32	-6.78
ii).	Kellman	40	-1.20 [#]
iii).	Papanek	85	0.39 [^] 0.17 ^Y 0.19 [■]
iv).	Gulati	38	0.26
v).	Mosley	83	-0.94 [^] -0.72 [■]

- * All the results listed are based on cross-sectional analysis.
- # Kellman used the value of imports to deflate the aid flows while the other authors have deflated these flows by the gross national product.
- ^ Coefficient for aid in grant.
- Y Coefficient for foreign direct investment.
- Coefficient for other financial inflows.

carried out on the subject, we have listed results obtained by some of the major studies in Table 4-3-3. It can be seen that results we have obtained do not conform with all the previous investigations. Furthermore, our growth model differs from the formulations of the studies listed in Table 3-3-3 in that none of these authors have included dummy variables to eliminate year-specific effects.

Griffin and Enos, Kellman, and Mosley, all reported a negative coefficient for the relationship between foreign assistance and economic growth. The coefficients estimated by Kellman and Mosley are large while the coefficient that Griffin and Enos obtained appear to be comparatively very large. In Mosley's exercise R^2 falls as low as 8% and estimated coefficients are not significant(16), implying that foreign inflows do not have any effect on economic growth. However, Mosley in a later study with Hudson, contradicted one of the conclusions of the study referred to in Table 4-3-3, stating that in the 1970s middle-income recipient countries achieved higher aid effectiveness than did the poorest countries(17). Indeed, Mosley is one of the few who based analysis on a consistent and logical exposition, and formulated the framework of his statistical exercise in an innovative manner(18). The same cannot be implied for the analysis of Griffin and Enos, since they based their analysis on an apparently hostile exposition and simply regressed all the capital

inflows on gross national product.

Kellman's model differs in his measure of aid from our model and from all the other authors listed in Table 4-3-3. He used aid deflated by imports(19). In his opinion, the import shortages are often the effective constraint to growth in developing economies and the relevant measure of aid should be deflated by imports rather than by GNP. As described earlier in this study, this view is not shared by theoretical critics of aid who dispute the two-gap theory in its attempt to provide a rationale of foreign aid in terms of its role in filling the import gap.

Papanek's work is very revealing and consistent as it is based on a system of simultaneous equations(20). The results that he obtained coincide with our results to a fairly large extent. The sign on his estimated coefficient for aid in grants is the same as ours. However, he had that coefficient for the contemporaneous values of grants, while our estimate is based on one year lagged values of aid in grant. But, our results do not conform with Papanek's position on foreign direct investment, as he obtained a positive estimated coefficient for the latter. Finally, our estimated coefficient for foreign loans and the coefficient that Papanek obtained for other capital inflows (which necessarily implies loans for the large part) are both less than unity, significant, and carry a positive sign.

The studies reported in Table 2-2-3, and 4-3-3, made a useful and significant contribution in analysing the naive view of the benefits of foreign inflows. But the differing sizes, and signs in some cases, of the coefficients render their findings inconclusive. Moreover, the reliability of the studies by Griffin and Gulati is further weakened when their statistical base is taken into account, which in their studies is the deficit on the current account, usually taken as measuring foreign resource inflows. The, deficit is, of course, financed in a variety of ways: by aid (whether in the form of grants or loans), foreign private investment, short-term commercial borrowing, changes in foreign exchange reserves and even 'errors and omissions' and the liquidation of foreign assets abroad.

Although our regression has picked up some form and level of relationships between foreign aid, domestic saving and economic growth, it is an old adage that conclusions drawn from quantitative data will be as good as the quality of data upon which they are based. Insofar as the data we have used has been taken from the balance of payments statistics of Pakistan, it is a good measure. But the conceptual problems of lags, price differentials, and exchange rates still remain to be addressed. Furthermore, questions about the accuracy of data are by no means confined to the reliability of the statistics on aid inflows; they apply too to other aggregates like

growth rates, saving and investment schedules. As statisticians and national accounts experts continuously stress, the less developed a country the more likely it will be that national economic aggregates will be incorrectly calculated or estimated. Even more importantly, given the complexity of the political, administrative, social, technical, and demonstrative factors that together affect domestic saving and economic growth and are, in turn, affected by the inflow of foreign assistance, a sheer statistical exercise is essentially bound to miss out and misinterpret many important aspects. This is evident from the fact that between the early 1960s and the mid-1980s the literature on aid records well over 20 major statistical exercises conducted to resolve the question of the contribution of aid to raising economic growth. But there is little doubt that the results of these tests provide a far from reassuring picture.

Finally, the discussion and, by and large, the failure to provide conclusive evidence of a positive relationship between aid, saving and economic growth raises a fundamental question. Can the whole approach in the literature of attempting to derive a quantitative link between aid, saving and economic growth be expected to support or challenge the validity of the assertions of foreign aid theory? If the answer is 'no' then criticisms of foreign aid, some of which we have discussed in the preceding chapter, cannot be taken as convincing proof

that aid's insertion is misplaced. Hence, one is obliged to look into the real factors and form the chain of causation in order to be in a better position to judge the assertions of foreign aid theory. The following chapters, therefore, attempt to delve deeper into the aid and development controversy by examining the economic, political, social, and institutional factors that have determined the course of economic development in Pakistan, whilst the country was a major recipient of aid. In this context we will first attempt to provide some evidence and analysis in the following two chapters to argue that the positive relationship between saving and foreign capital as postulated by the aid proponents is not spontaneous, rather it depends on the level and direction of change of economic policy and on the political situation in the recipient country.

NOTES

1. The flows consist of, (i) the exchange record data on foreign investment in shares of companies registered in Pakistan and on other long-term investment net of repatriated foreign capital, (ii) data derived from special surveys, representing investment in the form of capital goods supplied to direct investment companies by their parent companies abroad and the reinvestment of

undistributed income.

2. The flows include Colombo Plan grants received, including grants from Canada, grants of agricultural commodities other than U.S., grants under various U.N. programmes, and grants from abroad to Indus Basin Development Fund (IBDF) and Tarbila Development Fund (TBF).

3. Covers both long-term and short-term loans and trade credits received by the private and public sector, excluding loans in Pakistan rupee from the U.S. Government.

4. See, IDS Working Paper No. 2: Econometric Methodology.

5. See, Pakistan Economic survey, 1988-89, Statistical Supplement, Table: 10.9, P. 162.

6. Ibid.

7. Ibid.

8. See, T. Haavelmo, "Comments on W. Leontief's 'The Rates of Long-run Economic Growth and Capital Transfers From Developed to Underdeveloped Areas'", Study Week on the Econometric Approach to Development Planning, Amsterdam; North-Holland Publishing Company, 1965.

9. See, T. M. Brown, "Habit Persistence and Lags in Consumer Behaviour", *Econometrica*, Vol. 20, No. 3, 1952.

10. See, (i) Milton Friedman, "Foreign Economic Aid: Means and Objectives", *Yale Review*, No. 47, June 1958, pp. 501-16, (ii) P. T. Bauar, "Dissent on Development: Studies and Debates in Development Economics", Cambridge,

Harvard University Press, 1972.

11. A large and significant negative coefficient of foreign direct investment renders it a serious concern to further investigate. But, the small share of FDI in total capital inflow to Pakistan mitigates its effect on the domestic saving rate of the country (see, Appendix Table 4-A).

12. The coefficients refer to the following studies respectively, (i) Rehman(1968), (ii) Areskoug(1973), (iii) Griffin and Enos(1970), (iv) H. B. Chenery and P. Eckstein(1970), (v&vi)_____and Elkington, and Sims, "A Uniform analysis of Development Patterns", Economic Development Report No. 148, Centre for International Affairs, Harvard University, (vii) Weisskopf(1972), Journal of International Economics, (viii) Papanek (1972), Mosley(1980).

13. See, K. B. Griffin, "Foreign Capital Domestic Savings and Economic Development", Bulletin of the Oxford University, Institute of Economics and Statistics, Vol. 30, May 1970, pp. 99-112.

14. See, Roger C. Riddell, "Foreign Aid Reconsidered", ODI, James Currey, London, 1988, P. 108

15. See, P. T. Bauer, op. cit.

16. The coefficients refer to following studies respectively: (i) Griffin and Enos(1970), (ii) Mitchell Kellman(1971), (iii) Papanek(1972), (iv) Gulati(1978), (v) Mosley(1980).

17. See, Paul Mosley, "Aid, Savings and Growth Revisted", Oxford Bulletin of Economics and Statistics, Vol. 42, No. 2, May 1980, P. 84.

18. See, Paul Mosley and J. Hudson, "Aid, The Public Sector and the Market in Less Developed Countries", University of Bath, Papers in Political Economy, Working Paper 0184.

19. See, M. Kellman, "Foreign Assistance Objectives and Consequences: Comment", Economic Development and Cultural Change, Vol. 20, October, 1971, P. 146.

20. Mosley used a lagged response of GNP to aid and a two-stage least-squares regression analysis. With Hudson he expanded the single equation to include the influence of estimates for changes in the stock of human capital and in export volumes and prices.

21. See, G. F. Papanek, "The Effects of Aid and Other Resource Transfers on Savings and Growth in Less Developed Countries", Economic Journal, September 1972, pp. 934-50.

CHAPTER: 4

FOREIGN AID AND DOMESTIC SAVING: GENERAL ANALYSIS (Pakistan: 1960 to 1988)

Introduction

Given the close nexus of saving, capital accumulation and growth, the need to understand the behaviour of the saving rate can hardly be overemphasised. This chapter attempts, therefore, to analyse the performance of domestic saving in Pakistan in terms of inter-country comparisons, saving theories, and several economic indicators.

The plan of this chapter is as follows. Part one compares the saving rate of Pakistan with those of the economic blocs and some Asian countries for the last eight years of the period of analysis in this study. Part two analyses the behaviour of average and marginal saving in Pakistan over the whole period. Finally, part three adds two further dimensions of domestic saving in Pakistan by segregating the total domestic saving into private and public saving, and by examining the behaviour of the two separately.

Part: 1-4

Inter-country Comparisons of Saving

Inter-country comparisons always have an element of artificiality. However, in the present case they may be helpful in determining the intensity of the effort for domestic resource mobilisation in Pakistan. Thus, in Table 1-1-4 we have listed the domestic saving rates in Pakistan for the last nine years of this study relative to the saving rates of the two major economic blocs and some Asian countries.

Regardless of the question of a negative or positive correlation between domestic saving and capital inflow in Pakistan, Table 1-1-4 explicitly shows the intensity of the problem of domestic resource mobilisation for the country. There are marked differences between the saving performance of Pakistan and that of the other countries listed in Table 1-1-4. The annual average of the saving rate of the country at 8.33% between 1980 and 1988 was less than half of the average of all developing countries, while during these years Pakistan was the fifth fastest-growing developing country(1). Nonetheless, this impressive growth performance was not accompanied by increased saving, as asserted by the two-gap theories of aid and development. The difference is even more marked when we compare the saving rate of Pakistan with some of the East Asian countries. The rates achieved by China,

Table 1-1-4

Comparative Domestic Saving Rates
(1980-88)[#]

(a) NO. Bloc/ Country	(b) Year/period									
	80'	81'	82'	83'	84'	85'	86'	87'	88'	80'-88'
<u>Bloc</u>										
1. North ^P	22	22	20	20	19	21	21	21	20	20.66
2. South [■]	24	23	22	22	23	23	24	25	20	22.88
<u>Country</u>										
3. China	31	30	32	32	33	34	36	38	37	33.66
4. India	20	20	22	20	20	21	21	22	21	20.77
5. Indonesia	30	23	19	29	30	32	24	29	25	26.77
6. Japan	31	32	31	30	31	32	32	34	33	31.77
7. Korea ^{☐☐☐}	23	22	24	26	30	31	35	38	38	29.67
8. Malaysia	32	26	25	32	35	33	32	37	36	32.00
9. Pakistan	6	8	9	10	9	8	8	9	8	8.33
10. Sri Lanka	14	31	12	14	20	13	13	13	13	15.88

Source:: The World Bank, "World Development Report", Issues from 1978 to 1990.

All figures are percentages of GDP.

P O.E.C.D.

■ Developing Countries.

☐☐☐ Korea, Rep, of.

Korea and Malaysia exceeded Pakistan's saving rate by about four times, while India's and Indonesia's domestic saving rates were more than double and triple respectively. Even the saving rate of a relatively small country like Sri Lanka, torn with civil war during the period, was fairly high relative to Pakistan. The most important thing to note is that the per capita GNP in China and India was less than in Pakistan during the period(2), thus ruling out the possibility of the existence of any phenomenon like the "vicious Circle of Poverty"(3). A particularly important thing in the context of this study is that Pakistan during this period received a much greater inflow of foreign aid, about three times, as a proportion of GDP than India. We have calculated the gross annual average capital inflow at the rate of 3.50% of GNP for Pakistan, as against 1.3% for India, during 1980 to 1988(4). Considering the more centralised and authoritarian political and administrative machinery in Pakistan than in India during these years, one would have expected the authorities in Pakistan to be capable of raising a higher rate of domestic saving by fiscal and monetary measures than authorities in India. Given that the saving rate in the former has been less than half that in the latter, it may follow that relatively greater success in its negotiations for foreign aid, indeed, induced authorities in the former to relax on the domestic saving front. The relatively lower level of GDP per capita

in India compared with Pakistan, strongly suggests that the country could have achieved a much higher saving rate, had it seriously intended to minimise external dependence. Hence, the dismal comparative performance of Pakistan in mobilising domestic resources as shown in Table 1-1-4, explicitly asserts the need for an extensive analysis of the behaviour of her domestic saving.

Part: 2-4

Domestic Saving
(Pakistan: 1960 to 1988)

This part analyses the behaviour of domestic saving in Pakistan in four sections. Section one lists the domestic saving rates along with some other ratios, while section two and section three analyse the behaviour of average and marginal saving respectively. Finally, section four examines the relationship between the domestic saving rates of Pakistan and aid inflows. One point is important to note: in the preceding chapter our analysis runs in terms of GNP, while in this chapter we are using GDP to calculate ratios of domestic saving and other relevant variables because for countries where the inflow and outflow of remitted income is about the same, or the difference is small, it is justifiable to consider saving as a percentage of GNP. For Pakistan, however, in recent years the inflow of income under this heading has been quite spectacular. Although our findings in the preceding chapter suggest that domestic saving is not significantly

related with remitted income for the period as a whole, there is little doubt that the inflow of income from this source played an important role in supporting the rate of national saving in the late 1970s and in the 1980s. This phenomenon is specific only to these years. In order to analyse the influence of domestic conditions and economic policies, domestic saving must be adjusted for the role of this variable in determining the saving rate of the country. This is particularly important in the present context because our purpose is to use the findings in this chapter as a background to the next chapter. Indeed, the analysis in this chapter is intended to be helpful in assessing the successes and failures of domestic economic policies in raising the propensity to save in Pakistan while she was receiving large amounts of external assistance. This consideration implies that it would be more appropriate if we adjust the saving rate for this difference.

Section: 1-2-4

Saving Rates

An implication common to the post-Keynesian theories of the saving function is that rapid increases in income exercise an important influence on saving behaviour(5). In other words, it can be inferred from these theories that the rate of growth of income is a major determinant of saving. Within the framework of these theories, this influence derives largely from lags in the adjustment of

consumption to rapid increases in income which, by raising transitory income relative to permanent income or current income relative to previous peak income, bring about a rise in the rate of saving. In the context of development in the low income countries, however, the positive impact of a rise in the rate of growth may not be limited to these short-term factors only. In the underdeveloped countries, higher growth rates can be instrumental in raising the rate of saving only when combined with several other factors. According to the line of argument described in the literature on development economics, a high rate of growth above a critical minimum level may be essential for a sustained increase in the rate of saving, and hence for sustained economic development(6). At lower rates of growth the potentially positive impact of an increase in income is thwarted by other forces generated by growth in the early stages of development which tend to depress domestic saving, e.g., a rise in the rate of population growth and the burden of dependency in the population as a result of an increase in fertility and a reduction in mortality brought about by higher incomes.

Each of the above factors might have played an important part in determining the domestic saving rate in Pakistan, but it is not particularly relevant for our purpose to quantify and analyse all these factor on their own. However, we do take account of the effect of population growth on saving by considering the growth rate

of per capita income. Table 2-2-4 lists the time series of average and marginal saving rates in Pakistan along with the growth rate of GDP, per capita GDP, and inflow of net economic assistance.

In Table 2-2-4, we have divided the 28 years period into five subperiods. This scheme encompasses medium-term planning in Pakistan. Also, it is interesting to note that the scheme of subperiods in Table 2-2-4, roughly coincides with the scheme in part three of Chapter One. The periods of the Second Plan and Third Plan, 1960-65 and 1965-70 respectively, largely represent the policies of Ayub Khan's military government. The Fourth Five Year Plan (1970-75), as mentioned in Chapter One, was shelved halfway through its course in 1972/73 and the economic policy-making in the country was carried out through 'rolling' Annual Plans up to 1977/78. We have designated the years between the Third and Fifth Plan as a Nonplan period. This period for the most part, consists of the civilian government of Zulfikar Ali Bhutto. The periods of the Fifth and Sixth Plan, 1978-83 and 1983-88 respectively, are exclusively covered by the military government of Zia-Ul-Haq. This scheme of policy regimes will be maintained in the following chapters as it is reckoned to be helpful for a consistent analysis.

Table: 2-2-4

**Domestic Saving, Gross Domestic Product and Foreign Aid
(Pakistan: 1960 to 1988)**

NO.	(a) Year	(b) Average Saving ^{***}	(c) Marginal Saving [#]	(d) GDP ^a	(e) GDP P.C ^p	(f) Foreign Aid ⁱ
1.	2nd Plan					
i)	1960-61	6.80	-6.04	5.66	2.98	7.91
ii)	1961-62	9.40	50.29	6.37	3.39	6.36
iii)	1962-63	13.06	61.74	7.58	4.57	9.87
iv)	1963-64	13.74	23.65	6.88	3.88	9.29
v)	1964-65	12.96	4.46	9.13	6.07	10.90
(i-v)	1960-65	11.19	31.50	7.13	4.18	8.87
2.	3rd Plan					
i)	1965-66	13.31	17.83	7.64	4.61	7.06
ii)	1966-67	11.45	-33.48	4.14	1.24	7.04
iii)	1967-68	10.70	-2.76	5.52	2.56	7.73
iv)	1968-69	9.47	-6.70	7.67	4.64	5.05
v)	1969-70	13.18	46.21	11.24	8.08	3.90
(i-v)	1965-70	11.60	10.20	7.24	4.23	6.12
4.	Nonplan					
i)	1970-71	12.27	-46.60	1.55	-1.41	4.06
ii)	1971-72	11.91	-12.90	1.46	-1.51	5.79
iii)	1972-73	13.60	39.41	6.55	2.43	2.37
iv)	1973-74	10.83	-41.29	5.32	2.20	3.38
v)	1974-75	8.41	-66.52	3.23	0.16	6.46
vi)	1975-76	9.97	43.86	4.61	1.50	6.19
vii)	1976-77	9.68	2.01	3.80	0.71	4.29
viii)	1977-78	8.30	-8.79	8.05	4.84	2.97
(i-viii)	1970-78	10.60	-3.40	4.32	1.12	4.43

FIGURE: 1-2-4

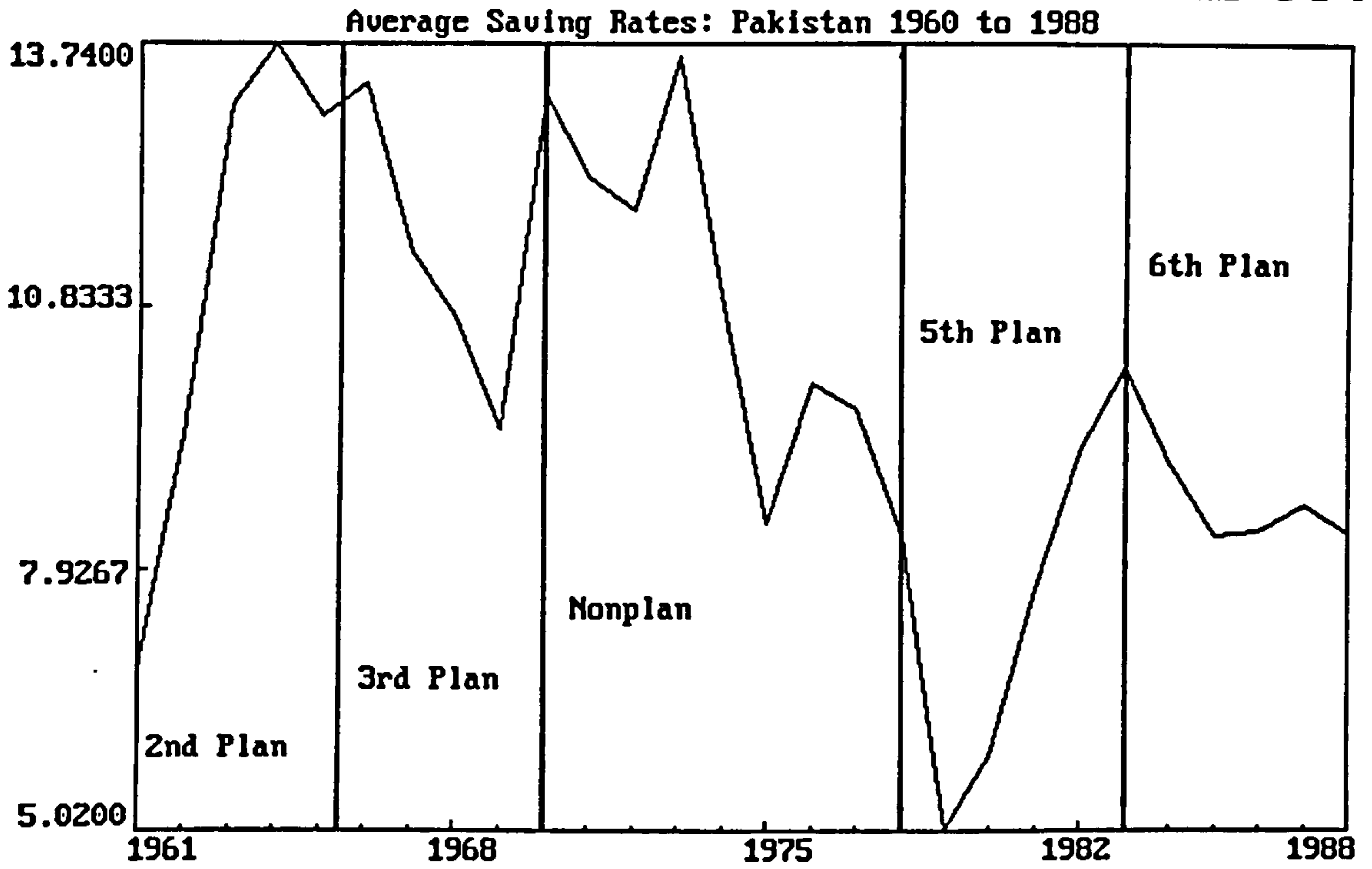


Table: 2-2-4 Continued.....

(a) NO.	(a) Year	(b) Average Saving [‡]	(c) Marginal Saving [#]	(d) GDP [■]	(e) GDP P.C ^p	(f) Foreign Aid ^ı
5. 5th Plan						
i)	1978-79	5.02	-63.72	4.76	1.66	2.60
ii)	1979-80	5.85	15.26	8.74	5.50	3.75
iii)	1980-81	7.70	34.91	6.89	3.73	1.32
iv)	1981-82	9.19	32.38	6.34	3.14	2.44
v)	1982-83	10.16	24.63	6.72	3.51	2.48
(i-v)	1978-83	7.59	8.69	6.69	3.50	2.52
5. 6th Plan						
i)	1983-84	9.10	-9.75	5.64	2.46	1.64
ii)	1984-85	8.29	-1.65	8.15	4.90	1.56
iii)	1985-86	8.34	8.99	7.84	4.60	1.96
iv)	1986-87	8.62	13.75	5.43	2.26	0.85
v)	1987-88	8.31	2.43	5.32	2.16	1.82
(i-v)	1983-88	8.50	4.40	6.48	3.28	1.57
(1-5)	1960-88	9.99	7.17	6.15	3.03	4.68

Source:: Appendix, table 1-A, 3-A, and 5-A.

- ‡ Domestic saving as percentage of GDP.
- # For each year the coefficients are calculated by $S_t - S_{t-1} / Y_t - Y_{t-1}$. The plan and nonplan averages are the means of yearly values of the coefficients. For the period as a whole the coefficient is calculated by running regression for the Keynesian saving equation, $S = a + bY$.
- Growth rate of GDP at constant market prices of Pakistan, 1959-60 is the base year.
- p Growth rate of GDP per capita at constant market prices of Pakistan, 1959-60 is the base year.
- ı Net foreign transfer as a percentage of GDP.

Section: 2-2-4

The Behaviour of Average Saving

The average rates of domestic saving over the period, listed in Table 2-2-4, have been plotted in Figure 1-2-4. No significant upward trend is observed in average saving over the period. During the Second Plan period the average saving demonstrates an upward trend for the first four years. In 1964 the saving rate is the highest of the whole period of analysis. After a slight decline in the last year of the Second Plan the saving rate picks up during the first year of the Third Plan. This is followed by a continuing decline until the last year of the Third Plan when the upward slope of the saving curve demonstrates significant recovery. This recovery is, however, short-lived as the saving rate again declines in the following year, the first year of the Nonplan period. During the Nonplan period the saving rate recovers only in 1973 when it demonstrates the second highest peak of Figure 1-2-4. Thereafter, it shows a declining trend for the next two years, while a marginal recovery in 1976 is followed by a secular downward slide until the second year of the 5th Plan, the saving rate plummeting to the lowest level of the whole period of analysis in 1979. Although the saving rate recovers after 1979, it generally remains much lower than the levels of the 60s' and the early 70s'. Furthermore, the recovery is soon followed by a generally declining trend during the Sixth Plan Years.

In order to have a clearer view of the behaviour of domestic saving in Pakistan, we calculated the time trend of average saving for the whole period of analysis and arrived at the following estimated regression equation:

$$S_t/Y_t = 12.24 - .16t \quad (1.4)$$

Both the actual and fitted values of average saving are plotted in figure 2-2-4 which demonstrates the negative slope of the curve representing fitted values, implying a constant declining trend of average saving over time. This result, however, appears misleading after we split the period of analysis into two equal length subperiods (from 1961 to 1974 and from 1975 to 1988) and run regressions for each of the two subperiods separately. Our estimated regression equations for average saving read as follows.

(a) From 1961 to 1974:

$$S_t/Y_t = 10.35 + .16t \quad (2.4)$$

(b) From 1975 to 1988:

$$S_t/Y_t = 8.03 + .02t \quad (3.4)$$

Three distinct changes are to be noticed: first, the sign of the time variable has changed from negative in equation (1.4) to positive in equations (2.4) and (3.4); second, the size of the coefficient on the time variable is much smaller in equation (2.4) as compared with that of equation (3.4); third, the size of the constant is lower in equation (3.4) than in equation (1.4) and equation (2.4).

FIGURE: 2-2-4

Average Saving Rates and Time Trend

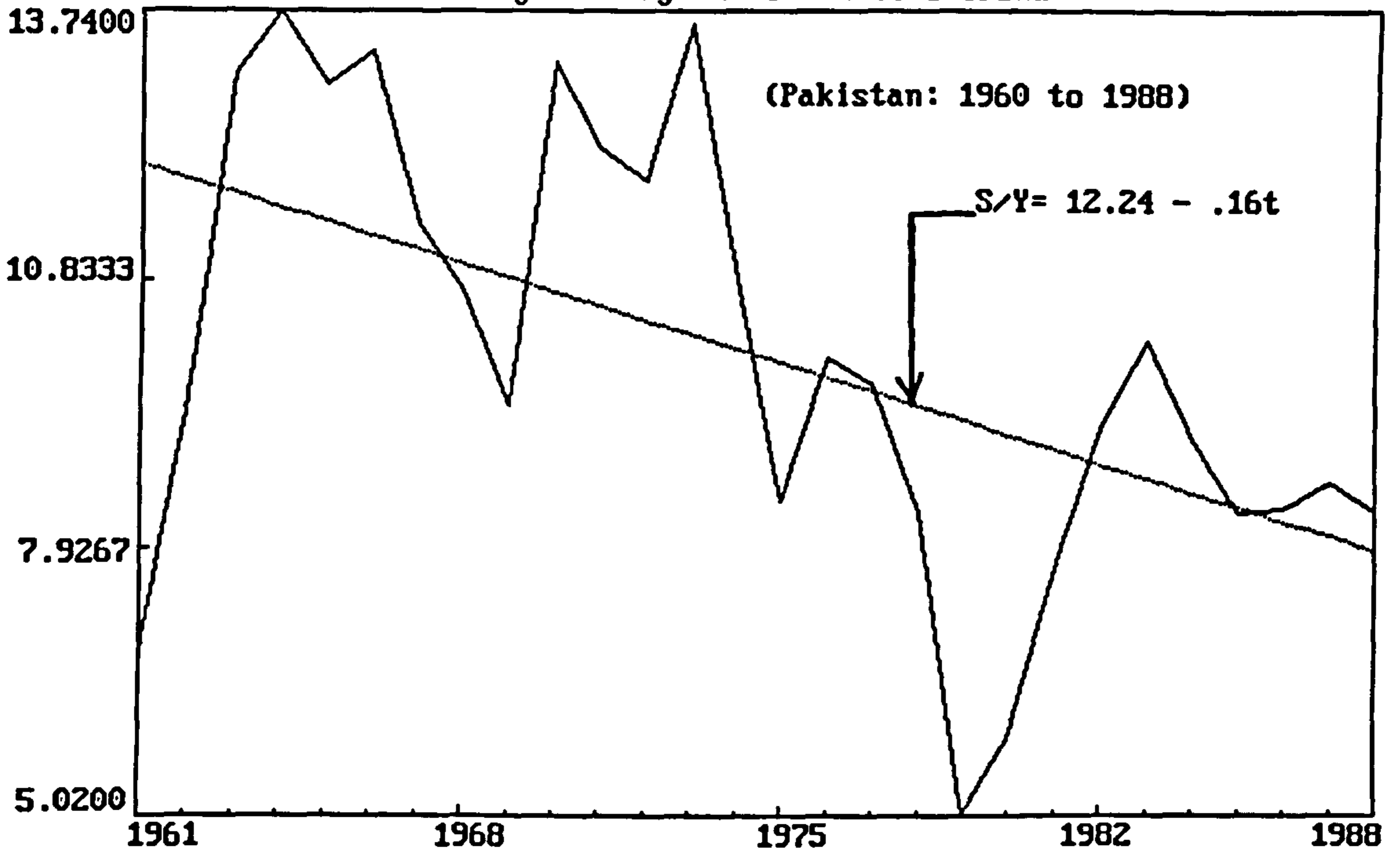


FIGURE: 3-2-4

Average Saving Rates and Split Time Trend

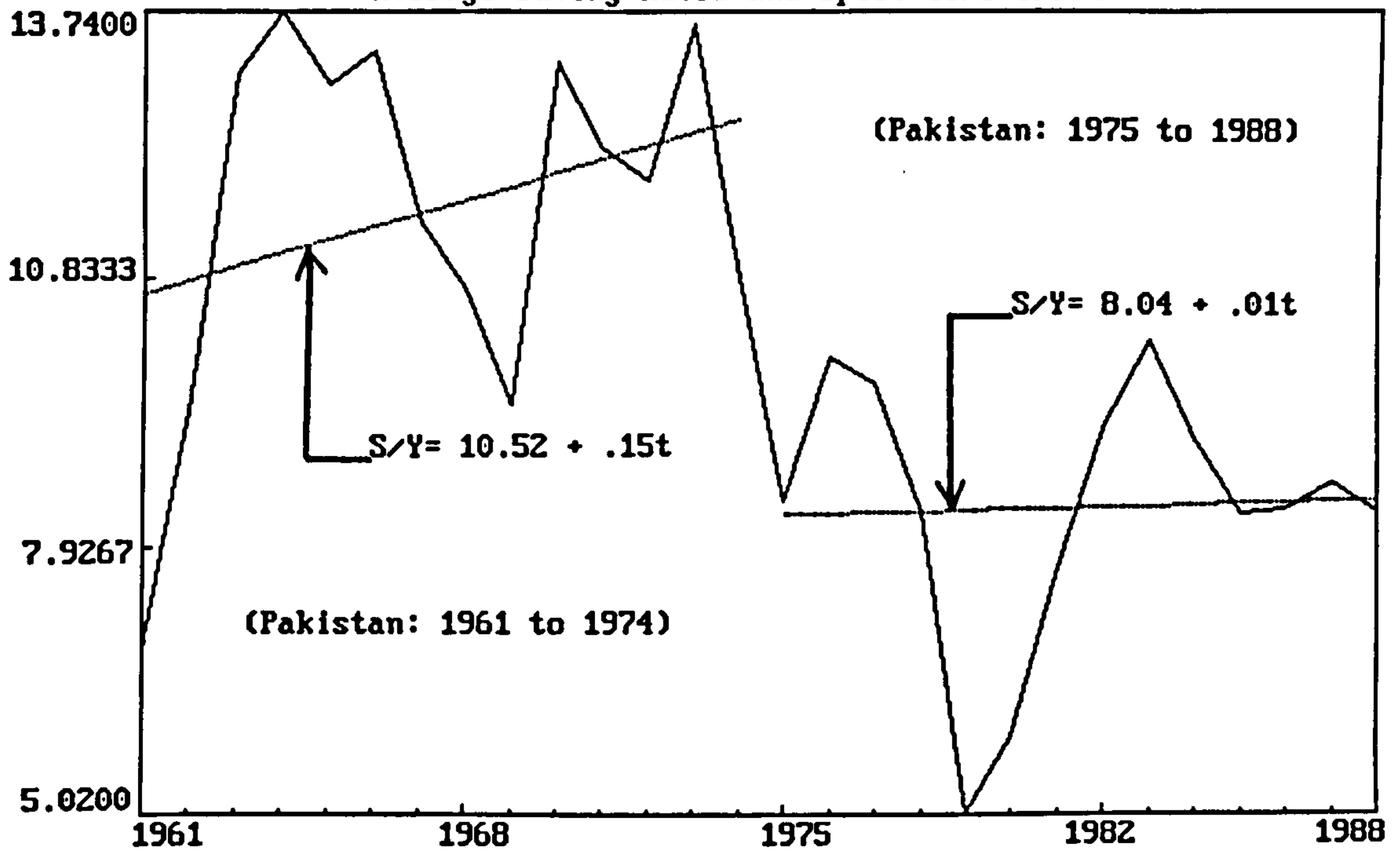


Figure 3-2-4 plots the actual and fitted values of average saving with a split time trend. The curves representing fitted values for the first period (1961 to 1974) demonstrate a positive slope which is much higher than the slope of the curve representing fitted values for the second period (1975 to 1988). The latter demonstrates fluctuations in the saving rate around an almost horizontal secular trend. This long-run proportionality of the saving rate at relatively low levels is different from that hypothesised by the post-Keynesian theories of saving. These theories envisaged the proportionality hypothesis in the context of steady-state growth, i.e., in the context of growth along a long-term equilibrium locus(7), while the long-term may be conceived as the one over which excessive short-term disequilibria even out. But the developing countries as a norm do not fit into this scheme of an equilibrium model, especially in the early stages of the growth process. In their case, the short-term disequilibria may instead be thought of as being super-imposed on an underlying long-term structural disequilibrium. In fact, it is the latter that more than anything else differentiates these countries from the developed ones. Also, it constitutes the major substance of the theory of critical minimum effort and the low level equilibrium trap(8). A developing country may be regarded as coming of age in terms of economic viability once it is strong enough to overcome this disequilibrium, a growing-

up process which is both arduous and long. The long-term disequilibrium is a composite phenomenon in the sense that it is constituted by persistent disequilibria in various sectors of the economy; for example: the disequilibrium between the existing socio-cultural milieu and the demands of the growth process, requiring substantial institutional reforms; the disequilibrium between the traditional models of production and technological advancement in an increasingly competitive world market; the disequilibrium characterised by the changes in the distribution of income brought about by the growth process; the disequilibrium between saving and investment, between resources and aspirations, and so on.

As a poor country embarks on the road to development, experiencing increases in income and narrowing down some of these gaps, one would expect a priori that a concomitant of this process is a sustained increase in the proportion of domestic resources that are set aside for investment. For example, this process could be seen working in the Lewis model with unlimited supplies of labour where growth in the economy and an expanding modern sector are accompanied by a sustained increase in the rate of saving(9). Of course, this notion is not limited to this model alone. It runs through the whole literature of development economics.

The upshot of this discussion is that in Figure 3-2-4 the higher upward slope of the fitted values during 1961

to 1974 conforms with both the process hypothesised by post-Keynesian saving theories and the saving theories of development economics. But the observed constancy of fitted values at relatively low levels during 1975 to 1988 in Pakistan, as portrayed in Figure 3-2-4 by fitted values of equation (3.4), cannot be designated as a phenomenon of long-run proportionality between saving and income as hypothesised by the permanent income and other post-Keynesian models. On the contrary, the phenomenon represents a result that contradicts a priori expectation based on the saving theories of development economics. Thus, the observed proportionality between saving and income in the case of Pakistan over a long period is a case of stagnation in the rate of saving rather than a steady-state equilibrium. Indeed, it is an explicit manifestation of the failure of a strategy of development that has to be explored and analysed by relating it to the relevant economic and institutional variables. Such an investigation appears particularly relevant in view of what we observe for Pakistan in figure 3-2-4. The curve plotting fitted values of equation (3.4) demonstrate a much lower intercept [compared with the curve plotting the fitted values of equation (2.4)], which is an explicit pointer to some sort of serious disequilibria in the economy of Pakistan which occurred during that period.

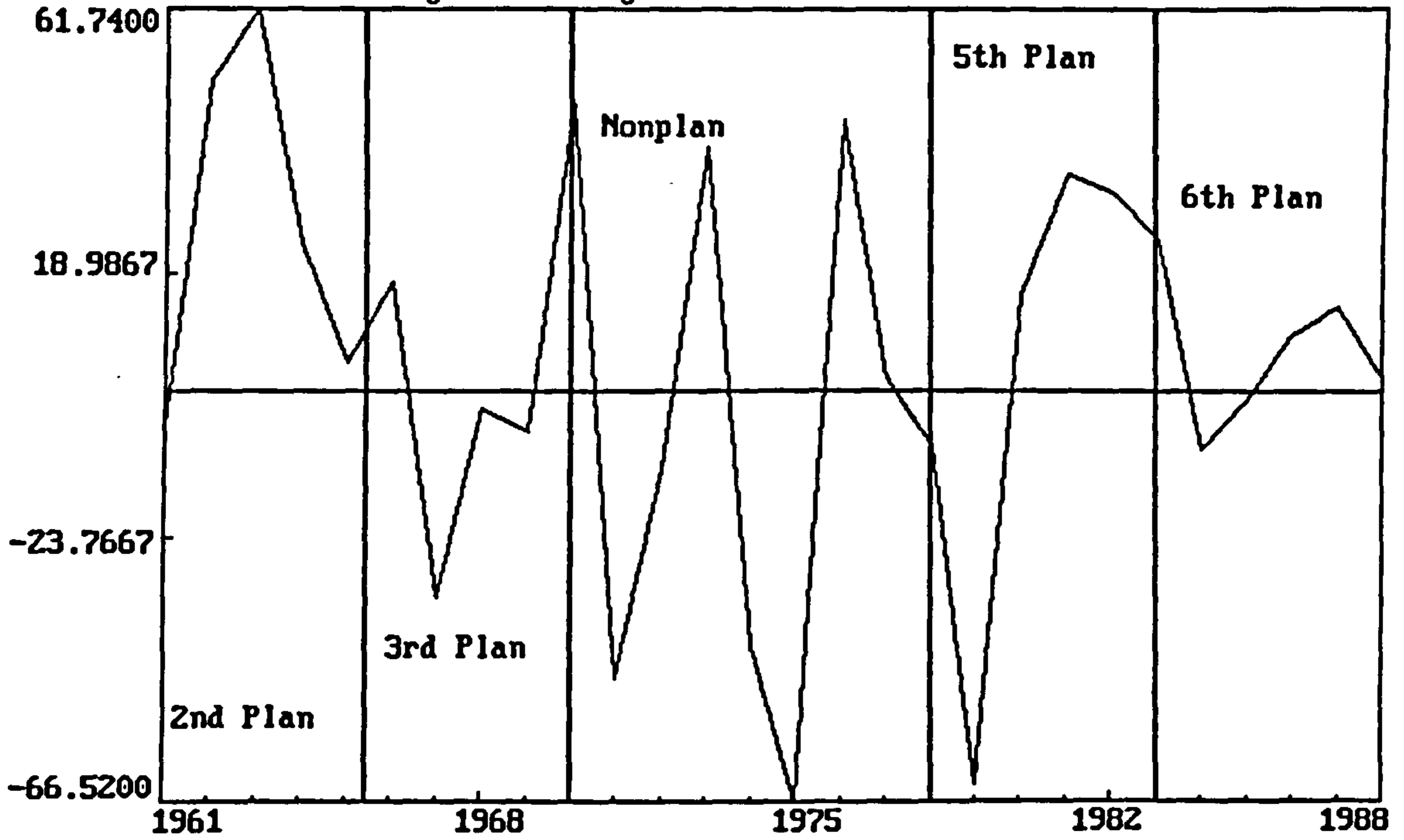
Section: 3-2-4

The Behaviour of Marginal Saving

Figure 4-2-4 plots the rates of marginal saving listed in column (c) of Table 2-2-4. The marginal saving curve exhibits wide margins of fluctuations over the period of analysis. During the Second Plan marginal saving registered the best record of performance over the whole period of analysis. We observe in Figure 4-2-4 that marginal saving, which lies in the negative segment during the first year of the Second Plan period, moves into the positive segment with a steep upward slope during the next two years. This is followed by a steep downward movement of the curve during the last two years of the Second Plan. The positive slope during the first year of the Third Plan is not sustained and the curve again plummets into the negative segment. But the steepest and longest plunge of marginal saving in the negative segment of Figure 4-2-4 is observed during the Nonplan period. Out of a total of eight years the marginal saving curve lies in the positive segment only during 1973, 1976 and 1977. The steep downward sloping movement of the curve during the first year of the 5th Plan period is followed by fluctuations in marginal saving taking place in the positive segment of Figure 4-2-4 during the next four years. During the Sixth Plan period the movements in the slope of curve do not demonstrate wide margins of fluctuations in marginal saving as observed during the

FIGURE: 4-2-4

Marginal Saving Rates: Pakistan 1960 to 1988



1960s and 1970s.

By calculating the time trend of marginal saving in Pakistan for the period as a whole we arrive at the following estimated regression equation:

$$S_t - S_{t-1} / Y_t - Y_{t-1} = 10.35 - .42t \quad (4.4)$$

The actual and fitted values of marginal saving are plotted in Figure 5-2-4. The curve representing fitted values demonstrates a declining tendency of the marginal saving behaviour over time. This result, however, partially conform with the scenario of the time trend of marginal savings after splitting the period of analysis into two equal length subperiods from 1961 to 1974 and from 1975 to 1988. The estimated regression equations for each of the two subperiods are given in the following:

(a) From 1961 to 1974:

$$S_t - S_{t-1} / Y_t - Y_{t-1} = 36.13 - 3.46t \quad (5.4)$$

(b) From 1975 to 1988:

$$S_t - S_{t-1} / Y_t - Y_{t-1} = -46.15 + 2.14t \quad (6.4)$$

Figure 6-2-4 plots the actual and fitted values of marginal saving with a split time trend. A very interesting picture emerges. The curve representing fitted values of equation (5.4) slopes downwards, a scenario which conforms with the plotting of equation (4.4) in Figure 5-2-4. But fitted values of equation (6.4) demonstrates an upward slope, while the intercept lies very low in the negative segment of Figure 6-2-4. The negative value of the constant in equation (6.4) now

FIGURE: 5-2-4

Marginal Saving Rates and Time Trend

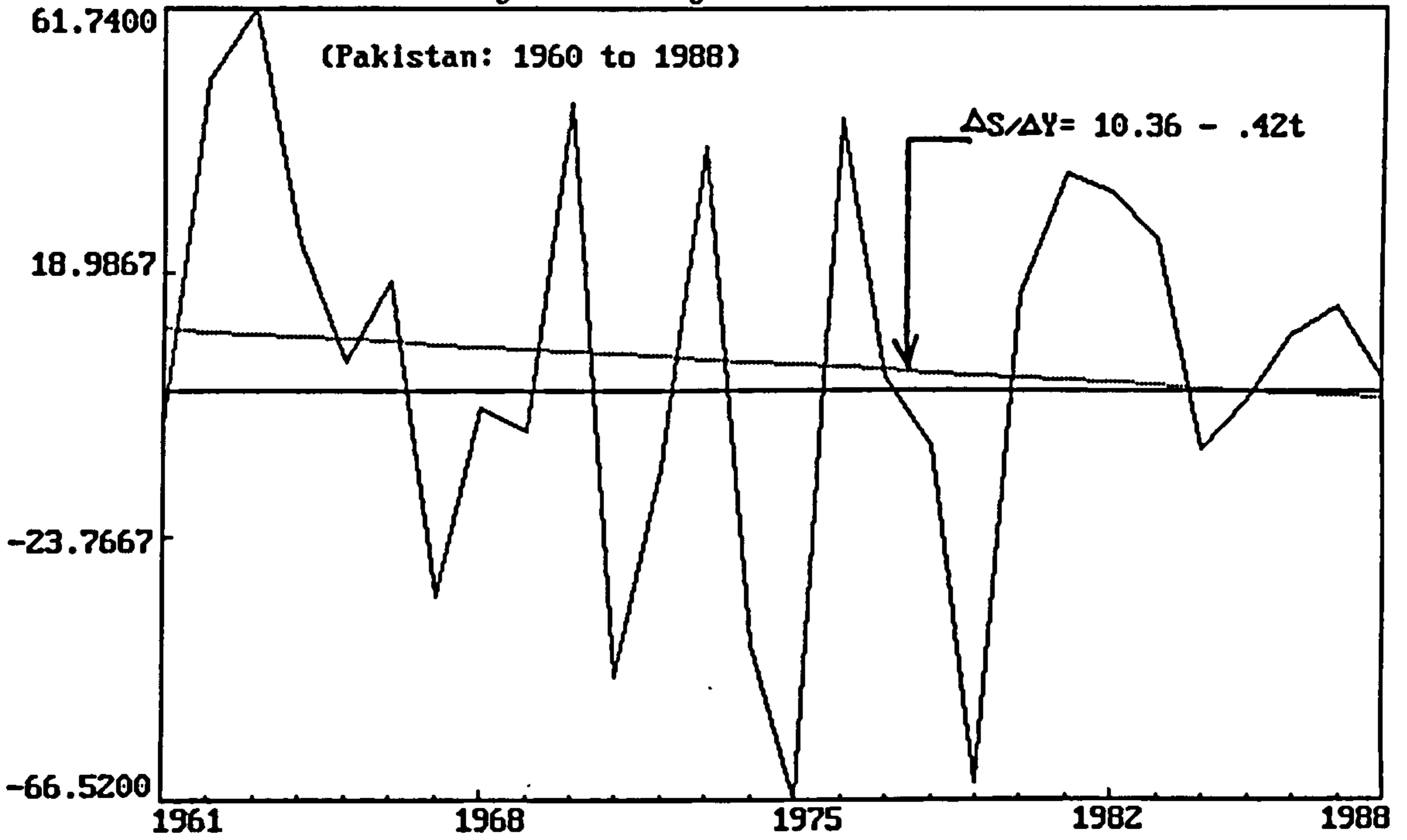


FIGURE: 6-2-4

Marginal Saving Rates and Split Time Trend

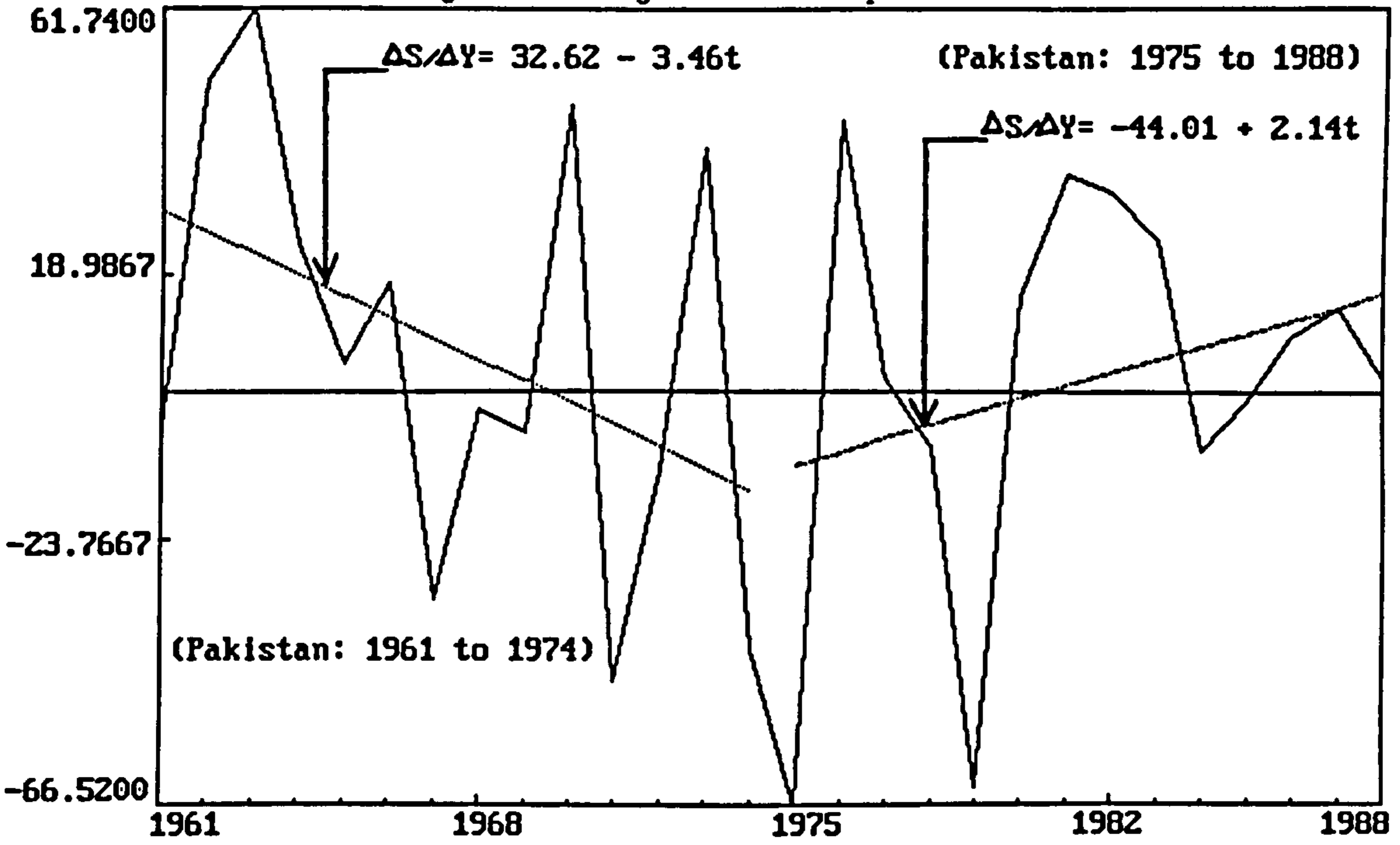
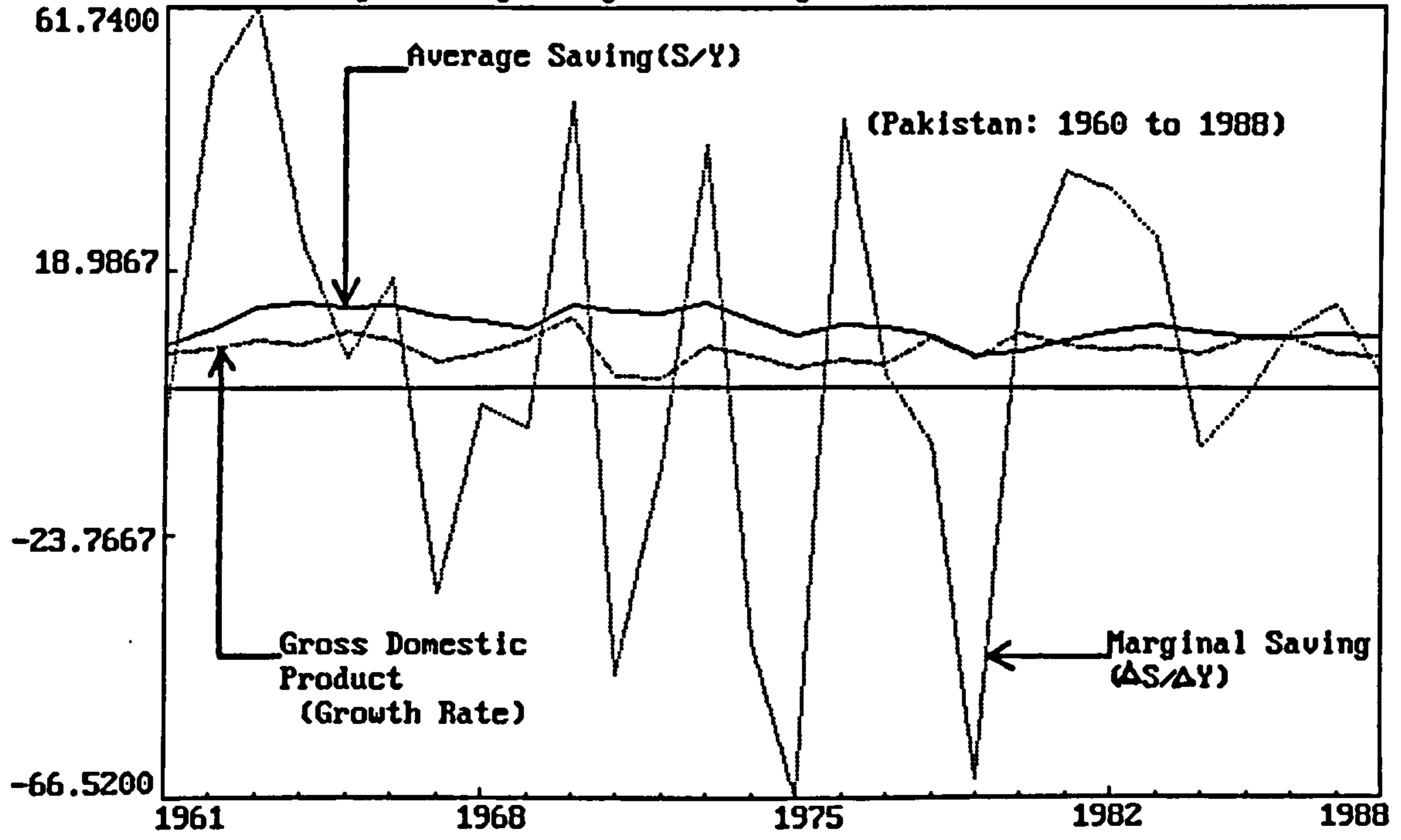


FIGURE: 7-2-4

Average Saving, Marginal Saving and Gross Domestic Product



provides an explanation for the decrease in the value of the constant in equation (3.4), which gives the estimated time trend of average saving during 1974 to 1988. Though due to some sort of disequilibria (which persisted or occurred in the economy of Pakistan) the constant for marginal saving became negative which caused a drop in the value of the constant for average saving, but the saving habit persists in the society since equation (3.4) and (6.4) both have positive gradients

The most revealing trend to be noted in Table 2-2-4, in the context of the gap models is that out of a total of 28 years the rates of marginal saving were negative for 13 years, while they were below the average saving rates for three years. Furthermore, the average annual marginal savings rate at 7.17% for the period as a whole lies considerably below the corresponding average saving rate of about 10 percent. The two-gap models, described in Chapter Two, visualise capital imports as having two effects, (a) increasing the level of investment directly by the amount of the aid, and (b) increasing the rate of capital accumulation indirectly by raising the level of income and the rate of domestic saving. The latter essentially requires marginal saving to be greater than the average. That is, it is imagined that all aid is invested, and this leads not only to a higher level of income but also to a larger proportion of income being saved. As given in Table 2-2-4, the time path of

Pakistan's growth rate of GDP, apart from a few years, is quite satisfactory, with an overall growth rate of 6.15% over the 28 years period of study. Further, if we exclude the generally dismal Nonplan years, the average growth rate over the planned period is 6.88 percent. Figure 7-2-4 plots the time series of Pakistan's growth rate of GDP, and average and marginal saving rate. Close examination of Figure 1-2-4, 4-2-4, and 7-2-4 together vividly explains the major factor behind the country's perpetual dependence on foreign aid in the light of assumptions of the gap models. As mentioned earlier, for growth to eventually become self-sustained, a necessary condition of this analysis is that with an increase in income, the marginal rate of saving must exceed the average. In the case of Pakistan, the time series in Table 2-2-4 shows the marginal rate exceeds the average only for 13 years over the whole period of analysis, while on the whole it lies below the average rate of saving. Hence, the observed behaviour of the saving rate in Pakistan does not conform with the basic requirement of gap analyses.

Section: 4-2-4

Domestic Saving and Foreign Aid: Rate of Change

In order to gauge the relationship between the movements in the rates of domestic saving and foreign aid ratios, we have calculated the rates of change in the Plan and Nonplan averages of the two variables listed in Table 2-2-4, columns (b) and (f) respectively. The results are

presented in Table 3-2-4. These proportions lead to quite interesting findings concerning the assumptions of the gap models, statistical analysis of the aid critics, and our own statistical results listed in Chapter Three.

In Table 3-2-4 column (d) lists the rate of of change in Plan and Nonplan averages of saving ratios (column [di]) and the change in corresponding foreign aid ratios (column [dii]). Both rates of change in subcolumns (di) and (dii) carry different signs for entry one. Column (di) shows a 3.66% increase in domestic saving during the Third Plan period over the average of the Second Plan, while column (dii) shows a 31.10% decrease in the corresponding aid ratio, a negative relationship. Entry two, however, lists a positive relationship between domestic saving and aid levels as both variables register a decrease in column (d) during the Nonplan period over the average of the Third Plan. A similar result is reported in entry three. However, the evidence of a negative relationship is again repeated between the corresponding averages for 5th Plan and 6th Plan.

Given the evidence in column (d) of Table 3-2-4, no firm conclusion can be drawn regarding any definitive one-to-one relationship between domestic saving and foreign aid. Only between two subperiods, between the 2nd 3rd Plan and again between 4th and 5th Plan, do we find evidence of

Table: 3-2-4

Domestic Saving and Foreign Aid
The Rate of Change^p
(Pakistan: 1960 to 1988*)

NO.	(a) Subperiod	(b) Domestic Saving [■]	(c) Foreign Aid [■]	(d) Rate of Change	
				(di) Domestic Saving [■]	(dii) Foreign Aid [#]
	i) 1960-65	11.19	8.87	—	—
	ii) 1965-70	11.60	6.12	—	—
1.	1960-65 to 1965-70	—	—	3.66	-31.10
	iii) 1970-78	10.60	4.43	—	—
2.	1965-70 to 1970-78	—	—	-8.62	-27.61
	iv) 1978-83	7.94	2.52	—	—
3.	1970-78 to 1978-83	—	—	-25.09	-43.11
	v) 1983-88	8.50	1.57	—	—
4.	1978-83 to 1983-88	—	—	7.05	-37.69

Source:: Table 2-2-4.

^p Change in the subperiod average of the variable relative to the average of the subperiod that preceded, e.g, i-ii/i.

* All figures are percentages.

■ Percentage of GDP.

■ Calculated from column (b).

Calculated from column (c)

a negative relationship between the two variables. But we have also found evidence of a positive relationship between the two variables, where a decline in one is accompanied by a decline in the other.

Finally, the analysis that we have carried out so far in this chapter, is a basis for continuing on a consistent line of reasoning in the following chapter. But before moving into that, we intend to analyse in part three of this chapter, another important dimension of the behaviour of domestic saving in Pakistan.

Part: 3-4

Performance of Public and Private Saving
(Pakistan: 1960 to 1988)

There have been quite a few studies on saving in Asia, for example, Fry(10) Giovannini)(11), Gupta(12), Ravillion and Sen(13) and Rossi(14). All of these studies have analysed total domestic saving without distinguishing between private and public savings. This is a valid procedure only under the strong assumption of Ricardian equivalence which yields automatic and complete neutralisation of any variation in government saving by opposite movements in private saving(15). However, serious doubts have been raised about the validity of Ricardian equivalence(16). There is greater room for these doubts where the country in question is not only an underdeveloped economy, but is also a major recipient of economic assistance. Insofar as official assistance is

given directly to the government, the latter may cause a drain in the domestic effort of resource mobilisation by unjustifiably increasing its non-development expenditures. Therefore, we now focus attention on the private and public components of the aggregate domestic saving in order to examine how the patterns and trends in the latter are explained by developments in these components.

Table 4-3-4 lists the ratios of private and public saving in Pakistan, following the yearly and periodic scheme adopted in Table 2-2-4. Public saving is taken here as identical to "surplus on revenue account" as given in the Economic Affairs Division documents of the Government of Pakistan. This surplus is deducted from gross domestic saving to arrive at the private share of total saving.

Figure 8-3-4 portrays the ratios listed in Table 4-3-4. The two curves depict very unstable movements in private and public saving. As shown in the figure, private saving was generally at a low relative level during the Second Plan period. And, with the exception of the first year of the Plan, the curve representing public saving lies above its private counterpart. The former shows a secular upward trend over the period of the Second Plan, implying that fiscal policy was working quite effectively to make up for the dismal private effort at domestic resource mobilisation.

During the 3rd Plan period the private saving rates

Table: 4-3-4

**The Rates of Private and Public Saving
(Pakistan: 1960 to 1988^p)**

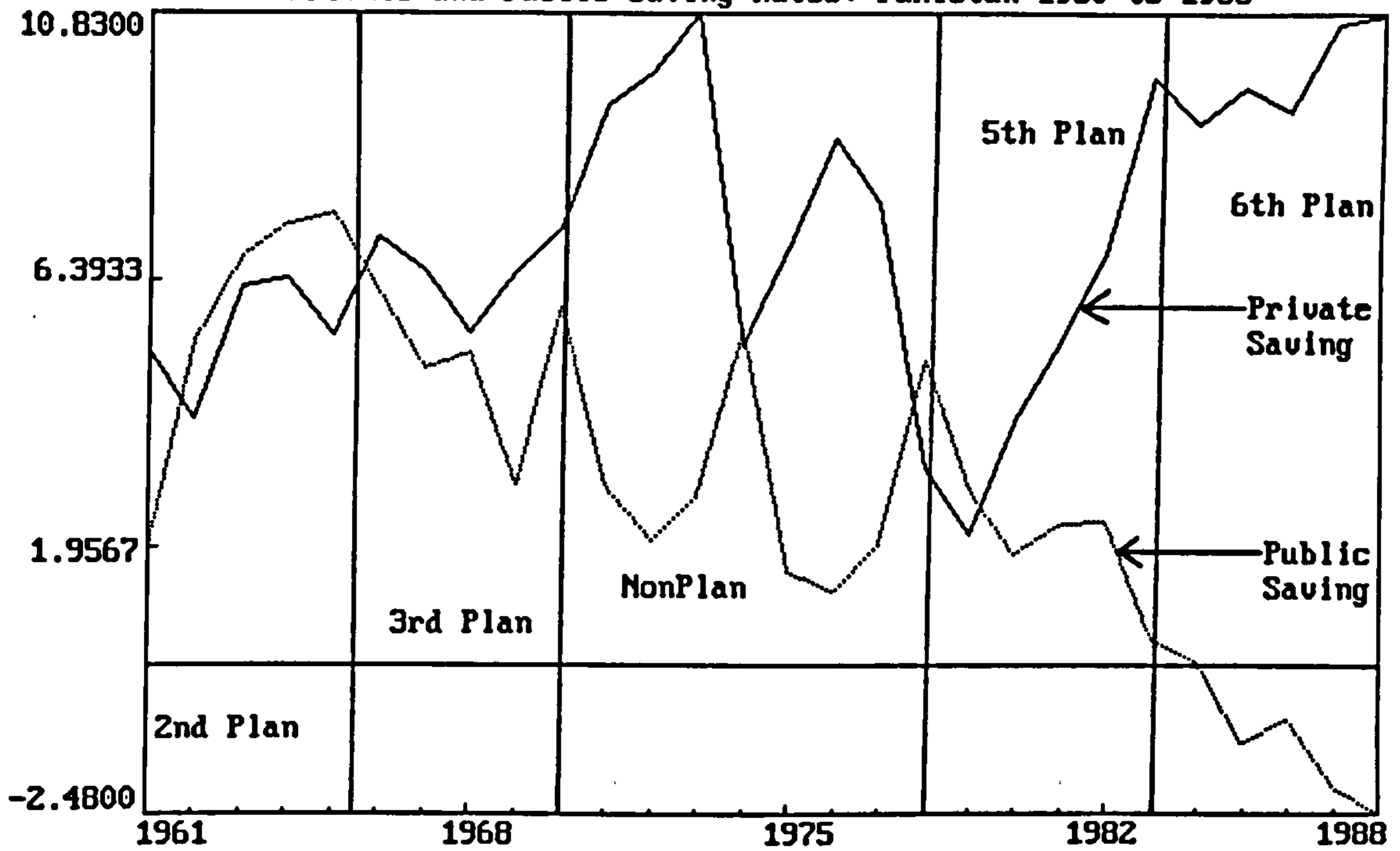
(a) No. Period/ Saving	(b) Year/Period							
	1. 2nd Plan	1961	1962	1963	1964	1965		
i) Private	5.20	4.07	6.27	6.40	5.46			
ii) Public	1.93	5.37	6.79	7.34	7.50			
2. 3rd Plan	1966	1967	1968	1969	1970			
i) Private	7.10	6.52	5.51	6.53	7.25			
ii) Public	6.21	4.93	5.19	2.94	5.93			
3. Nonplan	1971	1972	1973	1974	1975	1976	1977	1978
i) Private	9.31	9.87	10.83	5.30	6.88	8.76	7.70	3.24
ii) Public	2.96	2.04	2.77	5.53	1.53	1.21	1.98	5.06
4. 5th Plan	1979	1980	1981	1982	1983			
i) Private	2.14	4.02	5.37	6.82	9.77			
ii) Public	2.88	1.83	2.33	2.37	0.39			
5. 6th Plan	1984	1985	1986	1987	1988			
i) Private	9.02	9.62	9.21	10.65	10.79			
ii) Public	0.08	-1.32	-0.87	-2.03	-2.48			
1-5. Period Average	1960-65	1965-70	1970-78	1978-83	1983-88	1960-88		
i) Private	5.61	6.58	7.74	5.62	9.85	6.96		
ii) Public	5.79	5.04	2.89	1.96	-1.32	2.94		

Source:: Appendix, Table 3-A.

^p All figures are percentages of GDP.

FIGURE: 8-3-4

Private and Public Saving Rates: Pakistan 1960 to 1988



still does not exhibit any satisfactory evidence of improvement. The curve oscillates between different levels of saving which are only marginally different from each other, implying that economic policy and the economic environment in the country were still not conducive enough for private savings to maintain an upward movement. We also find that Government's fiscal effort to mobilise resources for investment has started to lose the momentum set in the 2nd Plan period, the upward movement of the curve during that period is replaced by a mixed trend of change. On the whole, the marginal improvement in private saving is largely offset by the marginal fall in the public savings rate.

A new dimension is discovered as we study the Nonplan period by combining it with the last three years of the 3rd Plan. What we find is that as the private saving rates started to pick up from the lowest point of the 3rd Plan period in 1968, a process begun for the first time in the history of private sector saving in Pakistan, this pushes saving continuously upward until 1973. The latter is the year in Figure 8-3-4 that demonstrates the highest point of the private saving curve during the whole period of analysis. The relatively stable upward trend in the curve, depicting the performance of the private sector in mobilising resources for development, is followed by a drastic fall in 1974, and that, in turn, by instability up until the end of the Nonplan period. Table 4-3-4 registers

the highest average of private saving for the Nonplan period. On the other hand, the average of public saving during the Nonplan period falls far below the corresponding averages of the 2nd and 3rd Plan. In 1976 public saving is at the lowest point on the respective curve in Figure 8-3-4 since 1961. Such a situation implies waning of the effectiveness of Government's fiscal effort in mobilising domestic resources.

The figures listed in Table 4-3-4 are even more revealing as we move into the 5th Plan. There we find that the starting year of the period records the rate of private saving showing in Figure 8-3-4, the lowest point on the private saving curve. Thereafter, an upward trend in the ratio of private saving continues, up until the end of the period of analysis, with the exception of relatively small falls in 1984 and 1986. This relatively stable upward pattern, in the private sector's resource mobilising effort, has not been previously observed over such a long time.

Although after the ever largest fall in 1979 the rate of private saving is continuously increasing until the end of the 5th Plan period, the period as a whole records the lowest average in column (b) of Table 2-2-4. This is because domestic saving was recovering at a very slow rate. This gradual recovery can be seen from the small slope of the private saving curve in Figure 8-3-4 up until 1982. The slope increased considerably in the last year of

the 5th Plan, as the private saving recorded in Table 4-3-4 the highest rate since 1974. The period average for the public saving also falls short of the corresponding averages for the previous periods. Further, the last year of the 5th Plan is the lowest point on the public saving curve in Figure 8-3-4.

The 6th Plan period presents a very alarming trend in public saving. After its almost zero level in 1984, the curve representing public saving lies in the negative segment of diagram until the end of the period. The evidence of the recovery in private saving, relative to the subperiod that preceded, is being largely offset by the high levels of negative public saving. The highest period average of private saving during the 6th Plan is therefore marred by the negative average for public saving. Such a scenario is not without important implications concerning the relationship between foreign aid and domestic saving, since in the basic model of Chenery and Strout the recipient country is "unwilling or unable to increase aid merely to increase consumption". And, they also believed that recipient governments have "no incentive to increase aid by reducing savings"(17).

Finally, for Pakistan we do not have any substantial evidence to support or discard the assertions of the gap models or the findings of the aid critics. However, in order to reach some valid conclusions, the quantitative analysis in this and the previous chapter needs to be

qualified by consideration of underlying economic policy factors. It is this vital aspect of the relationship between domestic saving and foreign assistance that we now attempt to investigate for Pakistan in the following chapter.

NOTES

1. Pakistan's growth rate was exceeded by only China, South Korea, Botswana and Cameroon. See, World Bank, "World Development Report", Issues from 1978 to 1990.

2. The GNP per capita for 1988, was US\$330, US\$340, and US\$350 in China, India, and Pakistan respectively. See, World Bank, "World Development Report", 1990.

3. See, (i) J. Viner, "International Trade and Economic Development", Oxford, 1953, P. 105, (ii) G. M. Meier and Robert E. Baldwin, "Economic Development, Theory, history, Policy", New York, 1957, P. 319.

4. The total public and publically gauranteed loans are taken as a proxy for the numerator.

5. See, (i) James Duesenberry, Income, Saving and the Theory of Consumer behaviour, Cambridge Mass: Harvard University Press, 1949, (ii) Milton Friedman, A Theory of the consumption Function, Princeton, N.J: Princeton University Press, 1957, (iia) Franco Modigliani, "The Life-cycle Hypothesis of Saving, The Demand for Wealth and

The Supply of Capital", Social Research, Vol. 33, No. 2, 1966, (iiib) "Life Cycle, Individual Thrift, and the Wealth of Nations", (Nobel Lecture Delivered in Stockholm, Sweden, 9 December 1985), Published in Rudigar Dornbusch, Fischer, and Bosson (ed.), "Macroeconomics and Finance: Essays in Honour of Franco Modigliani", The MIT Press, London, 1987.

6. See, (i) R. R. Nelson, "A Theory of Low Level Equilibrium Trap", American Economic Review, December, 1956, (ii) H. Leibenstein, "Economic Backwardness and Economic Growth", New York, 1957.

7. Steady-state growth is a feature of an economy in which all variables grow (or contract) at a constant rate: for example population may rise at 2 percent a year, national income at 5 percent and the saving at 8 percent. One of the many common characteristics of the post Keynesian saving theories is that they envisaged that in conditions of long-run steady state growth, a rise in income will not in itself bring about a rise in the rate of average saving, i.e, saving may show a stable pattern as a proportion of income. In Modigliani's formulation the behaviour of the saving rates is inferred from that of aggregate private wealth, W_t through the relation $S_t = W_t - W_{t-1}$, implying:

$$s = S_t/Y_t = W_t - W_{t-1}/W_t (W_t/Y_t) = pw$$

Where w is the wealth income ratio and p is the rate of growth of economy, which in steady-state equals the rate

of growth of wealth, $W - W_{t-1}/W$. The positive value of w is based on a level life cycle consumption and earnings, which ensures that it is independent of the level of income. The proportionality of saving rate to growth is introduced by taking the age-profile of the wealth-income ratio as independent of growth. Actually, the model implies that w is, generally, a declining function of p , though with a small slope, so that the slope of the relation between s and p tends to flatten out as p grows. See, Modigliani (1985), op. cit.

8. See, Nelson, Leibenstein, op. cit.

9. See, W. Arthur Lewis, "Economic Development With Unlimited Supplies of Labour" The Manchester School, May 1954.

10. See, Maxwell J. Fry, (i) "Money and Capital or Financial Deepening In Economic Development", Journal of Money Credit and Banking, Vol. 10, November, 1978, pp. 464-75, (ii) "Terms of Trade Dynamics In Asia: An Analysis of Domestic Savings and Domestic Investment Response to Terms of Trade Changes In 14 Asian LDC's", Journal of International Money and Finance, Vol. 5, March 1986, pp. 57-73.

11. See, Alberto Giovannini, (i) "The Interest Elasticity of Savings In Developing Countries: The Existing Evidence", World Development, Vol. 11, July 1983, pp. 601-7, (ii) "Savings and Real Interest Rate In LDCs", Journal of Development Economics, Vol. 18, August 1985, pp. 197-217.

12. See, Kanhaya L. Gupta, "Aggregate Saving, Financial Intermediation, and Interest Rate", *The Review of Economics and Statistics*, Vol. 69, May 1987, pp. 303-11.
13. See, Martin Ravallion, and Abhijit Sen, "On Some Estimates of Asian Savings Function", *Economic Letters*, Vol. 20, 1986, pp. 121-24.
14. Nicola Rossi, "Government Spending, The Real Interest Rate, and The Behaviour of Liquidity Constrained Consumers In Developing Countries", *Staff Papers, International Monetary Fund*, Vol. 35, March 1988, pp. 104-40.
15. The so called Ricardian equivalence states that, for a given expenditure path, substitution of debt for taxes does not affect private sector wealth and consumption. The underpinnings of this theory are based on the premise that the issue of public debt in the current period is always accompanied by a planned increase in future debt collections, which would be needed to serve this higher level of indebtedness. Thus, because debt financing is perceived only as a change in the timing of taxation, the Ricardian proposition asserts that such a change has no impact on private sector wealth and consumption as long as the present value of the stream of taxation remains unchanged. The proposition is, however, based on certain assumptions that, when relaxed, not surprisingly lead to deviation from equivalence. The key assumption for arriving at Ricardian equivalence are the existence of perfect capital markets with no borrowing constraints, a

tax structure that is nondistortionary, no uncertainty about future taxation and expenditure, and identical planning horizons for the private and public sectors. See, David Ricardo, "On The Principles of Political Economy and Taxation", Published in Piero Sraffa (ed.), "The Works and Correspondence of David Ricardo", Cambridge University Press, 1951.

16. For a demonstration of its invalidity see, Nadeem-Ul-Haq, and Peter Montiel, "Ricardian Equivalence, Liquidity Constraints and The Yarrri-Blanchard Effect: Tests For Developing Countries, Staff Papers, International Monetary Fund, Vol. 6, 1987. The writers argue that the level of private sector consumption would be reduced with increase in current taxation but would be insensitive to the increase in the current debt of the government. Although an increase in current government debt represents merely a shift in the timing of tax collection from the current period to the future, to the extent that the future tax implications of the shift are not fully preceived by the private sector, there will be a net wealth effect leading to an increase in consumption, and hence decline in savings.

17. See, H. B. Chenery, and A. M. Strout, "Foreign Assistance and Economic Development", American Economic Review, Vol. 56, No. 4, September 1966, pp. 686-87.

CHAPTER: 5

FOREIGN AID AND DOMESTIC SAVING: SPECIFIC ANALYSIS (Pakistan: 1960-1988)

Introduction

In this chapter we attempt to explain the underlying causes of the poor domestic effort of resource mobilisation in Pakistan. Although these causes are explained here mainly in terms of social, political and policy influences in different time periods, our purpose is to attempt to establish whether there is a link with the inflow of foreign aid.

At this point it makes sense to divide our period of analysis into three subperiods, each roughly representing a different public policy regime. Accordingly, this chapter is divided into three parts. The first part analyses the first subperiod that consists of the Second and Third Plan years from 1960 to 1970, while the second part represents the Nonplan years from 1970 to 1978. Finally, the third part examines various influences from 1978 to 1988 and it encompasses the Fifth and Sixth Plan years.

Part: 1-5

Saving Performance During the First Military Regime
(Pakistan: 1960 to 1970)

This part is subdivided into three sections. Section one analyses the government's position on the comparative importance of foreign and domestic savings for the economic development of Pakistan, while section two looks at the economic achievements of the period and the pattern of aid inflow. Finally, section three presents a brief analysis of policy influence on the behaviour of private saving in Pakistan.

Section: 1-1-5

Foreign Aid and Domestic Saving: Government's Position

As mentioned earlier in chapter two, the Government that formulated the Second and Third Plan faced a very critical situation when it assumed power in 1958. In the first Budget Speech of the new Government, the Finance Minister strongly emphasised the urgent need for increasing the level of domestic saving. While acknowledging the importance of economic assistance for Pakistan's economic development, he emphasised that:

"We can count on a generous measure of foreign assistance effort only if we do everything possible to mobilise our own resources. This means that we must hold our consumption down for the sake of investing in productive facilities which will benefit us in the future"(1).

He proposed that:

"We can force saving by raising more money through taxation than is required for the ordinary operating expenditures of the government. To some extent this form of saving will be necessary. But we will like more and more to rely on genuine voluntary saving"(2).

The Minister announced many measures including, most importantly, a tax holiday for a period of two years for industries established after 1st April, 1959(3). Thus, private enterprise was given greater scope. Indeed, it can be argued that this was the period when private enterprise was at its pinnacle. The Pakistan Industrial Credit and Investment Corporation [PICIC](4), which is the principal institution for financing private industry, was given advance approval to proceed with investments in a broad field(5).

In his second Budget Speech the Finance Minister expressed the expectation that:

"If we persevere in our own efforts to put the country's economy in order, we shall, I hope, merit continued generous foreign support for our development".

He explicitly conceded that:

"Without a large measure of foreign aid we cannot expect to accelerate the pace of development in such a way that production and income will be raised enough to permit us to set aside an ever increasing proportion for financing investment. Considering current low level of incomes in

Pakistan, we should be frank in recognising that even with the maximum effort on our part it will take many years before we can be fully self-supporting on a reasonable standard of living"(6).

The Minister reiterated the objectives of the Government to set aside the maximum possible resources for development and to avoid unsound budgetary practices(7).

Section: 2-1-4

Achievements and the Pattern of Aid Inflow

The Second Five Year Plan (1960-65) envisaged a gradual increase in foreign assistance to the extent that the amount received in the final year of the Plan was expected to be about 60% greater than in the year 1959-60(8). Indeed, the actual receipts far exceeded that expectation. Initially, the Plan was legitimately claimed an outstanding success. The achievement of its targets exceeded projections in most spheres of economic activity. The most significant achievement in the present context was that over one-fourth of the additional income was saved and reinvested (see, Table 2-2-4). Further, it is interesting to note that Griffin's indifference curve analysis, representing the choice of a government or a community between present and future consumption(9), has no practical relevance for Pakistan during this period. We have observed in Chapter Four that not only the inflow of annual average foreign assistance was the largest ever during this period, but also that the annual average of

government saving demonstrated a level that remained unrivalled during the periods that followed (see, Tables 2-2-4 and 4-3-4 respectively).

However, for the assertions of the aid theories to hold true in the long run what is required is a consistent and well integrated functioning of economic factors. An important feature of this process is the uninterrupted availability of required amounts of foreign assistance to an underdeveloped country successfully embarking on the process of development while its own resources are not sufficient to continue with an effective programme of capital formation. Given the process envisaged by the aid theories, such an effort requires to be increasingly augmented for a fairly long period. Even at an early stage economists like Rosenstein-Rodan(10) and Rostow(11) predicted the process of accelerating expansion, leading to take-off into self-sustained growth in not much less than a decade. The authors of the two-gap models, on the other hand, visualised these process taking place over a period longer than a decade. These authors gave due consideration to the obstacles, and to the strategies for overcoming them more rationally. Likewise, the Government of Pakistan clearly admitted that:

"We shall have need, of course, for aid from abroad in very large amounts for a considerable time to come, during the period of building up of our economic infrastructure and of gestation and infancy of our industries"(12).

But aid was not provided in a well-integrated phased manner conducive to enabling the process of expansion to culminate in self-sustained growth, to use the widely popular, though largely irrelevant catchphrase of economics.

Here, we put forward a reasoning that runs completely contrary to the one conceived by the aid critics. Given the evidence in Chapter Four that domestic saving increased during the Third Five Year Plan as foreign aid reduced considerably as a percentage of GDP (see, Table 2-2-4), it may not necessarily imply a negative relationship between the two flows. There is an equally strong possibility that the domestic saving rate would have been even higher than that actually observed had the inflow of economic assistance maintained the tempo set during the Second Plan years. This argument gets further support as we consider the intricate process of capital accumulation in a country just embarking on the road of development: entrepreneurship is an evolutionary process and its effectiveness requires coherence, economic incentives and continuation even in developed countries. In countries which are late-comers in development, the element of risk and uncertainty is much higher compared with countries that have achieved a fair degree of competitiveness. Such a situation can only be overcome by government initiatives both direct and indirect: the former by the government itself adopting the role of

entrepreneur and the latter by it providing safe havens to indigenous potential private investors. Such was the process observed in the case of Pakistan. Both the public and private sectors shared in the expansion of investment in the country. The entrepreneurial activities of the public sector were undertaken and monitored by the Pakistan Industrial Development Corporation (PIDC). The PIDC operated under the policy of taking up certain projects when private initiative was lacking, and of selective disinvestments in these projects at the opportune time. The Government also facilitated investment by introducing certain tax incentives, and by establishing the Investment Promotion Bureau. Hence, the government not only merited the confidence of private investors but retained and strengthened it to such an extent that an effective process of capital formation was set in motion for the first time in the short economic history of the country.

In order to sustain all these activities Government needed external resources, and those resources were provided very generously during the Second Plan period. But, the impressive performance of foreign aid in Pakistan over such a short period of time required successively increasing funding of development projects over a certain period of time. In 1960, when the Second Plan was initiated, the country was still struggling desperately for its economic and political viability. In a scenario

like that the impressive performance of the economy, supported by the infusions of economic assistance may be ranked as an economic miracle. But, the miracle in this case turned into mirage at the end of the day, partly because the decline in inflow of economic assistance, which followed in the Third Plan period, was unexpected. The Third Plan envisaged an amount of foreign assistance that exceeded the requirement of the Second Plan by about one billion dollars(13), but the actual amount of funds was relatively much lower than during the Second Plan (see Table 2-2-4).

Although the annual average of domestic saving during the Third Plan was marginally higher than the average of the Second Plan, such a small increase could not make up for a major shortfall in the supply of capital needed for accelerated development. Consequently, the Finance Minister was obliged to announce in his budget speech that:

"due to the shortfall in the anticipated foreign assistance and its delayed accrual, the import requirements of the industries could not be fully met"(14).

Against the projected rate of 16%, the growth rate of the manufacturing sector of the country turned out to be 11% during 1967-68, the third year of the Plan. The Finance Minister had to concede that:

"the growth of the manufacturing sector was affected

by the shortage of imported inputs occasioned mainly by the short or delayed accruals of foreign assistance"(15).

There is no doubt that in spite of the shortfall of economic assistance during the Third Plan years, the overall performance of the Plan was quite respectable. But it must also be remembered that as far as physical output is concerned, there is always some lag between the time of investment and the time when its results become fully visible in terms of production. This is particularly true in agriculture where many different development activities have to be undertaken and only their combined effect produces the desired results. Much of the fruits of the successful implementation of the Second Plan were, therefore, reaped during the Third Plan.

Although a direct one-to-one link could hardly be drawn between theory and performance, the record of solid performance under the Second Plan suggests that the claim of the Government of Pakistan that, "if the Development Programme of the third plan is successfully implemented the economy would move towards the threshold of a 'take-off'"(16) seems to have some substance. The reduction in aid inflow was mainly caused by the suspension of US aid after the 1965 War with India. While the war itself brought serious dislocations to the economy, the unanticipated reduction in the inflow of aid further added to the difficulties. All these problems were compounded by the political disruptions of 1969, as mentioned in Chapter

One.

Section: 3-2-5

Industrial Versus Financial Capital

The relatively higher saving rate of this period owes much to the Government's own fiscal effort. Indeed, in spite of all the incentives and concessions for private investment, the private saving rate during this period remained at a low level (see Table 4-3-4). The poor performance of private saving might be explained in terms of the interconnection between industrial capital and financial capital(17). The latter played a very important role in keeping low the saving of the corporate sector within the private sector. We do not have data for corporate saving, but the findings of another study reveal that in the 50s' reinvestible earnings were the main source of financing investment, while in the 60s' the main source was borrowed capital(18). One of the major sources of the latter was the large inflow of foreign aid, which was made available to finance industrial investment and was channelled through two financial institutions, PICIC and Industrial Development Bank of Pakistan (IDBP). The link between large investors and the financial institutions like PICIC and IDBP show the financing of the domestic capitalists by the inflow of economic assistance from abroad. In an unpublished report submitted by a World Bank team on the working of PICIC it was stated that:

"From the beginning, PICIC promised to be a

profitable enterprise and this promise was realised. It proposed to lend principally to large scale enterprise and there was no difficulty in securing equity participation from foreign interests with large Pakistani industrialists. For the first few years, foreign management was in charge and the Board of Directors has always been dominated by representatives of principal industrial families. A substantial portion of its loans, in fact, has been given to enterprises controlled by the same families. Three-fourths of PICIC's investment has been in West Pakistan and it has contributed little to small and medium size enterprises in either wing. Nor has it contributed to the mobilisation of domestic saving in Pakistan"(19).

As for the IDBP, its main stated purpose was to provide credit facilities mainly to small and medium industrial units in the private sector. In practice, the main beneficiaries were again the large industrial establishments(20).

However, by the middle of the sixties, the need to channel the domestic saving of the non-corporate sector was eagerly felt by the industrial sector especially because of cuts in foreign aid inflows. But there seemed to exist considerable suspicion and hesitation on the part of the middle classes to invest their money in the shares of companies floated on the stock exchange. There was a very strong feeling that these companies were meant only

for the benefit of those who owned them and that industrialists would be very reluctant to share profits. In order to channel the saving of the newly emerging middle class in the cities as well as the agricultural sector, the government sponsored two organisations: the National Investment Trust (NIT) and the Investment Corporation of Pakistan (ICP). These two organisations, as it turned out, also became part of the financial empire of the large industrialists, since this group enjoyed a dominant position in utilising the capital resources raised by these organisations(21).

In spite of all the deficiencies of public policy on the private saving front, there is little doubt that on the whole the results achieved during this subperiod, support the assertions of the aid theory. But the foreign-aid-financed growth during this period had not been an unmixed blessing for Pakistan. However successful the development strategy of the period, it left a legacy of debt accumulation and economic inequality, the effects of which were to be realised in the years to come.

Part: 2-5

Saving Performance During the Civilian Rule
(Pakistan: 1970 to 1978)

As mentioned in Chapter One, the social and economic confrontations in late 1968 and early 1969 toppled the Ayub Government. By 1971 regional and class conflicts had gone too far. With the armed intervention of India, East

Pakistan seceded from the Union. In 1971 a shrunken and politically demoralised Pakistan entered a new phase of its history. The military transferred power to Z.A. Bhutto's Pakistan Peoples Party (PPP). This part examines the saving performance of Bhutto's period in five sections. Section one looks at the position of aid inflows during this period, while section two and three describe the nationalisation policy of the government and private investors' response to it respectively. Section four analyses the high government expenditures resulting in high inflation rates and, effects of the latter on domestic saving are discussed in section five.

Section: 1-2-4

The Debt Legacy and New Sources of External Financing

By the time the Bhutto Government assumed office the country had accumulated an enormous foreign debt. Debt servicing had already become burdensome by 1970. The interim Government of Pakistan announced in April 1971 that it could no longer service all its external debts and Pakistan selectively stopped payments on about two-thirds of its foreign debts because the burden on its limited foreign exchange had become intolerable. Indeed, the political upheaval of 1968-69, the civil war and military confrontation with India in 1971 together almost shattered Pakistan's economy. Consequently, the Bhutto Government had no option but to declare a unilateral moratorium on debt repayment. The debt total had reached US\$4.6 billion,

the fourth highest among developing countries at that time, and Pakistan had the highest debt to gross national product ratio among the countries having the largest external debts(22). However, in 1972 and 1973, the Aid to Pakistan Consortium agreed to reschedule(23) part of the debt to help relieve some of Pakistan's repayment problems(24). Some Chinese and Swedish non-Consortium loans were subsequently converted to grants(25). The International Monetary Fund agreed to grant a standby loan on its 'usual' terms, which included a 44% devaluation of the Pakistan's rupee and the liberalisation of imports(26). But, the debt problems continued to increase, making additional rescheduling necessary. Hence, once again, each Consortium member agreed in June 1974 to reschedule some of the debt owed to it(27).

The nominal average yearly capital inflow during this period was quite high. However, in real terms the net inflow of aid had reduced considerably as compared to the previous period. In Table 1-2-5 we have listed the constant dollar values of net and gross aid flows to Pakistan in developed countries' market prices of 1959-60.

Table 1-2-5 shows that in real terms, the net inflow of resources decreased during this period. The extent of the decrease was a little over 36 percent. This scenario, of course, required greater effort to mobilise resources domestically. Further, given that the difference between column (bi) and (bii) was accounted for by debt services,

Table: 1-2-5

Gross and Net Aid Disbursements
(Pakistan: 1960 to 1988)*

NO.	(a) Period	(b) Foreign Aid (US\$ Milloin)		(c) (bii) % of (bi)	(d) Percentage Change ^p		
		(bi) Gross	(bii) Net		(bi)	(bii)	(c)
1.	1960-1970	453	387	85.43	—	—	—
2.	1970-1978	338	229	67.75	-25.39	-40.83	-20.70
3.	1978-1988	328	145	44.20	-2.96	-36.68	-34.76
4.	1960-1988	376	256	68.08	—	—	—

Source::Appendix, Tables 5-A, and 7-A.

* Annual average of economic assistance in developed countries' market prices of 1959-60.

^p Percentage change in the annual average between the two consecutive subperiods.

the need for increasing domestic resources for development became more important. In order to be certain that the process of economic growth is not seriously halted, a country must become capable of both financing development and meeting repayment obligations, especially in the case that the amount of foreign aid is drastically reduced (due to some special circumstances). We find in Table 1-2-5 that about 32% of gross aid was going to meet debt service obligations during this period, and according to one estimate, were it not for the debt relief and rescheduling arrangements, debt service would have accounted for close to 45% of the net inflow(28).

The inability to repay foreign loans and the dearth of resources for development should have made the government pursue every practical policy to increase domestic saving. But, on the contrary at the end of 1971 a truncated Pakistan, underdeveloped and dependent, was desperately looking for new sources of financial assistance and for substitute markets, as the economic problems were compounded by the loss of markets for West Pakistan's goods in East Pakistan to the tune of US\$300 million annually(29). The advanced capitalist countries upon which Pakistan had traditionally depended offered few prospects either as expanded markets or as sources of increased economic assistance. The oil-rich Muslim countries, particularly those of the Arabian/Persian Gulf region, seemed to be the logical answer. Indeed, without

that new source of foreign aid the net inflow of aid given in Table 1-2-5 would have been much smaller.

Prior to 1974-75 the only loans received from Muslim countries were a US\$5 million suppliers' credit from Kuwait in 1969-70 and a US\$30 million general purpose loan from Libya in 1973-74(30). In 1974-75, the year in which the OPEC countries edged out the OECD as the major aid donor in the world, the Muslim countries pledged US\$896 million or 51.4% of the record aid commitment of US\$1,744 million made to Pakistan by the various donors(31). Iran also agreed to advance US\$580 million over a three-year period(32). Saudi Arabia, Libya, Abu Dhabi and Qatar were other countries pledging aid to Pakistan. In comparison Pakistan's traditional aid donor, the US, committed US\$194 million, while the former USSR, making its largest commitment ever to Pakistan, pledged US\$214 million, mainly for the Karachi Steel Mills(33).

Our main argument here is that had it not been for the rescheduling arrangements and the alternative external sources of development finance, the Government would have been compelled to exert greater efforts in mobilising domestic resources. But, as those alternative were there, public policy for mobilising domestic saving was not effective while overall economic policy of the Government caused lower domestic saving. In the following we attempt to support our assertion by analysing the economic policy of this period in terms of its effects on domestic saving.

Section: 2-2-5

Effects of Nationalisation on Domestic Saving

As mentioned in Chapter One of this study, the PPP government carried out a series of nationalisations after assuming power. Consequently, in contrast to its progress during the 1960s, the class of nascent Pakistani entrepreneurs suffered a severe setback during this period. The level of private investment, especially in manufacturing, fell precipitately as on-going projects were abandoned. The confidence of the investors was broken not just by the PPP Government's actual measures, but more so by the unpredictability of Mr. Bhutto and his Government. They feared that much worse was to come. That fear seemed to be confirmed by the nationalisation of the vegetable ghee (hydrogenated vegetable cooking oil) industry in September 1973, notwithstanding assurances that had earlier been given by the government that the nationalisation programme had been completed, and that no further nationalisation would take place. Hence, by 1973-74 investors had decisively lost faith in Government's words and assurances and were no longer prepared to invest in the country, with its attendant risks, when they had other alternatives. As a result, private saving fell from the peak level in 1973 to the lowest level since 1963 (see Table 4-3-4). However, average total saving was still above 10%, as the fall in private saving was matched by the Government's greater effort to mobilise resources.

However, the Government very soon had to backtrack on its policy towards private investment. It provided special incentives for the private investor in the budgets for 1974-75 and 1975-76(34). It reiterated assurances that it would not resort to further nationalisation. The radical rank and file of the PPP was repressed by its own Government, 'Marxist' ministers were sacked. The reversal was undoubtedly genuine. However, it is another matter that all this had little effect in winning back the confidence and support of private investors. The little improvement that we observe in private saving after 1974 (see Table 4-3-4) was mainly attributable to small scale investors, who responded to the incentives offered by the Government. Indeed, the pattern of the share of public and private investment in total investment, was completely reversed during this period compared to the 1960s. This may be seen from Table 2-2-5 which lists the annual average share of public and private sectors in total investment expenditures of the country.

Further, in July 1976, Bhutto preparing the ground for the forthcoming elections, in a surprise move announced the nationalisation of agro-processing industries, mainly cotton ginning, flour milling and rice husking. The nationalisation of the agro-processing industries was perhaps the last blow for potential small investors. It must be noted that the long-run impact of this policy on domestic saving was far greater than its

Table: 2-2-5

Gross Fixed Capital Formation
(Pakistan: 1960 to 1980)#

(a) No. Period	(b) Investment Expenditures		
	(bi) Total ^p	(bii) Public [■]	(biii) Private [▤]
1. 1960-70	16.82	44.57	55.43
2. 1970-78	13.66	55.63	44.37
3. 1978-88	13.78	54.81	46.19
1-3 1960-80	14.83	51.40	49.60

Source:: Appendix, Table 3-A.

All figures are percentages calculated at fixed market price of 1959-60.

^p Gross fixed capital formation as percentage of GDP.

■ Percentage of (bi).

▤ Percentage of (bi)

immediate relevance in this context. The PPP government was overthrown by the military after country-wide agitation in 1977. But in 1978 private saving fell to its lowest level since 1960 (see Table 4-3-4), because the confidence of private investors was completely shattered by the political instability and the inconsistency and unpredictability of the Government's policies.

In terms of greater public saving, the nationalisation programme under the PPP was not efficient in the corporate sense. However, initially the performance of public sector enterprises was not altogether disheartening, since some of these enterprises performed very well(35). The cement industry, for example, showed impressive profits, as did the automotive, petroleum and fertiliser industries. But later the expansion of public enterprises increasingly became a symbol of the PPP's potency as successive interventions were increasingly determined by political pressures, irrespective of their economic logic. Hence, various non-economic constraints worsened the financial situation of these enterprises. For example, public enterprises had to employ surplus workers because of political pressure. This resulted in overmanning and a fall in productivity. In 1972-73, for example, enterprises under the Board of Industrial Management employed 40,817 people. The number rose by 58% in 1976-77, whereas production did not increase correspondingly(36). Indeed, in many cases it declined. A

similar, but even more dramatic fall in productivity due to excessive employment was experienced by the Cotton Trading Corporation(37). These sorts of measures which can be perceived as protecting and increasing employment directly proved self-defeating, since particular jobs were protected by increased inefficiency which indirectly led to jobs being lost elsewhere in the economy.

Moreover, the public enterprises were quite often established with a view to meeting some social and political objective. Units were frequently set up in remote, backward areas. Such measures are socially desirable, of course, and the economic costs, within reason, worth bearing. Yet, the merits of such a policy were distorted by the method by which the remote areas were selected for favourable treatment. Projects mushroomed around places such as Larkana, Bhutto's home town. In these cases, the Government appeared to be less concerned with promoting balanced regional development and more with token measures to please politically powerful groups. An example of inefficient location is provided by the Bannu Sugar Mills. The absence of a sufficiently well-developed local infrastructure made the plant uncompetitive. On average, 90% of the plant capacity was not utilised(38). Insufficient attention to economic criteria for investment also led to huge losses at Sind Engineering and Anti-Biotic Ltd(39).

The poor performance of public sector enterprises

hampered their ability to raise investment resources internally. The failure to generate investment funds was also due partly to their pricing policies. The nationalised units were expected to limit price increases while the inflation rate, as already mentioned in Chapter One, was high and accelerating during this period. The pricing pattern of the nationalised units seemed to allow only the recovery of operating costs and not current market replacement costs(40). Consequently, internally generated funds for financing investment only contributed 7% of the amount required(41). As a result, nationalised industries had to borrow from Government. This borrowing added to the dependence on external assistance, since a fairly large part of the budget deficits was financed through external borrowing.

The burden imposed by public enterprises was not, of course, the only result of nationalisation which hindered the domestic effort for resource mobilisation to finance economic development. As mentioned earlier, private investment had also slackened after the random nationalisation measures. In the following section, we consider the response of the private investors to this policy in some detail.

Section: 3-2-5

The Private Investors' Response to Nationalisation

After nationalisation of the large industrial units, the capitalists who were affected found lucrative

investment opportunities in the Gulf States, using their technical and managerial expertise as leverage. No estimates on the flight of capital are available, but it is openly conceded that many leading capitalists moved their capital out of the country. The First Secretary of the Embassy of the United Arab Emirates, for example, wrote:

"Several Pakistani firms are planning to undertake the installation of heavy industries in the UAE in the private sector. Pakistani businessmen have quite generously offered to provide the necessary capital for such industries on a joint venture basis"(42).

Pakistan's private sector was moving in a big way to capture the Arab markets for technical and managerial expertise. Bankers like Abidi helped the flight of capital and expertise to the Middle East by setting up a bank there(43). Some of the investors went as Third World multinationals to Tanzania, and some even to Ireland and Canada(44).

The discriminatory treatment of private owners with respect to the compensation given for nationalisation of their enterprises was another factor that generally lowered the confidence of the private sector in the security of any future investment. Many investors who suffered nationalisation received no compensation or they received bonds only redeemable in the distant future(45). Equally significant was the liberal

compensation paid to some of the expropriated capitalists(46).

The main effect of nationalisation on corporate sector saving was that the large, modern capitalist sector became weary of the economic environment. To guard against any further nationalisation, emphasis was placed on short-term credit and reduced involvement. Even bonus payments to labour were made from short-term borrowings from banks. The rush was on to take away whatever one could from the unit/firm. Only a handful of investors in the large corporate sector decided to go into manufacturing under these changed circumstances. The debt-equity structure was drastically changed to include the extra added risk, from 60:40 to 70:30, then to 80:20, and finally ended up at 90:10. In some cases domestic financial institutions provided 100 per cent capital, leaving the entire control to the private sector, i.e., a state enterprise in private hands(47). These sorts of enterprises existed because the nationalisation of the commercial banks and other financial institutions gave the Government significant control over investment priorities, and creation and disbursement of credit with which to reward political allies. The following section discusses some other effects in the context of Government control over financial institutions.

Section: 4-2-5

Unproductive Expenditures and Poor Collection of Taxes

Insofar as the state was more free to use commercial banks for its own deficit financing, their nationalisation had significant indirect effects on domestic saving. Thus in the five years between 1972-73 and 1976-77, government borrowing from the banking system totalled Rs. 14 billion, and notes in circulation increased from Rs. 23000 million in 1971-72 to Rs. 57,000 million in 1976-77; in 1975-76 alone, the government borrowed US\$287 million from these commercial banks, while the notes in circulation increased in the same years by US\$200 million, or by 20%(48). This rate of credit formation, heavily tied to borrowing by the state, led Pakistan into an untenable monetary situation so that as of 1977 only 15% of Pakistan's currency was covered with foreign exchange and other real assets(49). This expanded money supply did not lead, however, to greater productive investment, especially in the manufacturing sector where the rate of investment as well as production registered significant decline. According to one estimate, calculated in constant prices, investment in the manufacturing sector stood at US\$135.9 million in 1964-65, then declined to US\$99.5 million in 1970-71, to US\$83.7 million in 1971-72, and to US\$70.8 million in 1973-74(50).

As mentioned in Chapter One, most of the growth of these years was accounted for by the service sector. But

the latter hardly included the expansion of those social services and infrastructural constructions which create value. Its growth was overwhelmingly concentrated on the expansion of 'unproductive' sectors like defence and public administration. These sectors, together, grew at an annual rate of about 11%, the highest annual average rate of all subperiods, as given in Table 3-2-5.

The increased Government expenditures on these activities were scarcely matched with its resource mobilising performance. In particular, indirect taxes grew slowly partly because of the relative stagnation in economic activity. The growth in indirect taxation was also limited by political pressures and leakages implicit in corrupt administration. A study conducted of international comparisons of taxation, for the period from 1972 to 1976, ranked Pakistan among the countries with below average tax ratios to GNP(51). Out of a total of 47 countries, Pakistan was placed in 37th position for her "tax effort index", while China, India, Iran, and Sri Lanka were placed at 11th, 27th, 1st, and 20th positions, respectively(52).

The increased expenditures on 'unproductive' services and the low level of public saving significantly contributed to the high inflationary pressure recorded during this period. Inflation, as described in the following, might also have been another reason for the lowering of domestic saving during this period.

Table: 3-2-5

National Expenditures on Defence and Public Administration
(Pakistan: 1960 to 1988)[#]

No.	(a) Period	(b) Growth Rate	(c) Percentage Change ^p
1.	1960-1970	8.36	_____
2.	1970-1978	11.04	32.10
3.	1978-1988	6.50	-41.04
4.	1960-1988	8.46	_____

Source:: Appendix, Table 6-A.

The figures are percentages, calculated at constant market price of 1959-60, in Pakistan.

p Percentage change in the average growth rate between two consecutive subperiods.

Section: 5-2-5

Effects of High Inflation Rates and Import Liberalisation

In the literature we find two reasons why inflation may discourage saving in economies like Pakistan. First, according to McKinnon(53), there is the "Conduit" effect of money and complementarity between money and physical capital because of lumpiness of investment and a preponderance of self investment in a developing country with highly imperfect capital markets. The return on money goes down with inflation, and so does saving and investment. Second, the administered deposit rates of interest are frequently not adjusted appropriately in response to inflation, so that the real rate of interest falls(54). Although the omission of the independent variable of real rate of interest in our estimated saving equation (see Chapter Three equation 1.3) renders the interest sensitivity of saving in Pakistan debatable, there is some evidence to believe that lower interest rates reduced savings during this period. During 1972-75, with inflation well in excess of deposit interest rates, saving placed in banks lost as much as 20% of their real value(55). This was virtually a financial penalty imposed on the savers, which led to a decline in household saving.

Furthermore, a flight from currency and increased purchase of consumer durables, raises consumption figures. Inflation led to the substitution of nominal assets by real assets, including consumer durables. In developing

countries what is measured is consumption expenditure and not consumption. Measured consumption will rise and measured saving will be adversely affected.

Apart from inflation, another factor that caused a general upward shift in the demand curve of consumer durables was the policy of import liberalisation. As outlined in part one, Pakistan in obtained a conditional loan from the IMF in 1972. The conditionality included liberalising Pakistan's imports and devaluing her currency. The former meant the lifting of import restrictions for over 300 commodities. Insofar as the liberalisation package included a large number of consumption items, it increased the consumption propensity in Pakistan(56). Consequently, a marked change in the composition of imports was observed. For example, in 1970-71, imports of consumer durables had amounted to \$US383.7 million, whereas machinery, transport equipment and raw material for capital goods stood at \$US378.1 million. The two categories of imports were thus roughly equal. However, in 1974-75 the comparable figures were US\$1,248.3 million and US\$356 million respectively. The consumer items thus accounted for almost four times the expenditure on other category of goods(57).

Finally, although this period witnessed a sharp reversal in aid donors' influence on policy making, foreign aid significantly contributed to the provision of resources for development finance. The Consortium

members and Pakistani representatives met annually in Paris to discuss the world economic situation and Pakistan's economic problems as reported by the World Bank. The latter, during this period, was critical of the Government's macro economic strategy. Particularly, it was not sympathetic to the general policy shift towards the public sector. Further, the World Bank expressed strong concern over a macroeconomic strategy which entailed expenditure increases without paying sufficient attention to domestic resource mobilisation. The Bank was not willing to resume lending on a substantial scale unless the Government undertook specific measures to tackle the domestic resource gap. The regime, on the other hand, was far more sensitive to sovereignty issues, and viewed policy dialogue with suspicion. Aid from Consortium sources fell from US\$400 million in 1968-69 to US\$52 million in 1971-72(58). This response was partly understandable in view of the Government's hostility to the Consortium's influence on policy making. The World Bank stipulated a set of reforms, particularly in the area of domestic resource mobilisation, as a precondition for further Bank lending. The refusal of the PPP Government to accept these conditions led to a deadlock in 1974-75. In view of Pakistan's poor record of domestic resource mobilisation and the oil price hike of 1974, the Bank felt that the expansionist policies of the PPP would lead to an acceleration in inflation and an excessively high debt

burden. Nevertheless, largely deprived of its traditional sources of finance, the Government turned to the alternative sources abroad. The new donors never questioned government's policy, they rather supported and strengthened it, both directly and indirectly.

Part: 3-5

Saving Performance During the Second Military Regime
(Pakistan: 1978-1988)

Events moved rapidly at national and international levels after the military coup of July 1977. The military, headed by General Zia-Ul-Haq, had once again tightened its grip on the country, making General Zia the ruler of Pakistan for the 'longest ever' period in the country's history. Lacking any claim for political legitimacy, Zia's military dictatorship decided to justify its attempt to perpetuate its rule by a new claim; namely that it had a mission to create an Islamic economy and polity in Pakistan. Since Soviet troops were in Afghanistan in the 1980s, the US supported Zia's Islamising military regime. Zia used Pakistan's willingness to act as a 'conduit' for military and economic aid to the Afghan Mujaheddin to develop a complex military and economic relationship with the US. Having rejected President Carter's initial offer of US\$400 million, Zia eventually settled for a six-year, US\$3.2 billion economic and military aid contract. Pakistan then became the third largest recipient of US

aid after Egypt and Israel. In 1987, the six-year contract was renewed for US\$4.02 billion(59). This US-Pakistani relationship might have best satisfied the Pakistan Government's external security and domestic economic requirements. We, however, attempt in this part to analyse its effect on the domestic effort for resource mobilisation. The analysis is carried out in three sections. Section one looks at the response of private saving, while section two brings into light the main factors responsible for negative public saving. Finally, section three gives information on the domestic and foreign component of capital formation in the country.

Section: 1-3-5

Public Policy and the Performance of Private Saving

In the quest for a more credible, long range policy, the regime turned to Mahbubul Haq, the Harvard-educated architect of Ayub's 'economic miracle'. Haq resigned his post as the Director of Policy Planning, World Bank, and was appointed the Deputy Chairman of Pakistan's Planning Commission. He re-emphasised some of the 60s' policies, such as growth by import substitution and, by expanding the share of the private sector in the economy. The latter also included a denationalisation package.

To encourage private investment, the Government issued a major policy statement(60). The policy objectives and the incentives structure placed a premium on industrialisation. Yet the private investment response was

poor. For the reluctance of the private sector to invest in long-term industrial projects, some economists place the blame on non-economic factors(61), particularly political uncertainty. Some blame the stop-go policies of the Government, and the balancing of the Government budget by tinkering rather than by fine tuning. For example, investors's demand for reductions in interest on fixed investment was accepted and the interest rate was reduced from 14% to 11%, but the special depreciation allowance at the rate of 15% was withdrawn. Similarly, the corporate tax was increased to 55% from 50% but this was offset by withdrawal of tax of 10% to 15% on bonus shares of public and private companies(62). On the surface all these factors, of course, were directly responsible for the inadequacy of private investment during this period. However, we attempt to construct a rather different line of argument in the following.

Indeed, the genesis of industrial and finance capital in Pakistan was always tied to merchants' capital, and the leading capitalists never wholly completed their transition from merchants to industrialists. During the 70s' as the crisis deepened, these capitalists, reluctant to undertake the long-range risks of industrial accumulation, had reverted to the short circuits of circulation. Some, perhaps many, departed to more lucrative openings in the Gulf and even to the metropolitan centres of Europe and America. Others

rediscovered their vocation in the wholesale trade, import/export trade, contracting, hoarding and speculation, smuggling, labour exports, and so forth. A lot of 'quick' money was made in these activities, because of the accelerated pace at which money and commodities were circulating in the country as a result of expanding influx of remittances into the domestic market, the rising incomes in the export sector of agriculture, elaborate expenditure by the state, and the growth of real estate as the main field of investment in saving. This can be seen in the figures listed in Table 4-3-5 for the growth rate of ownership of dwelling and whole sale and retail trade. The growth rate of the latter is only marginally lower than the first subperiod (1960-70).

As a primitive economy moves along, the process of development causes the size of the market sector to become increasingly large. But, the growth rate of these services expenditures should keep pace with the growth rate of the commodity producing sector. Once adjusted for inflation, the excess of the former over the latter is a pointer of the growth of consumption, a part of which is satisfied not by domestic productive capacity, but by the import of real economic resources.

The marked increase in the average annual growth rate of expenditure on the ownership of dwelling implies that a lot of money was being made, perhaps more than ever before. Consumption orientation had become the hall-mark

of the society. The touch-stone of one's status had become ostentatious living. An increase of about 114% in the growth rate of these expenditures over the average of the previous period hardly renders the situation as one conducive to sustained growth. The most eminent purpose it was serving was in precipitating the 'demonstration effect' in society.

Nevertheless, merchant capital was not alone in being involved in these activities. As a result of military dictatorship, the army members also developed lucrative involvements with civil, political, economic and social institutions. Political power had ensured economic well-being. Soldiers had access to better pensions, scholarships and medical facilities than civil servants. Generous grants of irrigated land and of valuable urban real estate were made to them. Zia reserved about 10% of the highest civil service positions for serving and retired officers. He also gave them special import facilities and the chairmanship of the largest public sector corporations, and the choice of diplomatic posts. Between 1979 and 1986 the army's own organisation for the welfare of retired servicemens' families, the Fauji Foundation, recorded a four-fold increase in assets and a seven-fold increase in profits(63).

The fall in private saving was also partly related to the measures taken for the 'Islamisation' of the economy.

Table: 4-3-5

Wholesale & Retail Trade and Ownership of Dwelling
Growth of National expenditures
(Pakistan: 1960 to 1988)*

No.	(a) Period	(b) Wholesale & Retail Trade	(c) Ownership of Dwelling	(d) Percentage Change ^p	
				(b)	(c)
1.	1960-70	7.81	2.88	—	—
2.	1970-78	4.83	3.54	-38.17	22.92
3.	1978-88	7.13	7.58	47.62	114.12
4.	1960-88	6.71	4.75	—	—

Source:: Appendix, Table 6-A.

The figures are percentage average annual growth rates, calculated at constant market prices of 1959-60, in Pakistan.

p Percentage change in the growth rate between two consecutive subperiods.

The introduction of Islamic banking, without a well-defined framework, led to uncertainty in the financial markets. The imposition of Zakat, a 2.5% Islamic welfare tax on saving deposits, also provided a disincentive to hold cash balances in Pakistani banks. Consequently, people were inclined to transfer their saving abroad or to other sources, such as real estate. The Fifth Five Year Plan (1978-83) targeted a rise in domestic saving from 8.3% of the GDP in 1977-78, to 12.5% by 1982-83. However, domestic saving showed no tendency whatsoever to rise. On the contrary the rate fell further, and over the period averaged well below the Plan target (see, Table 2-2-4).

Private saving started to revive by 1983 (see Table 4-3-4). Yet in less than two years the Sixth Plan's targets were abandoned due to the failure to raise domestic resources. Such a scenario severely constrained the development process. Accordingly, the Planning Minister, Mahbub-Ul-Haq, advocated a consumption tax in 1985 to curtail the consumption orientation of the society(64). The Minister, however, offered no explanation for negative public saving which at that time was partly responsible for the dismal performance of the domestic saving (see Table 4-3-4). In the following section, we attempt to point out some of the major factors responsible for the poor performance of public saving during this period.

Section: 2-3-5

Dissaving in the Public Sector and Low Level of Investment

During the Sixth Plan period the limited improvement observed in private effort to mobilise resources domestically was largely eroded by the dissaving in the public sector (see Table 4-3-4). Such a wide gap between Government's revenue and its current expenditure was indicative of the heavy pressure that was being placed on the meagre resources of the economy by the non-development expenditures of the national budget. The negative public saving during this period was also caused mainly by the inefficiency of the public enterprise sector of the economy. Insofar as domestic resource mobilisation is part of the larger issue of the resource gap (the difference between expenditures and income), the public enterprise sector as a whole was not self-sufficient during this period and was a substantial contributor to the Government's resource gap. In Table 5-3-5 we have listed the investment and saving gap of a total of 167 public sector enterprises for 1980 and 1985. The saving performance of these enterprises is defined here as retained earnings and depreciation after subsidies have been deducted. This measure indicates the net resources generated by public enterprises that are available for reinvestment after taxes and dividends have been paid.

As shown in Table 5-3-5, the saving and investment gap of the public sector enterprises decreased to about

Rs. 8.6 billion in 1985 from the relatively high level of about Rs. 10.2 billion in 1980. However, an examination of various sectors shows that this gap would have been much greater if required investment had been made. A growth rate of about 6.6% of GDP during this period was quite impressive. But this growth rate was achieved by relatively low investment rates. The latter were only marginally above the rate of the previous period (see Table 2-2-5). The high growth rates were achieved by the running down of infrastructure and the neglect of appropriate replacement investment(65). For example, in departmental commercial undertakings, the Post Office showed a need for much greater investment than it received in facilities such as electronic sorting equipment and modern buildings, and improved working conditions for its employees(66). In the finance sector in 1985 investment in capital assets was only Rs. 383 millions while the total assets managed by this sector were Rs. 291 billions(67), a fairly wide gap.

In the manufacturing sector the Government followed a policy of little or no new investment in projects, yet it provided large subsidies to keep the sector going. The subsidy for this sector in 1985 was only marginally less than that in 1980. Although a major contributor to this gap was the steel mill which required substantial support to cover its operating losses, the nationalised manufacturing sector was still a heavy strain on the

Table: 5-3-5

Selected Public Sector Enterprises
Saving and Investment Gap
(Pakistan: 1980 to 1985)

(Rs. Million)

(a) No. Enterprise	(b) 1980			(c) 1985		
	(i)	(ii)	(iii)	(i)	(ii)	(iii)
1. Telegraph & Telephone	912	481	431	2798	1743	1055
2. Post Office	-43	14	-57	-150	40	-190
3. Finance	784	232	552	3439	383	3056
Manufacturing	-238	3887	-4125	-1058	2640	-3698
4. Transport & Communication	352	4461	-4109	857	3896	-3039
5. Energy	2075	3745	-1670	3722	8847	-5125
6. Trade & Commerce	-1024	125	-1149	133	50	83
7. Mining	-13	4	-17	-35	11	-46
8. Agriculture	19	49	-30	64	-26	90
9. Construction	4	0	4	-806	-40	-766
1-9 TOTAL	2828	12998	-10170	8964	17544	-8580

Source:: This table is the reorganisation of Table: 3.41 given in Robert Laporte Jr; and Muntazar Bashir Ahmed Public Enterprises in Pakistan: The Hidden Crisis in Economic Development Westview Press, San Francisco, 1989, P. 93.

- (i) Saving.
(ii) Investment.
(iii) Gap= Surplus/deficit.

Government budget. Little progress was made in denationalising the large industrial concerns which were expropriated by the previous regime(68). Nationalisation occurred in Pakistan as part of the increasing interventionist role of the state. As such, once implemented and integrated into the structure of economic production as a whole, nationalisations are extremely difficult to reverse, especially in the industrial sector, as was shown by the experience of Sadat's otherwise very stable regime in Egypt. In Pakistan, the nationalised commercial banks had become a very important source for the state's own deficit financing. The stratum of the bureaucracy that administered the nationalised sector developed a vested interest in the continued existence and even expansion of the sector. Also, the workers in the nationalised industries, who had made considerable economic gains as a result of nationalisations, were so hostile to the return of the capitalists that the Government was forced to slow down considerably the process in view of the need to build a broad political consensus.

Although Zia's regime was the longest in office, it did not seek to restructure the taxation system which desperately needed reform. Pakistan's tax revenue remains one of the lowest in the world, largely because of three characteristics of the country's taxation structure: first, direct taxation contributes only a small proportion

of the revenue, about 18.6% of the total tax revenue(69); second, Pakistan has one of the eight most external-sector dependent taxation systems in the world, since taxes on foreign trade contribute 40% of her total tax revenue(70); third, Pakistan's tax-GDP ratio is also much lower than the average of the LDCs. The ratio in Pakistan is 13%, whereas the average for LDCs is 17.5%(71). Indeed, Government did not want to change the status quo. Any reformative action was likely to deprive it of the political support of the feudal and merchant classes, on whom it was largely counting for the legitimacy of a centrifugal regime.

Section: 3-3-5

The Share of Foreign Aid in Capital Formation

Even to maintain relatively low levels of investment, substantial external resources were required during this period. However, a harsh international climate of rising debt service charges and reduced lending to developing countries meant that Pakistan had to confront a fall in net aid inflow. The recourse to funding from the World Bank entailed the adoption of stringent conditions, as part of the structural adjustment loan (SAL). But American aid after the Afghanistan Crisis relieved the Government of pressure to follow the strict policy ruling of the donors. Indeed, early on 12 June 1980 the Aid-to-Pakistan Consortium, meeting under the policy direction set by the United States, approved US\$980 million for 1980-81. More

significant than that was the willingness to reschedule the debt payment under explicit US prodding. Pakistan's total debt at that time stood at US\$10.3 billion, half of which was owed to the Consortium. If aid were held at previous levels without rescheduling, the entire amount would have gone for servicing debt(72).

Hence, the Government was in a position, stronger than ever before, to effectively substitute foreign saving for its own potential saving. Although the figures listed in Table 1-2-5, indicate a net fall in real inflows of aid during this period, that is only a relative measure. In absolute terms that amount represents a quite substantial inflow of real economic resources for a country that was a major recipient of foreign aid for about forty years.

In order to obtain some idea of the extent of the contribution of foreign aid to the development finance of the country, we have listed in Table 6-3-5 the annual average share of domestic and public saving in total and public investment respectively.

Table 6-3-5 clearly reveals the unprecedented share of the foreign saving that financed investment in Pakistan during 1978-88. The annual average of the share for this subperiod was higher than the averages of the previous two subperiods. Further, it is quite evident that even after thirty years of extensive external help, the country

Table: 6-3-5

Share of Domestic Resources In Capital Formation
(Pakistan: 1960 to 1988)*

No.	(a) Period	(b) Total investment		(c) Public Investment	
		(bi) Domestic Saving	(bii) Foreign saving	(ci) Public Saving	(cii) Other Saving ^p
1.	1960-70	68.02	31.98	77.70	22.30
2.	1970-78	78.72	21.28	48.90	51.10
3.	1978-88	59.75	40.25	8.99	91.01
1-3	1960-88	68.12	31.88	44.93	55.07

Source:: Appendix, Table 3-A.

All figures are percentages calculated at Pakistan's constant market price of 1959-60.

p Implies, both, domestic private and foreign saving, since government can pre-empt the supply of private saving by offering after tax returns on national saving instruments, with which private intermediaries and borrowers might be unable to compete.

was still unable to finance domestically about half of the total development expenditures. The Government was effectively substituting both domestic private saving and foreign saving for its part of capital formation. As given in Table 6-3-5, Government saving during this period financed only an annual average of about 9% of public investment, the lowest in relative terms of the Table, and low in general terms.

Finally, as shown in Table 6-3-5, Pakistan's development effort has involved domestic investment greater than domestic saving, and we have shown in Chapter Four that Government expenditure was greater than Government revenue. The excess demand on domestic resources must spill over to the balance of payments with imports greater than exports. There must be an external financing requirement equivalent to the deficit on goods, services, private transfers plus net net purchase of foreign assets. The resource gap must be filled by foreign saving and foreign exchange. And this will entail external debt if foreign exchange reserves, direct private investment and grant aid are insufficiently available. The following chapter attempts to analyse the balance of payments deficit and foreign debt obligations of Pakistan.

NOTES

1. See, Interim Budget Speech, 1959-60, Published in, "Budget Speeches: 1947-48 to 1984-85", Budget Wing, Government of Pakistan, Finance Division, Islamabad, September, 1984, Vol. I, P. 326.

2. Ibid.

3. Ibid; P. 331.

4. PICIC is a privately owned development finance company established in 1957, largely on the advice of the World Bank. It is supported by foreign financing. PICIC played a very important role in the growth of the private investment in the 1960s. There are many people who find it difficult to visualize the interlink between the economic assistance and domestic private investment. This link is made when foreign aid is channelled into domestic industry through organisations like PICIC. For instance, from France, loans through PICIC went to Crescent Sugar Mills, Hyesons Sugar Mills and Premier Sugar Mills. From Italy, through PICIC, loans went for the setting up of the Shahtaj Sugar Mills, and from Japan came loans for Karnaphully and Dawood Chemicals. See, Rashid Amjad, "Industrial Concentration and Economic Power", Published in Hassan Gardezi and Jamil Rashid (ed.), "Pakistan: The Roots of Dictatorship", Zed Press, London, 1983.

5. See, Budget Speech, 1959-60, Published in "Budget Speeches" op. cit. P. 338.

6. Ibid; P. 348.
7. Ibid; P. 345.
8. See, Budget Speech, 1960-61, P. 9, in Budget Speeches, op. cit.
9. K. B. Griffin, "Foreign Capital, Domestic Savings and Economic Development", Oxford Bulletin, May, 1970, P. 103.
10. See, P. Rosentein-Rodan, "International Aid For Underdeveloped Countries", Review of Economics and Statistics, May 1961, PP. 107-38.
11. W. W. Rostow, "The Take-off Into Self-sustained Growth" Economic Journal, March 1956, pp. 25-48.
12. See, Budget Speech, 1961-62, Published in "Budget Speeches" op. cit., Vol. II, P. 31.
13. See, Government of Pakistan, "Third Five Year Plan, 1960-1970"
14. See, Budget Speech, 1967-68, Published in "Budget Speeches", op. cit., Vol. II, P. 182.
15. See, Budget Speech, 1968-69, Published in "Budget Speeches" op. cit., Vol. II, P. 208.
16. See, Budget Speech, 1965-66, Published in "Budget Speeches" op. cit., Vol. II, P. 125.
17. Industrial capital refers to the share of corporate saving and dividends in new investment while financial capital implies investment undertaken by funds borrowed from financial institutions of the country.
18. See, Rashid Amjad, op. cit., P. 246.
19. Ibid; P. 249-50.

20. Ibid; P. 250.
21. Ibid; P. 251.
22. See, Report to The Congress By The Controller General of The U.S., "Assistance to Pakistan Should Be Reassured" Dept; of State, Agency For International Development, Feb; 6, 1976, P. 6.
23. Indeed, rescheduling or debt relief is a unique financial arrangement, involving complicated relationships between the creditors and the borrowing countries. Debt relief should not be equated with aid, since the rescheduling only constitutes temporary acquiescence in nonpayment of resources that debtor does not currently have.
24. See, Report to the Congress, op. cit., P. 8.
25. Ibid; P. 9.
26. See, Feroz Ahmed, "Partners in Underdevelopment: Pakistan and The U.S." MERIP Report No. 26, March, 1974, P. 26.
27. See, Report to The Congress, op. cit., P. 8.
28. See, Aijaz Ahmed, "Democracy and Dictatorship", Published in Gardezi and Rashid, op. cit., P.113.
29. See, Feroz Ahmed, "The New Dependence", Published in Gardezi and Rashid, op. cit., P. 193.
30. See, Pakistan Economic Survey, 1974-75, PP. 121 and 130.
31. Ibid; P. 135.
32. Ibid; P. 137.

33. Ibid; P. 129.
34. See, Budget Speechs, 1974-75 and 1975-76, Published in Budget Speeches, op. cit.
35. See, K. Sarmad and S. S. Haider Naqvi, "Pakistan's Economy Through the Seventies", PIDE, Islamabad, 1983. The authors, however, do not argue that public enterprises were particularly efficient, especially when evaluated at world prices, but their inefficiency was no less than that of private units.
36. See, Omar Noman, "The Political Economy of Pakistan: 1947-85", KPI Limited, London, 1988, P. 80.
37. Ibid.
38. See, Sarmad and Naqvi, op. cit., P. 48.
39. See, Omar Noman, op. cit., P. 81, Table 2.
40. See, World Bank, "Public Sector Resource Mobilisation", Washington D. C., US, 1978.
41. See, Omar Noman, op. cit., P. 82.
42. See, Khamis Saleh Suhail, "Growing UAE-Pakistan Economic Ties", Dawn, 2 December, 1975, Karachi.
43. See, The New Dependence, op. cit., P. 205.
44. See, Z. Altaf, "Entrepreneurs in The Third World", Croom Helm LTD; New York, 1988, P. 83.
45. Market value of the share of three companies Ravi Rayon, Metropolitan Steel, and Synthetic Chemical was Rs. 10.00, Rs. 6.92 and Rs. 5.13, their break up values for bonds were given as Rs. 2.57, Rs. 2.08, and nill respectively. Further, the bonds were redeemable at a very

- low rate of interest, i.e., 7%. See, Z. Altaf, op. cit., P. 73.
46. The Habibs, The leading monopoly house in Pakistan Banking, for example, received, Rs. 36.31, for each share originally valued at Rs. 5, see, Aijaz Ahmed, op. cit., P. 110.
47. See, Z. Altaf, op. cit., P. 64.
48. See, Aijaz Ahmed, op. cit., P. 111.
49. Ibid.
50. Ibid; P. 115.
51. See, Alan A. Tait, Wilfrid L.M. Gratz, and Barry J. Eichengreen, "International Comparisons of Taxation For Selected Developing Countries: 1972-76", I.M.F. Staff Papers, Vol. 26, 1979, PP 123-56.
52. Ibid; P. 133, Chart two.
53. See, Ronald I. Mckinnon, "Money and Capital In Economic Development", Washington, The Brooking Institution, 1973.
54. In developing countries the price of money usually does not rise with other prices because of capital market distortions. Consequently, the real rate of interest decreases with an increase in inflation rate. In Pakistan, during this period, the average real rate of interest was negative for the years between 1972 and 1977 (see, Appendix, Table 4-A).
55. See, Omar Noman, op. cit., pp. 88-9.
56. In theory devaluation is equivalent to an overall

protective tariff encouraging import substitution, but nature of 'product' requirements is different in developing countries. In these countries, in the rural areas, prestige is attached to urban goods, for the urban consumers, prestige and status follow from purchase of imported goods. This kind of market structuring offsets the effect of devaluation when imported goods are more freely available.

57. see, Aijaz Ahmed, op. cit., P. 114.

58. See, Pakistan Economic Survey, 1988-89, Statistical Supplement, Tables 11.6 and 11.7.

59. Pakistan: Dimensions of Insecurity", Adelphi Papers, No. 246, IISS, Winter 1989/90, P. 56.

60. See, "Industrial Policy Statement", Government of Pakistan, Ministry of Industries, Islamabad, June, 1984.

61. See, Omar Noman, op. cit., pp. 171-2.

62. See, Z. Altaf, op. cit., P. 29.

63. See, Mahnaz Ispahani, op. cit., pp. 14-15.

64. The statement of the Planning Minister appeared in the daily, 'Dawn' of 6.01.1985.

65. For Details see, "Pakistan: Review of The Sixth Five Year Plan" A World Bank Country Study, The World Bank, Washington, D. C., U.S., 1984.

66. See Robert Laporte Jr; And MuntazarBashir Ahmed, "Public Enterprises in Pakistan: The Hidden Crisis in Economic Development", Westview Press, San Francisco, 1989, P. 68.

67. Ibid.

68. Although the 1976 nationalisation of small, agro-based units was undone in 1977, yet the major units were left in the public sector. In 1984, two sugar mills and a paper mill were sold off. On the whole, however, denationalisation has been remained, to date, patchy and hesitant.

69. While the average for all LDCs was 29.3% and for East Asian Countries it was 43.3%, See D. Newbury and N. Stern, "The Theory of Taxation For Developing Countries", Oxford, 1987, P. 212.

70. Ibid.

71. Ibid; P. 215.

72. See, Aijaz Ahmed, op. cit., P. 137.

CHAPTER: 6

BALANCE OF PAYMENTS AND INDEBTEDNESS PROBLEM (Pakistan: 1960 to 1988)

Introduction

Pakistan is heavily in debt and her debtor position is deepening each year. Whether the country will be able to meet all debt obligations without seriously bringing economic growth to a halt depends on her ability to improve the balance of payments situation. The present chapter attempts to address and analyse the balance of payments situation and the indebtedness problem of Pakistan.

There are three distinct parts in this chapter. The first part scrutinises the balance of payments position of Pakistan. The second part provides a rapid survey of her foreign exchange reserves position. Finally, the third part reviews the indebtedness position of the country, considering particularly the debt service ratios. Also this part asks the difficult question, what economic indicators could be employed to determine if the country is capable of continuing with further borrowing and meeting debt service obligations without any negative impact on the long-run growth rate.

Part: 1-6

Balance of Payments
(Pakistan: 1960 to 1988)

This part is divided into two sections. Section one describes the current account deficit/surplus position, while section two analyses one of the most important variables in the current account of the balance of payments table of Pakistan, workers' remittances.

Section: 1-1-6

Current Account of the Balance of Payments

External debt service problems manifest themselves in current account deficits and foreign exchange shortages. When this occurs, difficulties may be of such magnitudes as to require a restructuring of all or part of a country's debt stock. There is, however, a tendency on the part of both debtors and creditors to avoid renegotiation of original loan terms. Borrowers are aware that deviation from payment schedules damages their credit standings, and lenders view rescheduling as at least a temporary impediment to their cash flows. Consequently, a nation may be already heavily in arrears before it elects to undergo the rescheduling of its debt. If allowed to continue without a successful rescheduling/refinancing accord being reached, debt service problems can lead to three undesirable events: a unilateral moratorium on payments by the debtor; an outright repudiation of debt by the debtor; or a declaration of default by the creditor.

In the 19th century and in the 20th century before

the 2nd World War America and many European nations often chose debt repudiation as a way out of a payment bind(1). The nineteenth century, in particular, was characterised with panics (for example 1836, 1857, 1873 and 1893), followed by depression and accompanied, despite the enormous and undisputed natural wealth of the US, by defaults or moratoriums on debt payments. The Congress refused to assume responsibility for unpaid state obligations(2). In the contemporary world, however, sanctions for international bankruptcy are severe. They almost certainly include the breaking of trade links upon which the nation normally relies, the denial of credits that are the lifeblood of trade, and in extreme cases a deliberate government-enforced trade boycott. The consequences of all these drastic actions are extremely grave for both parties, and over the years instances of them have been rare.

Pakistan, however, has so far had no record of unilateral repudiation as a way out of payments crises. But as mentioned in the preceding chapter, the payments on debts were 'rescheduled' twice in the 1970s with the co-operation of the creditor countries. In the 1980s two exogenous developments helped to ease the balance of payments difficulties. First, in the wake of the Afghan War, the Government made frantic efforts to solicit massive aid from the Western bloc, particularly from the US, and from the conservative Arab regimes. The second

'bright spot' was the dramatically steep increase in home remittances by Pakistani workers abroad.

In Table 1-1-6 we have listed the annual magnitudes of balance falling into various categories. These data were obtained from the current account of the balance of payments of Pakistan(3). The figures indicate the intensity of the situation as it developed over the period. Table 1-1-6 reveals the persistent and generally increasing magnitude of the deficit in the balance of payments. The period averages in column (d) of the table denote that the country was either drawing down her foreign reserves, or else she depended on external borrowing to finance the persistent deficit in the balance of payments. Further, if we consider column (b [bi+bi]), we find that with the exception of the 6th Plan the annual average of the total deficit on visible and invisible items shows a secular increasing trend. The significance of the marginal improvement during the 6th Plan period, however, is considerably diminished by the fact that the annual average of the deficit on visible and invisible items, together almost doubled between the Nonplan and the 5th Plan periods.

The gross figures listed in Table 1-1-6, are instructive, but in many respects they conceal more than they reveal. A closer look at the various component items of the balance of payments table, and some explanation of

Table: 1-1-6

Current Account Performance
(Pakistan: 1960 to 1988)

(US\$ Million)

(a) No. Year/ Period	(b) Balance on Current Account Transactions			(c) Private Trans- fers	(d) Current Account Deficit/Surplus	
	(bi) Visib- le Items ^p	(bii) Invis- ible Items [#]	(biii) Total (bi+ bii)		(biii- c)	% of GDP ^q
1. 2nd Plan						
i. 1960-61	224.61	55.70	280.27	1.95	278.32	7.05
ii. 1961-62	244.54	73.00	317.54	5.69	311.85	7.43
iii. 1962-63	310.89	58.12	369.00	4.61	364.40	8.09
iv. 1963-64	344.67	128.02	472.70	18.80	453.89	9.45
v. 1964-65	446.86	118.47	565.33	27.87	537.46	10.21
i-v. 1960-65	314.31	86.65	400.97	11.78	389.18	8.45
2. 3rd Plan						
i. 1965-66	246.22	125.21	371.43	31.09	340.34	6.03
ii. 1966-67	445.08	138.52	583.61	33.61	550.00	9.25
iii. 1967-68	256.00	146.17	402.17	61.10	341.07	5.51
iv. 1968-69	241.35	144.22	385.58	78.73	306.84	4.59
v. 1969-70	373.61	172.22	545.83	56.25	489.58	6.59
i-v. 1965-70	312.45	145.27	457.72	52.16	405.57	6.40
3. Nonplan						
i. 1970-71	274.69	158.27	432.96	42.51	390.45	5.17
ii. 1971-72	144.00	111.87	255.87	79.73	176.14	5.28
iii. 1972-73	-11.45	89.87	78.42	84.14	-5.73	-0.15
iv. 1973-74	453.71	138.11	591.81	90.54	501.28	12.03
v. 1974-75	531.71	135.57	667.28	26.38	540.90	12.58
vi. 1975-76	434.70	126.80	561.49	83.63	377.86	8.41
vii. 1976-77	505.90	140.05	645.95	32.10	413.85	8.87
viii. 1977-78	536.16	132.21	668.37	47.77	220.60	4.37
i-viii. 1971-78	358.67	129.09	487.77	160.85	326.92	7.07

Table: 1-1-6 Continued.....

(a) No. Year/ Period	(b) Balance on Current Account Transactions ^{¶¶}			(c) Private Trans- fers	(d) Current Account Deficit/Surplus ^{¶¶}	
	(bi) Visib- le Items ^p	(bii) Invis- ible Items [#]	(biii) Total (bi+ bii)		(biii- c)	% of GDP [■]
4. 5th Plan						
i. 1978-79	732.55	147.72	880.27	504.55	375.72	7.11
ii. 1979-80	768.48	158.52	927.00	578.80	348.20	6.06
iii. 1980-81	775.32	144.46	919.78	628.89	290.88	4.74
iv. 1981-82	914.63	131.50	1046.10	639.45	406.68	8.08
v. 1982-83	764.84	155.83	920.68	788.38	132.30	2.59
i-v. 1978-83	791.16	147.60	938.77	628.02	310.75	5.71
5. 6th Plan						
i. 1983-84	802.51	173.10	975.62	734.91	240.71	5.07
ii. 1984-85	823.75	189.01	1012.80	623.15	389.61	7.90
iii. 1985-86	682.98	228.10	911.09	633.59	277.50	5.63
iv. 1986-87	500.98	214.46	715.44	558.42	157.02	3.06
v. 1987-88	543.70	293.64	837.34	479.69	357.64	6.67
i-v. 1983-88	670.78	219.66	890.45	605.95	284.50	5.66
1-5. 1960-88	475.53	143.88	619.44	277.72	341.62	6.70

Source:: For nominal values of (b) and (c): (i) From 1960 to 1966, and 1967 to 1976, International Financial Statistics, Yearly Book, I. M. F., 1968 and 1989, respectively, (ii) From 1977 to 1988, Pakistan Economic Survey, 1988-89, Statistical Supplement, P. 143.

* The nominal values are deflated by the GDP deflator of the industrial countries. The base year is 1959-60.

¶ + = deficit, - = surplus.

^p Balance on merchandise exports and imports.

[#] Balance on non-factor services and investment items.

[■] GDP at constant market price of 1959-60, converted into \$US at official exchange rate.

what they include or exclude, will be useful. Such an analysis is, however, beyond the scope of this study. But it is very important for our purpose to take account of the component which acquired unprecedented and remarkable importance during the 1970s and 1980s, workers' remittances.

Section: 2-1-6

Net Factor Income From Abroad

The improvement in the balance of payments that we observe after the 3rd Plan period in Table 1-1-6 arises exclusively from incomes of Pakistani workers abroad which were remitted to their families back home. These remittances registered a negative balance up until 1971, except for 1970 when a small surplus was obtained for the first time. As mentioned earlier, in 1972 Pakistan started an effective programme of exporting her labour force to the oil-rich Middle Eastern Muslim Kingdoms. Starting from a positive balance of about five million dollars in 1972, this heading of the balance of payments registered a continuously increasing and spectacularly large yearly surplus up until 1983. Table 2-1-6 lists five different measures of workers' remittances for each year of the period of our analysis. The absolute and proportionate magnitudes of these remittances, in columns (b) and (c) to (f) respectively, underscore the absolute and relative significance of these inflows for Pakistan's payments deficit. The figures in Table 2-1-6 also partly explain

Table: 2-1-6

Workers' Remittances
(Pakistan : 1960 to 1988)

(a) No. Year/ Period	(b) Absolute Value ^p	(c) ^q (b) % of 1-1-6 (c)	(d) ^r (b) % of 1-1-6 (b)	(e) % of Aid ^s	(f) % of Exports
1. 2nd Plan					
i. 1960-61	-5.37	-275.00	-1.92	-1.69	-2.13
ii. 1961-62	-5.31	-93.33	-1.67	-2.05	-2.09
iii. 1962-63	-9.41	-204.00	-2.55	-2.25	-2.78
iv. 1963-64	-6.54	-34.76	-1.38	-1.53	-1.85
v. 1964-65	-10.02	-35.94	-1.77	-1.80	-3.32
i-v. 1960-65	-7.33	-128.61	-1.86	-1.86	-2.44
2. 3rd Plan					
i. 1965-66	-8.74	-28.11	-2.35	-2.27	-2.46
ii. 1966-67	-8.28	-24.63	-1.42	-1.92	-2.13
iii. 1967-68	-3.71	-6.08	-0.92	-0.77	-0.90
iv. 1968-69	-4.64	-5.89	-1.20	-1.45	-1.13
v. 1969-70	0.42	0.74	0.08	0.16	0.05
i-v. 1965-70	-4.99	-12.79	-1.16	-1.25	-1.31
3. Nonplan					
i. 1970-71	-11.18	-26.31	-2.58	-3.98	-1.95
ii. 1971-72	5.56	6.98	2.17	3.14	2.23
iii. 1972-73	26.79	31.84	18.14	28.89	4.45
iv. 1973-74	31.87	35.20	5.40	20.70	5.01
v. 1974-75	53.26	42.15	7.98	15.92	8.27
vi. 1975-76	128.16	69.72	22.83	37.08	21.38
vii. 1976-77	227.38	97.97	35.20	89.06	45.31
viii. 1977-78	422.21	94.29	63.17	218.53	83.02
i-viii. 1970-78	110.51	43.99	19.05	51.17	20.97

Table: 2-1-6 Continued.....

(a) No. Year/ Period	(b) Absolute Value ^p	(c) [■] (b) % of 1-1-6 (c)	(d) [#] (b) % of 1-1-6 (b)	(e) % of Aid [■]	(f) % of Exports
4. 5th Plan					
i. 1978-79	471.50	93.45	53.56	273.58	91.50
ii. 1979-80	532.68	92.03	57.46	196.84	74.21
iii. 1980-81	593.55	94.38	64.53	573.44	57.95
iv. 1981-82	589.87	92.25	56.39	364.16	62.16
v. 1982-83	738.49	93.67	80.21	432.68	71.96
i-v. 1978-83	585.22	93.16	62.43	368.14	71.56
5. 6th Plan					
i. 1983-84	660.79	89.92	67.73	609.57	71.62
ii. 1984-85	567.25	91.03	56.01	521.54	65.42
iii. 1985-86	582.62	91.96	63.95	417.20	72.80
iv. 1986-87	497.71	89.13	69.57	767.34	55.23
v. 1987-88	428.02	89.23	51.12	284.72	46.58
i-v. 1983-88	547.28	90.25	61.67	520.08	62.33
1-5. 1960-88	231.60	20.07	27.06	172.67	29.23

Source:: For column (b), (e), and (f), Appendix, Tables 4-A, 5-A, and 7-A.

^p US\$ million, at constant market prices of the developed countries, 1959-60 is the base year.

[■] Workers remittances as percentage of private transfers.

[#] Workers remittances as percentage of total deficit on visible and invisible trade items.

[■] Foreign aid disbursements, net of debt service payments.

why Pakistan did not experience a balance of payments crisis in the 1980s, as did many of the other debtor countries.

The critical importance of remittances can be better judged from columns (c) to (f) in Table 2-1-6. The remittances, as an annual average, added to column (b) of Table 1-1-6 (total deficit [bi+bi1] on visible and invisible transactions) by 1.85% and 1.16% of the total during the 2nd and 3rd Plan periods respectively. But during the Nonplan period they financed about one fifth of the deficit. Further, during the same period remitted incomes of workers abroad appear to have considerably supplemented other private transfers and foreign aid in filling up the current account deficit. As an annual average they amounted to as much as about 44% of total private transfers and about one third of the net disbursement of all external assistance. They also supplemented export earnings by a little over one-fifth of total earnings from the export of goods and non-factor services. All these contributions increased remarkably during the 5th Plan period. Then, remittances almost completely replaced all other forms of private transfers as they constituted a little over 93% of the total amount of the latter. More significantly, their contribution was about twice as much as the traditional remedy for current account deficit, external assistance. And, they financed a little over 62% of the total deficit on visible and

invisible trade items as they provided foreign exchange equivalent to about 72% of export earnings. During the 6th Plan period, however, all the magnitudes in Table 2-1-6 registered a slight annual average decline over the respective averages of the 5th Plan. Nonetheless, the decline was too small to undermine the significance of this source of foreign exchange in relieving pressures on the current account deficit of Pakistan. Yet, the declining trend is a definitive indicator of the vulnerability of Pakistan's economy to an exogenous factor in determining the performance of her external sector.

It is evident that Pakistan may face difficulties if foreign exchange flows from workers' remittances go back to their 60s' level. Such a reversal is almost predictable in that the real inflows had already started to decline after the peak level of 1983. By the mid 1980s stagnating oil prices, competition from other labour exporting developing countries, a general slowdown in Arab development and the changing structure of specific programmes had reduced Pakistani migration and remittances. According to a Report by the International Labour Organisation (ILO), the Gulf states have decreased all migrants' wages by up to 20% and about 700,000 workers have left. The ILO estimated that the number of Pakistani migrants would fall by nearly 300,000 between 1985 and 1990 and they will be earning 25% less in real terms(4). A net annual return migration of about 50,000 was

expected(5). In fact, by June 1987 about 100,000 Pakistani workers had returned(6). Further, the country is currently suffering economic difficulty in the wake of the Iraqi occupation of Kuwait and its "aftermath". This caused the return of tens of thousands of workers, largely destitute. This perspective along with the drastic changes in international political and economic environment, may render recent public legislation relieving many of the foreign exchange controls in Pakistan a desperate effort, rather than a conscious and consistent policy(7) on the part of the Government to cope with the balance of payment problems that threaten to escalate out of control. A balance of payments deficit is not necessarily the same as a balance of payments crisis, but a long succession of deficits often leads to a crisis. The current transactions balance, set out in Table 1-1-6, suggests that Pakistan is chronically consuming more than she earns and, therefore, building up heavy indebtedness. And it is often the debt repayment burden that precipitates a payments crisis.

Part: 2-6

Foreign Exchange Reserves
(Pakistan: 1960 to 1988)

The typical balance of payments or foreign exchange crisis in LDCs arises when debt repayment obligations necessitate the earmarking of so much foreign exchange that other items, usually imports, have to be cut back.

The chronic deficit on the current account of the balance of payments of Pakistan in past years, as listed in Table 1-1-6, may result in an exchange crisis now or in the years ahead.

In this context the foreign exchange reserves of the country are of immense importance. Their importance lies in the fact that the larger the reserves, the longer the country can avoid having to take steps to adjust the payments deficit. As long as a nation can continue to draw down its reserves there is no crisis. In Table 3-2-6 we have listed the magnitudes of the foreign exchange reserves of Pakistan for the period of our analysis. It is readily seen from Table 3-2-6 that the foreign exchange reserves position of Pakistan was never strong. On the contrary, for most years of the period the reserve position was precarious. The reserve position was at its peak level in 1983, the year when remittances registered their largest earnings of foreign exchange (see Table 2-1-6). In 1988, the last year of analysis, the reserves were at their third lowest level after the levels of 79' and 71' respectively. The latter was the year when the country defaulted on payment of debt service, and it was followed by rescheduling arrangements. In 1979 and thereafter crisis was avoided by the increased inflow of foreign exchange from workers' remitted incomes, and by the increase in aid receipts as a result of Pakistan's Afghan War strategy.

Table: 3-2-6

Foreign Exchange Reserves^P
(Pakistan: 1960 to 1988)

(US\$ Million)

(a) NO. Year/ Period Reserves	(b) Year/period							
	1. <u>2nd Plan</u>	1960-61	1961-62	1962-63	1963-64	1964-65		
Reserves	199	201	220	165	153			
2. <u>3rd Plan</u>	1965-66	1966-67	1967-68	1968-69	1969-70			
Reserves	129	91	149	205	87			
3. <u>Nonplan</u>	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78
Reserves	75	124	218	188	143	182	163	134
4. <u>5th Plan</u>	1978-79	1979-80	1980-81	1981-82	1982-83			
Reserves	57	143	187	226	481			
5. <u>6th Plan</u>	1983-84	1984-85	1985-86	1986-87	1987-88			
Reserves	220	181	156	106	83			
Period Average	(1) 1960-65	(2) 1965-70	(3) 1970-78	(4) 1978-83	(5) 1983-88	(1-5) 1960-88		
Reserves	188	132	153	219	149	167		

Source: IMF, International Financial Statistics, Year Book, 1990.

^P Calculated at the 1959-60 market prices of the developed countries.

Furthermore, one useful measure of the adequacy of reserves is the relationship between reserve holdings and the current level of imports. A country whose reserves are sufficient to pay for six months' imports has a fairly comfortable reserve 'cushion' against shortfalls in earnings, while one with only two months' worth is in a more precarious position. But reserves covering only a few weeks' imports signal a crisis(8).

In Table 4-2-6 we have listed the quarterly import payments and foreign exchange reserves from the first quarter of 1986 through to the first quarter of 1991. Though the last nine quarters go beyond the period of study, they are very helpful in assessing the effect of the changes in earlier favourable exogenous factors on the present balance of payments.

If only foreign exchange reserves are taken as a standard, we find that the balance of payments position of Pakistan has been precarious since the time of the first entry in Table 4-2-6. The reserves did not cover even nine weeks' import requirements through the first three quarters of 1986. The position further worsened later and the last quarter of 1986 registered foreign exchange reserves less than the value of eight weeks' imports. Also, for the year as a whole the reserves were not enough to cover the import payments. The year 1987 registered a record on this account that was poorer than that of 1986, the reserves on the whole being less than worth six weeks'

Table: 4-2-6

Import Requirements and Foreign Exchange Reserves(*)
(Pakistan: January 1986 to March 1991)

(US\$ Million)

(a) No. Year/ Imports/ Reserves	(b) Year/ Quarter				
	(1)	(II)	(III)	(IV)	(I-IV)
	Jan. to March	Apr. to June	July to Sep.	Oct. to Dec.	January to December
1. <u>1986</u>					
i. Imports	1298	1318	1069	1186	1218
ii. Reserves	924 [#]	898 [#]	741 [#]	696 ^{*~}	815 [@]
2. <u>1987</u>					
i. Imports	1252 ^{jl}	1389 ^{*~}	1299	1375	1329
ii. Reserves	720 ^{tr}	886 ^{*~}	442 ^p	486 ^p	634 ^p
3. <u>1988</u>					
i. Imports	1425	1696	1316	1584	1505
ii. Reserves	555 ^p	427 [■]	352 [■]	388 [■]	431 [■]
4. <u>1989</u>					
i. Imports	1776	1772	1302	1676	1632
ii. Reserves	583 [■]	524 [■]	402 [■]	519 [■]	507 [■]
5. <u>1990</u>					
i. Imports	1684	1682	1482	1879	1682
ii. Reserves	548 [■]	604 ^p	433 [■]	295 ^U	470 [■]
6. <u>1991</u>					
i. Imports	1699	—	—	—	—
ii. Reserves	225 ^U	—	—	—	—

Source: I.M.F., International Financial Statistics, various monthly issues.

(*) Nominal Values.

Less than nine weeks' imports.

*~ Less than eight weeks' imports.

@ Only covering eight weeks' imports.

jl Less than seven weeks' imports.

p Less than six weeks' imports.

■ Less than four weeks' imports.

■ Less than three weeks' imports.

U Less than two weeks' imports.

imports. Deterioration continued in the three years that followed. The quarterly entries very occasionally showed marginal recovery, but on the whole the foreign exchange reserve level remained less than the amount required for four weeks' imports. The last two quarters provide ample evidence for the fears outlined in the preceding part of this chapter, i.e., the high potential risk of an over extended reliance on exclusively exogenous factors. The reserve position in the last and first quarters of 1990 and 1991 respectively heralds a balance of payments crisis for Pakistan. In the wake of the Iraqi Invasion of Kuwait and the 'War in the Gulf' that followed, the foreign exchange reserves fell to very low levels; not sufficient even for two weeks' imports.

Finally, as the time limit of the many debts accumulated in the past is coming nearer, given our analysis in this and the preceding part, the inference is clear: if workers' remittances return to their 60s' level or are considerably reduced, Pakistan will be forced to undergo a rapid transition from trade deficit financed by capital inflows to net capital outflows made possible by running trade surpluses.

Part: 3-6

The Indebtedness Problem
(Pakistan: 1960 to 1988)

Pakistan was compelled to seek renegotiation of debt during the 1970s. In the 1980s, however, the country did

not encounter the kind of circumstances of imminent crisis that would have qualified her for debt relief. Nevertheless, Pakistan found herself seriously hampered by the encroachment of debt service on import capacity. To perceive the fuller extent of the growing burden of debt service, we have divided this part into two sections. Section one analyses the extent of international indebtedness along with the trends in service payments. Section two attempts to appraise the burden of debt in terms of the trade balance after exports are adjusted for debt service payments. It also measures the debt service capacity of the country in terms of the domestic savings remaining after service payments. Further, this section provides a new direction in analysing debt servicing capacity by taking into account the per capita measures of debt burden and the domestic production of traded goods.

Section: 1-3-6

International Indebtedness and Debt Service

The volume of international debt flows to Pakistan has increased rapidly in recent years and so also has servicing of the debt. The nominal value of foreign indebtedness more than doubled between 1978 and 1988 (see, Appendix, Table 7-A). Table 5-3-6 sets forth the extent of the indebtedness problem in terms of several ratios.

The ratios produced in column (b), (c), and (d) of Table 5-3-6, clearly reveal the debt profile of Pakistan. Column (b) lists the ratios of total outstanding debt of

Table: 5-3-6

The Measures of Indebtedness
(Pakistan: 1960 to 1988)

(a) No. Year/ Period	(b) Fore- ign Debt ^a % of GDP	(c) Debt Service [#]		(d) Net Tran- sfer ^p (%)	(e) Foreign Reserves ^q	
		% of GDP (ci)	% of Export (cii)		% of Debt ^a (ei)	% of Debt Servi- ce (eii)
1. 2nd Plan						
i. 1960-61	4.1	0.4	6.6	95.0	119.3	1200.0
ii. 1961-62	5.2	0.7	10.8	89.8	94.2	683.9
iii. 1962-63	8.9	1.0	12.5	90.6	58.3	506.4
iv. 1963-64	12.8	1.2	15.6	88.5	27.8	296.8
v. 1964-65	17.3	1.1	14.9	91.2	17.2	283.8
i-v. 1960-65	9.7	0.8	12.1	91.0	63.4	594.2
2. 3rd Plan						
i. 1965-66	20.4	1.1	16.5	86.1	11.6	208.1
ii. 1966-67	22.5	1.3	16.8	84.6	6.5	115.6
iii. 1967-68	26.1	1.3	16.7	85.2	9.2	178.7
iv. 1968-69	29.3	1.8	24.6	73.4	10.9	175.9
v. 1969-70	29.8	1.7	26.2	68.8	4.3	71.6
i-v. 1965-70	25.6	1.5	20.2	79.6	8.5	150.0
3. Nonplan						
i. 1970-71	32.3	1.7	27.5	70.3	3.4	63.2
ii. 1971-72	76.0	2.5	19.5	70.2	5.3	163.9
iii. 1972-73	59.0	2.8	20.6	45.7	9.5	196.9
iv. 1973-74	49.7	2.2	19.4	60.4	8.3	186.8
v. 1974-75	59.2	2.2	23.6	74.6	4.7	125.4
vi. 1975-76	57.5	1.9	21.3	76.6	5.7	172.3
vii. 1976-77	54.6	2.1	27.5	67.6	5.0	133.1
viii. 1977-78	51.8	1.8	25.5	61.8	4.0	112.5
i-viii. 1970-78	55.0	2.2	23.1	65.9	5.7	144.3

Table: 5-3-6 Continued.....

(a) No. Year/ Period	(b) Fore- ign Debt [■] % of GDP	(c) Debt Service [#] % of GDP (ci) % of Export (cii)		(d) Net Tran- sfer ^p (%)	(e) Foreign Reserves [▣] % of Debt [■] (ei) % of Debt Servi- ce (eii)	
		4. 5th Plan				
i. 1978-79	52.3	2.2	26.6	53.9	1.6	38.4
ii. 1979-80	47.5	2.5	25.0	60.3	4.2	80.0
iii. 1980-81	40.5	2.2	21.5	38.0	5.9	110.3
iv. 1981-82	46.8	2.0	21.1	55.4	7.3	173.7
v. 1982-83	46.0	2.4	24.1	51.3	15.2	296.4
i-v. 1978-83	46.6	2.2	23.7	51.8	6.8	139.8
5. 6th Plan						
i. 1983-84	47.1	2.7	27.2	38.2	7.1	125.5
ii. 1984-85	46.6	2.6	32.1	37.3	5.6	99.1
iii. 1985-86	51.5	2.9	30.8	40.7	4.3	76.8
iv. 1986-87	52.0	3.2	31.5	21.6	2.7	44.1
v. 1987-88	51.3	2.9	25.6	38.8	1.9	34.7
i-v. 1983-88	49.7	2.8	29.4	43.5	4.3	76.1
1-5. 1960-88	39.2	1.9	21.8	64.8	16.5	212.7

Source:: Appendix, Tables, 2-A, and 7-A.

- Total external debt outstanding at the end of each calendar year ___ percent of GDP.
- # Includes both, principal and interest payment. The latter, however, excludes the interest on short-term borrowing and IMF charges.
- p Percentage of gross external assistance.
- ▣ Total foreign exchange reserves.

Pakistan to her gross national product at the end of each calendar year. The annual average ratio was highest during the Nonplan years, the debt being 55% of Gross Domestic Product. The average annual ratio declined by about 8 percentage points during the 5th Plan period, while it again increased to about 50% during the 6th Plan. For the period as a whole the annual average ratio is 39.2%, a figure which has been greatly reduced by the relatively lower ratios of the 1960s. The general trend indicates an ever increasing claim of foreign debt on the gross domestic product of the country.

Column (c) measures payments made to creditors on account of the servicing of past debts. The numerator is debt service which includes both amortisation and interest payments. Subcolumn (ci) lists the debt service measured as a percentage of GDP. It shows that not only Pakistan spared an annual average of 1.9% of her gross domestic product for the period as a whole, but also servicing of the debt was claiming an increasingly high amount of the gross domestic product of the country. This indicates that debt servicing is rising more proportionately than income.

Although the ratio of debt service to income is not the best measure of this pressure, the size of the ratio indicates the effort which the country is called upon to make in providing debt service. The higher the debt service expressed in relation to income the more effort is

involved in making service payments. And as far as fixed debt service is concerned the ratio is a measure of the rigidity that is built into the economic system by importing foreign capital.

The ratio of annual debt service payments to yearly export earnings is the most widely-known and widely-used indicator of debt burden. However, experts have never been able to agree on the 'danger' level of this ratio. As one of the OECD reports puts it, "there seems to be no critical level beyond which default may be expected"(9). In 1962 the World Bank suggested that 7% was the maximum prudent ratio(10). Hence, in the 1960s 10% was commonly taken as significant. But as the years went on and debt burden climbed faster than the growth of borrowers' economies, the ratios for several major borrowers exceeded 10 percent and climbed towards 20 percent. It was then suggested that a ratio of 20% or more is cause for concern(11). But even 20 percent did not prove to be a barrier. Indeed, there seemed to be very little connection between the size of the ratio and the actual debt service difficulties. Algeria, for example, carried a debt service ratio of 30% for several years in the early 1980s without failing to service its debt, while African countries with ratios under 10 percent fell deeply into arrears(12). Further back in history, Australia and Canada did not default during the 1930s, despite the fact that they had investment service ratios (which include profit

remittances as well as debt service) of 44 and 37 percent respectively(13).

Subcolumn (cii) lists the ratio of annual debt service of Pakistan to her yearly export earnings. We find an ever increasing trend in this ratio over the Plan and Nonplan periods with the exception of the 5th Plan period. The annual average ratio of the 5th Plan period is marginally lower than the Nonplan period. Even this small improvement largely arises from the debt rescheduling arrangements obtained in the second half of the 1970s which postponed the 'hump' of principal payments a few years. Once these arrangements were exhausted, the ratio showed the highest annual average of the debt service payments during the 6th Plan period.

The most serious problem with using the debt service ratio as an indicator of difficulties, however, is that it fails to take into account new inflows of capital from creditors. A country which has a debt service ratio of 20% may get along fairly well if it at the same time receives new loans which more than cover the outflow of debt service. Another country with the same 20 percent ratio might find itself plunged into crisis if that 20 percent actually had to be paid out of export earnings. These two countries may have identical export earnings and debt service ratios, but one country can use 100 percent of its earnings while the other can use only 80 percent.

It is because it takes account of this critical

element of inflow of new funds that some analysts consider the net transfer as a superior indicator of crisis(14). Net transfer measures the relationship between new inflows of money and debt service on the previously incurred debt. In column (d) we have listed the net transfer as a percentage of the gross inflow of external assistance. As given in that column, the net transfer exhibits a consecutive pattern of decline for the subperiod averages. All through the period the country did not encountered a single year of negative net transfer, but there are two snags regarding positive net transfer to Pakistan during the 1980s, the decade which came to be known for an ever widening spread of the phenomenon of negative net transfers(15). First, as we have mentioned several times in this study, the country capitalised on the Afghan War to negotiate large inflows of economic assistance in the 1980s. Second, and most important from an analytical point of view, negative transfer is a good but only an approximate indicator of the precise onset of crisis. Since each country has its own net transfer profile, and as every positive net transfer does not necessarily imply a tolerable debt burden, not every negative net transfer indicates crisis. It could just as easily indicate a healthy transition to an economy that can run trade surpluses and repay debts(16). Hence, it makes sense to explore the issue even further in the following sections of this part, before drawing any final conclusions about

the indebtedness problem of Pakistan.

Section: 2-3-6

Growth of External Indebtedness

The trends in the growth of debt and debt servicing over time are good indicators of the debt burden of a country. If the growth rate of debt becomes negative after some early years while the growth of debt servicing increases or remains positive, it can be inferred safely that that country is ridding itself of the debt burden without incurring additional borrowing. In Table 6-3-6 we have produced the yearly and periodic growth rates of debt and debt service for the period of our analysis.

During the 1960s growth of both external debt and debt service, as shown in Table 6-3-6, was noticeably high(17). From this level indebtedness increased considerably during the years that followed. During the Nonplan period we observe that both the growth of debt and debt services generally declined and became negative. This was the result of several favourable factors. The most important of these were the high inflation rates in industrial countries during this period which reduced the amount of real dollar indebtedness. The negative and generally lower growth of debt services was mainly the result of debt rescheduling arrangements. During the 5th Plan period the growth of debt was again low and negative for three years because of increased inflow of remittances which greatly decreased the need for additional foreign

Table: 6-3-6

Growth Rates of Debt and Debt Service^p
(Pakistan: 1960 to 1988)[■]

(a) No. Period/ Debt/ Debt Service	(b) Year/Period							
	1. <u>2nd Plan</u>	1960-61	1961-62	1962-63	1963-64	1964-65		
i. Debt	13.17	21.70	43.34	36.40	33.46			
ii. Service	33.74	43.50	32.23	21.89	-2.78			
2. <u>3rd Plan</u>	1965-66	1966-67	1967-68	1968-69	1969-70			
i. Debt	20.13	19.91	14.37	12.87	9.33			
ii. Service	13.15	20.97	5.79	28.16	4.88			
3. <u>Nonplan</u>	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78
i. Debt	8.26	3.71	-1.10	-1.67	25.90	4.76	1.19	3.67
ii. Service	-2.68	-57.86	31.74	-9.63	11.59	-7.92	13.69	-2.44
4. <u>5th Plan</u>	1978-79	1979-80	1980-81	1981-82	1982-83			
i. Debt	3.02	-1.21	-7.93	-2.41	2.07			
ii. Service	18.97	17.37	-5.46	-29.94	19.76			
5. <u>6th Plan</u>	1983-84	1984-85	1985-86	1986-87	1987-88			
i. Debt	-1.83	4.40	11.22	7.32	6.79			
ii. Service	7.57	3.96	10.16	15.41	-1.24			
1-5. <u>Period</u>	1960-65	1965-70	1970-78	1978-83	1983-88	1960-88		
i. Debt	29.61	15.32	5.60	-1.29	5.56	10.39		
ii. Service	25.72	14.59	-2.94	4.14	7.17	8.38		

Source: Appendix, Table 7-A.

^p Includes interest and amortisation payments.

[■] Calculated at constant market price of industrial countries, the base year is 1959-60.

loans to finance development expenditures. Burney provides evidence that between 1979-80 and 1982-83 the period of the largest inflow of remittances, new foreign loans contracted decreased at an average rate of 4.36 percent(18). The growth rates of debt servicing during this period are generally higher than in the Nonplan period, which demonstrates the exhaustion of earlier rescheduling arrangements. The high growth rates of debt outstanding during the 6th Plan period clearly indicate that earlier low and negative growth rates were not the result of a spontaneous and sustained reduction in debt burden. On the contrary, increased new borrowings during this period were largely incurred incidental as to settlements of foreign claims for servicing the debt accumulated in the past. This conclusion is supported by the growth of debt service which also exhibits a substantial trend increase over the last decade of analysis. Burney points out that as remittances decreased after 1982-83 new foreign loans contracted increased at an average rate of 11.87 percent between 1982-83 and 1985-86(19).

The growth rates of the 6th Plan represent a very large denominator. Hence, even a small increase in the growth rate implies a large increase in total debt. Given our analysis in parts one and two of this chapter, the generally increasing growth rate of debt service during the 1980s and the considerably high, positive, growth

rates of debt during the last four years of analysis merit due consideration. They are indicative of the grave fact that if the net transfer disappears, Pakistan may face difficult choices ahead. These choices comprise the policies that may have to be undertaken to generate the foreign exchange for the payment of interest and amortisation. Pakistan will have to generate an export surplus equivalent to the net outward transfer of amortisation on capital account and of interest payment on current account. The country will have to generate an export surplus by reallocating resources so as to expand exports or replace imports. And to accomplish this, the country may have to impose internal and external controls or experience exchange depreciation. The adverse effects of these measures of balance of payments adjustment are the indirect cost of borrowing.

Section: 3-3-6

Debt Servicing Capacity

The fundamental difficulty with analysis of debt servicing capacity is the absence of a comprehensive and consistent theoretical framework. The latter has not yet been formulated, despite the fact that some aspects of the problem have been thoroughly explored. However, Avramovic et al. hold that as long as the incidence of debt service falls on a part of the increment in per capita income, it is possible for consumption and nationally financed investment to rise in parallel with service payments(20).

In another study Avramovic maintained that if the rate of increase in real income and saving remaining available after the claims of foreign capital have been met is reasonably high and if growth occurs in a continuous fashion and its benefits are widespread, then it can plausibly be argued that debt service payments will also be made smoothly(21).

The problem with the analysis of the debt service adjusted growth rate is that when we take a time series of both income and debt service, very little, if any, effect can be gauged on the growth rate of income. A lot of information can be uncovered, however, if we measure debt service adjusted domestic saving. The performance in the external sector is an equally important factor for determining the debtor country's capacity to meet obligations that foreign debt incurs. Not only must the debtor country's economy be able to do without an amount of domestic income and saving equivalent to the debt service, it must also be in a position to convert such segregated saving into the required foreign exchange. And if debt service is increasing, there must also be an increase in both the capacity to save and the capacity to transfer saving into foreign exchange by exports. Growth in the latter has to provide resources both for service payments and for import requirements. Unless new external funds are forthcoming, the generation of foreign exchange has to occur through successful exporting. That is, in

order to transfer purchasing power back to the lenders as repayment, borrower country's exports must be stimulated and imports reduced so as to have sufficient foreign exchange available. This 'transfer problem' of freeing up resources can be difficult indeed. If exports grow at a rate which is sufficient to meet service payments but which does not leave any additional resources to satisfy minimum import requirements, the country is likely to experience difficulties in ensuring a sustained long-run growth in income and saving, which provide the internal base for continuing debt servicing. Except in those cases in which net import substitution can be achieved, export earnings have to increase sufficiently fast to provide resources for income growth after service payments have been met.

In order to reduce the scope of analysis to a manageable proportion, we have chosen to focus first on the debt services adjusted estimates of domestic saving and exports. These observations are listed in Table 7-3-6.

The debt service adjusted balance of trade of Pakistan, in subcolumn (biii) of Table 7-3-6, can at best be described as precarious. Needless to say, the column lists the poorest performance during the last decade of analysis, the deficit going all the way up to 16% of the gross domestic product of the country. The comparative improvement of the 3rd Plan period (deficit at 5.99% is the lowest Plan average) was accompanied by substantial

changes in the composition of gross domestic product. The high rates of industrial expansion almost doubled the share of manufacturing in the GDP to 11 percent. The share of the agricultural sector declined from 45% in 1960 to 39% in 1970 (see, Appendix, Table 2-A). These structural changes and the rapid growth of the economy were reflected in the expansion of exports. Yet, Table 7-3-6 registers an account of exports during this period lower than the preceding subperiod, the reason being the burden of debt service which had begun to bite as the period started. The improvement in deficit was attained by relatively lesser dependence on imports as compared with the 2nd Plan period. Since the country was passing through the easy stages of import substitution (the consumer goods and some simple-*tec* intermediate goods), its import requirements were modest, and it increasingly provided a number of goods domestically which were previously imported. As the country started to embark upon the difficult stage of import substitution (capital goods) in the 70s, its import requirements shot up. The improvement observed in exports, however, as compared to the 3rd Plan period is largely attributable to the rescheduling arrangements which simply shifted the burden of debt service to the future. In spite of this pressure relieving facility, however, the debt service adjusted trade deficit worsened during the Nonplan period.

During the 5th and 6th Plan periods, the strength of

Table: 7-3-6

Debt Servicing Capacity
External Sector And Domestic Saving
(Pakistan: 1960 to 1988)

(a) No. Year/ Period	(b) Current Account Transactions ^a (% of GDP)			(c) Saving ^b (% of GDP)
	(bi) Imports	(bii) Exports ^p	(biii) Balance (bi+bii)	
1. 2nd Plan				
i. 1960-61	-11.30	2.40	-8.90	6.34
ii. 1961-62	-10.62	1.88	-8.74	8.67
iii. 1962-63	-12.04	3.34	-8.70	12.10
iv. 1963-64	-11.67	3.06	-8.62	12.59
v. 1964-65	-12.77	2.93	-9.85	11.94
i-v. 1960-65	-11.68	2.72	-8.96	10.33
2. 3rd Plan				
i. 1965-66	-9.01	2.67	-6.35	12.21
ii. 1966-67	-10.51	2.44	-8.07	10.13
iii. 1967-68	-8.73	2.97	-5.76	9.36
iv. 1968-69	-7.04	2.19	-4.85	7.73
v. 1969-70	-6.45	1.52	-4.94	11.53
i-v. 1965-70	-8.34	2.36	-5.99	10.19
3. Nonplan				
i. 1970-71	-6.55	2.05	-4.50	10.69
ii. 1971-72	-11.84	8.70	-3.14	9.65
iii. 1972-73	-11.54	9.03	-2.50	10.81
iv. 1973-74	-16.73	10.18	-6.55	8.41
v. 1974-75	-22.59	8.45	-14.14	5.76
vi. 1975-76	-19.49	8.37	-11.12	7.62
vii. 1976-77	-19.59	6.99	-12.50	7.06
viii. 1977-78	-20.34	7.12	-13.22	5.93
i-viii. 1970-78	-16.08	7.61	-8.47	8.24

Table: 7-3-6 Continued.....

(a) No. Year/ Period	(b) Current Account Transactions [■] (% of GDP)			(c) Saving ^p (% of GDP)
	(bi) Imports	(bii) Exports ^p	(biii) Balance (bi+bii)	
4. 5th Plan				
i. 1978-79	23.46	8.12	-15.34	4.15
ii. 1979-80	25.19	9.47	-15.73	2.75
iii. 1980-81	24.70	10.75	-13.95	4.97
iv. 1981-82	29.59	10.39	-19.21	6.61
v. 1982-83	26.82	10.31	-16.50	6.99
i-v. 1978-83	25.95	9.81	-16.14	4.71
5. 6th Plan				
i. 1983-84	28.92	10.38	-18.54	5.40
ii. 1984-85	27.76	8.00	-19.76	4.59
iii. 1985-86	25.66	9.86	-15.81	4.22
iv. 1986-87	22.87	10.99	-11.88	3.94
v. 1987-88	25.33	13.23	-12.10	3.88
i-v. 1983-88	26.11	10.49	-15.62	4.41
1-5. 1960-88	17.47	6.71	-10.76	7.65

Source:: Appendix, Tables, 3-A, and 7-A.

■ Goods and non-factor services

p The residual after debt service is payed.

the industrial and agricultural sectors as described in Chapter One was associated with strong export performance. After a small decline in 1976-77, debt service adjusted exports rose continuously in the four years that followed. This rise was unsustainable, however, in the face of global recession, the domestic supply capacities, and, above all, the exhaustion of debt rescheduling arrangements. Hence, exports started declining in 1981-82.

If we momentarily ignore all but subcolumn (bii) in table 7-3-6, we find that debt service adjusted performance of exports can be rated 'the best' during the last decade of the analysis. Indeed, apart from the enhanced performance of the industrial and agricultural sector, the exports performance improved during this period by a return to large export subsidies. Further, in January 1982 the rupee was cut loose from the dollar which had been appreciating(22).

But relaxation of import controls during this period caused rapid import growth, as shown in subcolumn (bi) of Table 7-3-6. Also debt service shot up as the earlier rescheduling arrangements were exhausted. Hence, despite the jump in exports, the debt service adjusted trade balance given in subcolumn (biii) registered the largest deficit during the decade. However, Consortium and OPEC aid, in conjunction with the continued stream of remittances, brought sufficient flexibility for Pakistan to avoid default. The IMF was also supportive without

asking for internal adjustments beyond the Government's capacity. As mentioned earlier, Pakistan's crucial strategic position provided sufficient incentive for the US and others, including Saudi Arabia, to cushion the payments problem.

Finally, column (c) in Table 7-3-6 lists the rates of domestic saving which have remained available after service payments and have thus served to finance national capital formation. The regrettably low annual average rates for the 5th and 6th Plans indicate that the rise in service payments has not proceeded in parallel with a strengthening of the country's long-run economic position. It also indicates that had sources of further external assistance dried up, investment in the country would have been exposed to severe pressures in the face of other competing claims.

An important feature of any new approach to debt servicing capacity should be the recognition that repayment obligations do not distinguish between the beneficiaries of foreign aid in the debtor country. In our opinion, insofar as public debts contracted by the representatives of a country place all the people of the nation under the repayment obligations, the debt service capacity is inextricably linked with the per capita productivity increases in tradeables(23). Further, another way to determine the burden is to compare per capita debt burden and the output of tradeables, as shared and

contributed respectively, by the labour force of the debtor country.

Insofar as in Pakistan tradeables overwhelmingly consist of the output of the commodity producing sector, it is the performance of this sector which provides internal and external economic soundness to the country. Accordingly, we have produced these comparable magnitudes for Pakistan in Table 8-3-6.

As shown in subcolumn (cii), the annual average debt per capita of population during the 6th Plan period increased by about four times as compared with the corresponding average of the 2nd Plan. The largest jump, however, is found between the annual averages for the 2nd and 3rd Plan periods. The annual average figure for the 6th Plan period is marginally lower than the Nonplan and 5th Plan averages. Indeed, this small decrease in debt per capita is due to the high growth rate of population rather than the diminishing of the debt burden.

Nonetheless, this level of debt per capita would matter less for the country if it was matched by impressive productivity increases. But the scenario on that side of the spectrum is not encouraging. The production of tradeables per capita of population given in subcolumn (bii) shows an increase only in the 3rd Plan. The decrease in productivity which we observe in the annual average for the Nonplan period is dwarfed by the corresponding figure for the last period, the 6th Plan.

Table: 8-3-6

Debt Servicing Capacity: Per Capita
(Pakistan: 1960 to 1988)

(US\$)

(a) No. Year/ Period	(b) Per Capita Production of Tradeables [■]		(c) Per Capita External Indebtedness [‡]	
	(bi) Labour Force ^p	(bii) Population	(ci) Labour Force ^p	(cii) Populati- on
1. 2nd Plan				
i. 1960-61	—	45.57	—	3.62
ii. 1961-62	—	47.68	—	4.49
iii. 1962-63	—	49.35	—	7.70
iv. 1963-64	153.83	50.15	36.08	11.76
v. 1964-65	162.17	52.17	53.42	17.18
i-v. 1960-65[#]	164.17	48.98	55.35	8.95
2. 3rd Plan				
i. 1965-66	163.28	51.84	65.85	20.91
ii. 1966-67	171.69	53.80	80.96	25.37
iii. 1967-68	183.72	56.84	93.08	28.80
iv. 1968-69	191.85	58.58	105.20	32.12
v. 1969-70	206.00	62.50	113.47	34.42
i-v. 1965-70	183.31	56.71	91.71	28.32
3. Nonplan				
i. 1970-71	199.32	60.62	119.79	36.43
ii. 1971-72	87.88	26.28	122.89	36.75
iii. 1972-73	98.18	29.22	117.40	34.94
iv. 1973-74	100.41	29.75	112.55	33.35
v. 1974-75	96.67	28.52	148.07	43.67
vi. 1975-76	95.77	28.60	148.96	44.49
vii. 1976-77	93.99	28.43	144.46	43.69
viii. 1977-78	94.73	29.02	143.69	44.00
i-viii. 1970-78	108.37	32.55	132.23	39.67

Table: 8-3-6 Continued.....

(US\$)

(a) No. Year/ Period	(b) Per Capita Production of Tradeables [■]		(c) Per Capita External Indebtedness [⏏]	
	(bi) Labour Force ^p	(bii) Population	(ci) Labour Force ^p	(cii) Populati- on
4. 5th Plan				
i. 1978-79	95.07	29.49	141.93	44.03
ii. 1979-80	100.24	30.89	136.99	42.21
iii. 1980-81	104.07	31.84	124.06	37.95
iv. 1981-82	84.13	25.57	118.28	35.95
v. 1982-83	82.07	24.78	117.90	35.60
i-v. 1978-83	418.57	28.51	127.83	39.12
5. 6th Plan				
i. 1983-84	70.45	21.04	113.50	33.91
ii. 1984-85	73.37	21.69	116.39	34.40
iii. 1985-86	72.63	20.86	130.87	37.58
iv. 1986-87	71.10	20.90	133.81	39.33
v. 1987-88	73.81	21.28	141.96	40.93
i-v. 1983-88	72.27	21.15	127.31	37.23
1-5. 1960-88^ï	117.06	37.04	115.26	31.63

Source:: Appendix, Tables, 7-A, 4-A, 2-A, and 9-A

■ Numerator is the total output of agricultural, mining and quarrying, and manufacturing sector at constant market prices of 1959-60 in Pakistan, converted into dollar at official exchange rate for each year.

^p Denominator is the total population of 10 years age and above.

⏏ Numerator is the value of total external debt in constant dollar.

For subcolumn (bi) and (ci) the average is only for two years, 1964 and 1965.

ï For subcolumn (bi) and (ci) the period is from 1964 to 1988.

The latter's annual average production of tradeables is less than half of the comparable figure for the 2nd Plan period.

The deteriorating trend in the per capita productivity of tradeables, listed in (bii), is largely to be blamed on the decline in labour productivity which is given in subcolumn (bi) of the table. The production of tradeables per head of labour force shows an increase only in the annual average of the 3rd Plan period. We have also produced in subcolumn (ci) figures showing the burden of foreign debt per capita of the labour force. While using the average of 1964 and 1965 (the years for which data on labour force are available) as a proxy for the annual average of the 2nd plan, we find that the real burden of debt per capita of labour force has more than doubled during the 6th Plan period. On the other hand, the 6th Plan's annual average production of tradeables per capita of the labour force, given in subcolumn (bi), has fallen to less than half of the comparable average for the 2nd plan.

Hence, it follows from Table 8-3-6 that external capital was utilised in an inefficient manner, or despite the efficient utilisation of external capital in the earmarked sectors, adverse influences had operated in the other sectors of the economy. In any of these cases, the bottom line is that the obligation to service debt is very likely to impose serious pressures on the economy of

Pakistan. And if sources of further borrowing dry up, the payment of debt service to foreign creditors will result in either a fall or a stagnation in the flow of income, saving, public revenue and external earnings which remain for domestic use. Given our analysis of the current account deficit of Pakistan in part one of this chapter, and the low level of domestic saving of the country in the preceding two chapters, it can be stated unambiguously that the capacity of the country to service foreign debt is seriously to be questioned.

Finally, the debt servicing problems emerged against an overall background that should explain the weaknesses in Pakistan's economy. We now attempt to analyse in the following chapter the type and structure of the growth which Pakistan has experienced.

NOTES

1. Some of these thoughts were inspired by Robert Solomon, "The United States As a Debtor in The 19th Century", Brookings Discussion Papers in International Economics, No. 28, May, 1985.
2. Ibid.
3. See, Pakistan Economic Survey, 1988-89, Statistical Supplement, Table: 10.1, P. 143.
4. See, 'Economist', 10-17 September, 1988, P. 21.
5. See, 'Inquiry', November, 1987, P. 31.
6. See, 'Dawn', 6th March, 1989, P. 7.
7. The foreign exchange controls have been abolished in Pakistan under the legislation passed by the Nawaz Sharif Government, which took office in October 1990. The new legislation allows the free movement of foreign exchange in and outside the country, also it provides the facility of keeping bank accounts in foreign currencies.
8. See, Cheryl Payer, "The Debt Trap", Monthly Review Press, New York, 1974, P. 13.
9. See, Organisation For Economic Cooperation and Development, "Debt Problems of Developing Countries" Paris: OECD, 1974, Para 41, P. 14.
10. Quoted in Cheryl Payer, "Lent and Lost", Zed Books LTD, London, 1991, P. 10.
11. See, Chris C. Carvounis, "The Foreign Debt/ National Development Conflict", Quorum Books, New York, 1986, P. 112.

12. See, Cheryl Payer, 1991, op. cit., P. 10.
13. Ibid.
14. Ibid; Chapter two.
15. For example, the net transfer for all Latin America became negative in 1982, the year Argentina, Mexico and Brazil shocked creditors by failing to meet scheduled payments. The African debt crisis, however, cannot be dated so precisely but the net transfer to that continent became negative in 1984, which is roughly the same time the some African countries fell into arrears on their IMF repayments. Asian developing countries had a negative net transfer for the first time in 1986. See, World Bank, World Debt Tables, 1988-89 Edition, Vol. 1, Analysis and Summary Tables, P. 20.
16. For example, Japan and Taiwan successfully negotiated that transition soon after World War 11. And, Most recently, South Korea, from a foreign debt of US\$47 billion in 1985, has now received "net-creditor" status, as its foreign assets have grown and expensive commitments been repaid. See, The Banker, April 1990, P. 62.
17. This phenomenal growth rate, however, is due to smaller magnitudes of earlier borrowing and repayments. With a small denominator, a small increase in absolute value over the previous year would result in high growth rates. Nonetheless, substantial indebtedness was incurred over the 60s' which, in its turn, resulted in high growth rates of debt servicing.

18. See, Nadeem A. Burney, "Workers Remittances From the Middle East and Their Effects on Pakistan's Economy", *The Pakistan Development Review*, Vol. XXVI, Winter 1987, P. 760.

19. Ibid.

20. See, Dragoslav Avramovic, et al., "Economic Growth and External Debt", *The John Hopkins Press*, Baltimore, 1964, P. 11.

21. This was implicit in one of Avramovic's previous studies, see, "Debt Servicing Capacity and post-War Growth in International Indebtedness" *The John Hopkins Press*, Baltimore, 1958.

22. The strengthening of the rupee along with the dollar was reducing the competitiveness of Pakistani goods. The rupee was then pegged to a basket of trading partners' currencies and underwent a de facto successive gradual devaluation, from Rs. 9.9 to the dollar in 1982 to Rs. 17.54 in 1988.

23. We are making here this distinction for the purpose of simplification, since for LDCs, as well as some developed countries, it may be difficult to tell the non-traded goods apart. The latter are, however, usually defined as those goods and services produced and consumed within a national boundary which at existing price levels are incapable of being exported. Such goods normally include the public utilities, education, health, etc. There is nothing intrinsic to these goods and services which

renders them non-tradeable. In this Roemer has challenged Corden on the classification of non-traded goods. See, (i) W. M. Corden, "The Booming Sector and Dutch Disease Economics: Survey and Consolidation", Oxford Economic Papers, Vol. 36(6), 1984, pp. 359-80, (ii) M. Roemer, "Dutch Disease in Developing Countries: Swallowing Bitter Medicine", in M. Laundahl (ed.), "The Primary Sector in Economic Development, London, Croom Hall, 1985, pp. 234-52.

CHAPTER: 7

FOREIGN AID AND ECONOMIC GROWTH RECONSIDERED (PAKISTAN: 1960 to 1988)

Introduction

As described earlier, Pakistan maintained high growth rates in the 1980s despite the recession in the world economy. This growth, however, was accompanied by a major weakness of economic policy, a continued dependence on foreign borrowing to fund domestic investment. The country had one of the lowest domestic saving rates in Asia. Further, the current account deficit was not reduced and was still about 7 percent of GDP in 1988 (see Table 1-1-6).

This state of affairs indicates two fundamental economic difficulties. First, Pakistan seems to have failed to develop self-sustaining growth that would have slowed down borrowing momentum and eased the burden of servicing its external debt. Second, the country might also have failed to sufficiently increase productivity in the commodity producing sectors, as was required both by its increasing debt burden and by its import requirements. A possible explanation of these issues involves integrating a number of interrelated factors.

The chapter is structured around three issues. Part one analyses the structure and growth of the gross domestic product of Pakistan over the period of this study. Drawing on the scenario which emerges in part one, part two attempts to identify the factors responsible for

inefficient operation of the manufacturing and agricultural sectors. Finally, with the help of available data, part three attempts to describe how foreign aid could have helped create a sustainable growth momentum.

Part: 1-7

The Gross Domestic Product
(Pakistan: 1960 to 1988)

In this part we investigate two important dimensions of the gross national product of Pakistan. Section one lists and describes the share of different sectors of the economy in GDP, while section two concentrates on sectoral performance in terms of growth rates and isolates the contribution of each sector to the overall growth rate.

Section: 1-1-7

Sectoral Share in The Gross National Product

The pattern of change in GDP structure is reflected in the changing share of its constituent economic sectors. The pattern of contraction and expansion of the latter is a major determinant of the type of development achieved by a country. In Table 1-1-7, we have listed the sectoral shares of the gross domestic product of Pakistan. Figures listed in Table 1-1-7 for the share of the agricultural sector also include output of fishing, forestry, and mining & quarrying activities, since their small contribution to the gross domestic product of Pakistan

Table: 1-1-7

The Structure of Gross Domestic Product
(Pakistan: 1960 to 1988)*

(a) No. Sector	(b) Period Average of the Sectoral Share					
	(bi) 2nd Plan 1960-65	(bii) 3rd Plan 1965-70	(biii) Non- plan 1970-78	(biv) 5th Plan 1978-83	(bv) 6th Plan 1983-88	(bvi) Total Period 1960-88
1. Agriculture ^P	42.71	39.02	34.95	30.09	25.79	34.56
2. Manufacturing	14.20	15.62	16.45	17.77	19.50	16.68
3. Services	43.08	45.36	48.60	52.13	54.71	48.76
i. Construction	3.74	4.14	4.33	4.97	5.48	4.52
ii. Electricity & Gas Distribution	0.62	1.04	2.51	2.99	3.42	2.16
iii. Transport & Communication	5.90	6.63	6.35	6.84	7.27	6.57
iv. Wholesale & Retail Trade	13.26	13.73	14.14	14.46	14.76	14.08
v. Banking & Insurance	1.11	1.60	2.36	2.54	3.04	2.16
vi. Ownership of Dwelling	4.55	3.81	3.38	3.10	3.55	3.65
vii. Public Administration & Defence	5.93	7.37	8.45	10.08	10.10	8.39
viii. Other	7.95	7.02	7.09	7.15	7.09	7.24

Source:: Appendix, Tables 2-A, and 6-A.

* All figures are percentages of GDP.

^P Includes mining and quarrying.

renders their separate treatment unnecessary. The structure of GDP, given in Table 1-1-7, does not seem to conform with the requisites of a dynamic economy. The contraction of the primary sector was small. Further, the secondary or manufacturing sector did not expand sufficiently, while the tertiary or services sector constituted a relatively increasing proportion of the GDP. This scenario varies from the GDP profile of the developing countries which have completed a successful transition from a primitive to a modern economy. For example, in South Korea the share of the primary sector decreased from 43% in 1962 to 15% in 1984(1), a 65% contraction over the period. But, the period averages for the primary sector of Pakistan as given in Table 1-1-7 are about 43% and 26% for the Second and Sixth Plans respectively, only a 40% contraction. The share of manufactured products in Korea increased from 9% in 1962 to 34% in 1984(2), a 278% increase over the period. In Pakistan the comparative figures are 14.2% and 19.5% for the Second and Sixth Plan respectively, only a 37% increase.

The services sector in Table 1-1-7, shows a generally expanding pattern. There is nothing inherently wrong with an expanded services sector, but if it is to be the basis of a higher rate of secular income growth in a developing country which largely trades in commodities, it may not generate sufficiently high growth in the export sector of

Table 2-1-7

Public Administration and Defence
Claims on the Government Revenue^P
(Pakistan: 1960 to 1988)

(a) No. Period	(b) Public Administration	(c) Defence	(d) Total (b+c)
1. <u>2nd Plan</u>			
1960-65	16.65	45.20	61.85
2. <u>3rd Plan</u>			
1965-70	10.40	51.24	61.64
3. <u>Non-plan</u>			
1970-78	46.52	9.79	56.31
4. <u>5th Plan</u>			
1978-83	35.96	4.36	40.32
5. <u>6th Plan</u>			
1983-88	43.29	5.91	49.21
1-5. 1960-88	44.67	9.46	54.13

Source:: Appendix, Table 10-A.

^P The figures are percentage of the total revenue receipts of Pakistan Government.

the economy. Further, within the services sector activities like defence and public administration together represent the largest areas of expansion, after wholesale and retail trade. Hence, the high growth rates of Pakistan's economy, particularly during the 1980s, are mostly due to expansion of the services sector, including an overwhelming expansion of 'unproductive' services like defence and public administration. Table 2-1-7 shows that these sectors have always claimed a large share of Government revenue in Pakistan. For the period as a whole, more than half of the Government revenue was spent on public administration and defence sectors. Although the share of these sectors was reduced during the Non-plan and the 5th Plan period over the average of the Third Plan period, but it increased again during the 6th Plan period.

Section: 2-1-7

Decomposition of Growth

In this section some simple growth accounting is considered by segregating the shares of the three major sectors of the economy in the aggregate growth rate of the gross domestic product. Contributions of the individual sectors to GDP growth rate are listed in Table 3-1-7.

The contribution of each sector to total GDP growth is computed as that sector's growth rate multiplied by its share in total output. A few general observations are useful for our analysis in the following part. First,

there are not significant differences in the sources of GDP growth across the five time periods. In all five periods the largest share of growth comes from the services sector. Second, this contribution is largest during the 5th and 6th Plan periods and it is exceptionally high during the 6th Plan; the annual average contribution being almost double those of the agricultural and manufacturing sectors together.

It is, therefore, clear that while the continuing rise in GDP growth rate is highly satisfactory, we cannot afford to ignore disturbing signs suggesting that economic growth in Pakistan probably does not rest on strong foundations. As shown in Table 3-1-7, the high GDP growth rates have to a large extent been sustained by a continued expansion of the services sector. Something of this sort is inevitable as an economy goes through various stages of development. However, growth of GDP which is overwhelmingly based on such changes generates purchasing power which is unsupported by increased domestic supplies of goods and makes the economy increasingly more dependent on imports and foreign capital inflows.

It is interesting to mention that the pattern of changes we have observed in the structure of Pakistan's GDP has only recently been considered as an indirect impact of the inflow of foreign saving, the Dutch disease(3) effect of foreign aid. Even before the emergence of most of the literature on the phenomenon(4),

Table: 3-1-7

The Growth Rate of Gross Domestic Product
Sectoral contribution
(Pakistan: 1960 to 1988)*

(a) No. Period	(b) Growth Rate of GDP	(c) Sectoral Growth Rate And Contribution [¶] to (b)		
		(ci) Agricult- ure ^p	(cii) Manufact- uring	(ciii) Services
<u>2nd Plan</u>				
1. 1960-65	6.91	3.87 (1.65)	11.74 (1.66)	8.30 (3.60)
<u>3rd Plan</u>				
2. 1965-70	6.86	6.33 (2.50)	8.12 (1.27)	6.77 (3.09)
<u>Non-plan</u>				
3. 1970-78	4.54	1.77 (0.61)	4.59 (0.76)	6.46 (3.17)
<u>5th Plan</u>				
4. 1978-83	6.68	4.22 (1.27)	9.94 (1.77)	6.97 (3.64)
<u>6th Plan</u>				
5. 1983-88	6.59	4.01 (1.05)	7.72 (1.51)	7.37 (4.03)
1-5. 1960-88	6.13	3.80 (1.33)	8.01 (1.33)	7.09 (3.47)

Source:: Appendix, Table 2-A.

* Calculated at Pakistan's constant factor cost of 1959-60.

^p Includes fishing, forestry, and mining & quarrying.

[¶] Given in parentheses.

Michaely(5) demonstrated the impact of an aid flow on the production of tradeables (the output of the commodity producing sectors) and non-tradeables (taken by Michaely the output of the services sector). However, little work has been done to model aid-related Dutch disease effects, or to estimate the magnitudes of foreign aid that would produce the phenomenon of "de-industrialisation" and "de-agriculturalisation" observed for export booms. Therefore, in the following part our main intention is limited to pointing out the weaknesses in the pattern of development of the commodity producing sectors of Pakistan.

Part: 2-7

The Performance of the Commodity Producing Sectors (Pakistan: 1960 to 1988)

This part attempts in two sections to analyse the performance of the commodity producing sectors, manufacturing and agriculture. The main focus of analysis is to identify the factors which accounted for these sectors not developing in a manner consistent with the requirements of self-generating growth.

Section: 1-2-7

The Manufacturing Sector

In this section we concentrate on the following three central questions.

(1) What were the policies behind the expansion of manufacturing activity in Pakistan?

(2) What was the pattern of expansion of this sector?

(3) What role has this sector played in saving or in earning foreign exchange?

The availability of foreign aid and domestic economic policy both played an important role in determining the expansion of the manufacturing sector in Pakistan. Table 4-2-7 lists the sectoral share of economic sectors in total project aid disbursements to Pakistan. The figures show that the manufacturing sector was the largest recipient of project aid over the period as a whole, more than a quarter of the total disbursements were allocated to this sector.

In the 1960s the manufacturing sector was allocated about 35% and about 39% of project aid during the 2nd and 3rd Plan periods respectively. During that decade Pakistan's growth effort was directed at rapid industrialisation through import substitution. Rapid expansion of the manufacturing activity occurred with the help of specific Governmental policies and with the availability of large amounts of foreign aid. Pakistan followed a highly protective industrial policy to encourage import substitution. Incentives were provided in the forms of a highly graduated tariff structure, import licensing, and quantitative restrictions on imports(6). Although the profusion of inducements encouraged growth of the output of the manufacturing sector, they generated inefficient resource use. Resources were often directed to

Table: 4-2-7

Sectoral Allocation of Project Aid Disbursements
(Pakistan: 1960 to 1988)^p

(a) No. Sector	(b) Period Average [■]					
	(bi) 2nd Plan 1960-65	(bii) 3rd Plan 1965-70	(biii) Non- plan 1970-78	(biv) 5th Plan 1978-83	(bv) 6th Plan 1983-88	(bvi) Total Period 1960-88
1. Water & Power	12.16	25.93	27.26	24.28	35.93	25.34
2. Transport & Communication	17.34	21.94	20.00	24.62	14.05	19.63
3. Manufacturing	34.72	38.80	26.03	22.36	17.09	27.61
4. Agriculture	3.30	5.90	11.77	9.78	13.66	9.20
5. Population Welfare	0.38	1.66	1.69	1.82	3.96	1.88
6. Education	0.67	0.66	1.35	1.38	2.68	1.35
7. Rural Development	0.16	0.02	0.54	4.12	3.01	1.46
8. Miscellaneous	31.27	5.09	11.36	11.71	9.62	13.61

Source:: Appendix, Table 8-A.

^p All figures are percentages of total project aid.

[■] Annual average for the period.

high cost industries that depended upon imported inputs. Guisinger and Lewis estimated effective rates of protection for thirty industries and found negative value added for three cases, implying that the world market value of material inputs exceeded the value of output(7). Domestic prices had become distorted by tariffs, quantitative restrictions, and multiple exchange rates. Thus, economically inefficient choices of processes and techniques by private businessmen became real possibilities. In effect, producers could purchase capital inputs at well below the opportunity cost to the economy since they were direct licensees for imported goods(8). An incentive was thereby created to use excessively capital-intensive techniques. Khan found that the capital-labour ratio in many industries in Pakistan was higher than in countries where labour was far less abundant(9).

In issuing licenses the governmental agencies usually judged large, well-established firms more competent and, therefore, more eligible. Such a situation turned the bargaining advantage sharply away from the inexperienced pleader and opened avenues for irregular emoluments. Bias against new firms limited diversification of the manufacturing sector. Larger firms received most of the licenses and continued to maintain or expand their shares of assets and production. Between 1960 and 1965 the leading forty-three families received capital goods' licenses totalling Rs. 1.5 billion or 51% of the

total(10). The process of industrial concentration was thus self-reinforcing. One source has estimated that access to direct import-licensing privileges generated 39 per cent more value added for beneficiary firms in comparison with those which did not receive licenses. Non-privileged producers of thread and yarn actually received negative protection(11). Similar favouritism operated in the allocation of foreign exchange. During the period from 1960 to 1965 the most wealthy seven families garnered one-fifth of all PICIC awards of foreign exchange(12).

The Bhutto Government of the 1970s introduced the nationalisation policy. The rhetoric of nationalisation was to change the uses and rewards associated with each of the four major factors of production in the economy: capital, labour, land and foreign exchange. But, in practice, as described in Chapter Five, the effect of taking over the large industrial establishment with the potential threat of further nationalisation, was to cause private investment to decline. The nationalisation policy won support from the bureaucratic establishment because it added to their power. It was supported by Bhutto's party politicians because it added to their patronage, and it was supported by intellectuals who generally identified capitalism with colonialism and who assumed that government control would contribute to social justice. It was also supported by the new aid donors of the 1970s. It can be seen from Table 4-2-7 that the allocation of

project aid to the manufacturing sector of Pakistan was a little over a quarter of the total during the Nonplan period. This amount included a loan of US\$214 million from the former USSR, mainly for the Karachi Steel Mills.

In practice, however, nationalisation policy did nothing to promote equality or growth. There is no evidence that the range of income inequality was narrowed. The economy was more capitalist than ever before, but it was a bureaucratically controlled and inefficient capitalism, which ultimately proved to be in contradiction with productivity requirements. A World Bank study of public enterprises revealed that in Pakistan between 1972-73 and 1976-77 the productivity index in the manufacturing sector declined by 10 percentage points(13). Indeed, the Government was drawn to investment projects with long gestation periods. Huge volumes of resources went to Karachi Steel Mills and other enterprises. Most of these were embarked upon without cost-benefit studies, but were connected in Bhutto's view with the design of an economically and politically powerful Pakistan.

We have already described in Chapter Five the adverse effects of nationalisation policy, particularly on private investment in the manufacturing sector of Pakistan. During the 1980s the manufacturing sector was still receiving quite a large share of project aid disbursements, 22% and 17% during the 5th and the 6th Plan periods respectively. The military Government issued a major policy statement to

boost manufacturing activity in the country(14). In investment sanctioning, the government tried to liberalise by substantially increasing the limit on investment requiring sanctions from Rs. 20 million to Rs. 300 million in terms of total project size, and from Rs. 10 million to Rs. 50 million in terms of foreign exchange requirements(15). However, little progress was made since the fiscal incentives followed a pattern consistent with the stop-go policies of that Government. For example, as mentioned earlier in this study, investors' demands for reductions in interest rate on fixed investment were accepted and interest was reduced from 14% to 11%, but the special depreciation allowance at the rate of 15% was withdrawn(16). Further, little progress was made in denationalisation for reasons already explained in Chapter Five. Therefore, in reality all the economic policies in the manufacturing sector of Pakistan after 1971 have appeared chaotic, illogical and contradictory. Indeed, they have failed to meet even commonsense tests or the standards of consistency, much less idealised efficiency or equity criteria. In fact, they have reflected the interplay of opposing and cooperating groups, moving the country from a capitalist style of development towards a socialist one, and then towards a more mixed economy. In each phase policy has never been fully spelled out, but has rather been announced as a consequence of political aims or generated in response to

obvious economic problems.

In the absence of a coherent and consistent manufacturing policy, and with the availability of large amounts of foreign aid, the pattern of expansion of this sector does not exhibit sufficient linkages within the domestic economy. Let's first consider the backward linkage of the sector in terms of drawing from the reservoir of labour in the agricultural sector. Studies have been conducted for the manufacturing sector of Pakistan which show that the process of industrialisation brought about increasingly capital-intensive techniques of production(17). Indeed, this sector absorbs only a small share of the labour force of the country. Table 5-2-7 gives a relative estimate of the sectoral absorption of the country's labour force.

The figures show that even the annual average of the last 6th Plan period gives a ratio of a little more than half of the labour force employed in the agricultural sector. It implies that the manufacturing sector did not expand in Pakistan in a fashion that radically changes the pattern of output and employment. Chenery showed in one of his studies that a typical country with a per capita income of US\$100 derives about 50% of its gross domestic product from the primary sector, about 35% from the services sector and the remaining 15% from the manufacturing sector. The corresponding figures at a per capita income of US\$1,000 are about 15%, 45% and 40%

Table: 5-2-7

Sectoral Share of the Employed Labour Force
(Pakistan: 1963 to 1988)^P

(a) No. Period	(b) Agriculture	(c) Mining & Manu- facturing	(d) Services
<u>2nd Plan</u>			
1. 1963-65	59.98	13.80	26.22
<u>3rd Plan</u>			
2. 1965-70	57.53	14.94	27.53
<u>Non-plan</u>			
3. 1970-78	55.37	13.91	30.73
<u>5th Plan</u>			
4. 1978-83	52.69	14.09	33.22
<u>6th Plan</u>			
5. 1983-88	51.32	13.60	35.08
1-5. 1963-88	54.74	14.12	31.30

Source:: Appendix Table 9-A.

^P All figures are annual average percentages of total labour force in Pakistan.

respectively. He suggested that the sectoral composition of employment moves in the same direction as that of income and output, and the proportion of the labour force in agriculture is initially even higher and declines more rapidly than the proportion of gross national product generated in agriculture(18).

An examination of Table 1-1-7 together with Table 5-2-7 reveals that Pakistan still largely represents an example of a country of the first category. The only difference is that the decline in the GDP share of the agricultural sector has been overwhelmingly replaced by the services, rather than the manufacturing sector. What is more relevant for our concern here, however, is that the change in employment of labour in particular, did not follow the course suggested by Chenery. On the contrary, the annual averages of the 6th Plan period in the Tables show that the share of the labour force employed in agriculture was still more than twice the GDP generated in this sector. Despite, however, an increase in the average GDP share of manufacturing sector during the 6th Plan (37% over the average for the 2nd Plan), the share of the labour force employed in manufacturing remained almost constant throughout the period of analysis. Indeed, a small decline is observed in the manufacturing employment during the 6th Plan period. Further, the actual figures for labour employed in the manufacturing sector are lower than the estimates listed in Table 5-2-7, since the data

in that table include employment in mining for which we do not have separate employment figures. Furthermore, results from a recent study conducted for the manufacturing sector of Pakistan, covering the time period 1959-60 to 1982-83, suggested a low elasticity of substitution between working capital and labour. The study concluded that there is not much scope for employment generation in the large-scale manufacturing sector of Pakistan(19). Given the evidence so far presented, we can now conclude that the capital/labour ratios of the manufacturing sector of Pakistan were inconsistent with national employment objectives. Unrealistic capital pricing policies of the Government might have been partly responsible for this pattern of expansion. These policies prevent entrepreneurs from investing in labour-intensive technology. There is little empirical evidence to suggest that it is profitability criteria which motivate the entrepreneur to invest in capital-intensive technology. On the contrary, the evidence of the profitability of labour-intensive technology comes from a variety of sources. For example, in a study of ten industries in India, Sandesara found that labour-intensive technology had higher output and a higher surplus per unit of capital, implying no conflict between employment and output(20). In a similar study of four industries in Pakistan, Ranis found that profits relative to capital stock seem to be maximised in medium-sized plants rather than in the largest and most

capital-intensive enterprises(21). Further evidence on these lines can be found in a paper by Stewart and Streeten(22).

Insofar as the expansion of the manufacturing sector is the "engine of growth", the pattern of its expansion must be consistent with the requirements of sustainable growth. The latter is, in turn, determined by the performance of the manufacturing sector in relieving the balance of payments difficulties of the country either by saving or earning foreign exchange, or by an effective combination of both. Unfortunately, there is little evidence of success on these lines for Pakistan. The persistent current account deficit figures for the country have already been listed in the preceding chapter of this study (see Table 1-1-6). Furthermore, import figures which are available in officially published sources for only the Nonplan, 5th Plan and 6th Plan periods show that the manufacturing sector has been a major drain on the meagre foreign exchange resources of the country. We have listed the percentage share of major import categories in Table 6-2-7.

The figures show that the industrial raw materials make up the largest part of imports for the 1970-88 period as a whole. And during the 5th and 6th Plan periods the share of raw materials is markedly greater than all other categories. The share of capital goods in total imports shows a decrease during the 5th Plan period

Table: 6-2-7

The Share of Major Import Categories
(Pakistan: 1970 to 1988)^P

(a) No. Period	(b) Capital Goods	(c) Industrial Raw Materials		(d) Consumption Goods
		(ci) For Capital Goods	(cii) For Consump- tion Goods	
<u>Non-plan</u>				
1. 1970-78	36.60	8.57	33.63	21.20
<u>5th Plan</u>				
2. 1979-83	31.00	6.60	46.20	16.20
<u>6th Plan</u>				
3. 1984-88	34.80	6.20	43.20	15.80
2-3. 1970-88	34.67	7.33	39.78	18.22

Source: Pakistan Economic Survey, 1988-89, Statistical Supplement, Table 10.4, P. 147.

^P All figures are annual average percentages of total imports.

over the average of the Nonplan period. Further, Table 6-2-7 reveals that over the years Pakistan has created an industrial structure that has an in-built dependence on external sources of input. Such a type and degree of dependence is potentially very dangerous in terms of the high vulnerability of the economy to destabilising changes in the external sector.

However, the structure of imports given in Table 6-2-7 could largely be justified if enough foreign exchange is earned by re-exporting a reasonable part of the imports. Unfortunately, the evidence listed for Pakistan in Table 7-2-7 provides little assurance on that front.

Table 7-2-7 shows that the share of manufactured goods has registered a reasonable improvement over the Nonplan and Plan periods. However, this owes little to the import figures in Table 6-2-7 since the types of manufactured goods exported by Pakistan use few, if any, import components. The overwhelming value of these exports consists of earnings made by basic manufactures like cotton cloth, ready-made garments and hosiery, carpets and rugs, and sports goods(23). All these activities are highly labour-intensive and they have strong backward linkages within the domestic economy. The major categories of the semi-manufactured and manufactured exports based on imported technology and raw materials are petroleum and petroleum products, synthetic textiles, cements and products, paints and varnishes, and drugs and

Table: 7-2-7

The Share of Major Export Categories
(Pakistan: 1970 to 1988)^P

(a) No. Period	(b) Primary commodities	(c) Semi-Manufactu- res	(d) Manufactured Goods
<u>Non-plan</u>			
1. 1970-78	40.60	20.88	38.62
<u>5th Plan</u>			
2. 1978-83	36.60	14.60	48.80
<u>6th Plan</u>			
3. 1983-88	29.40	17.60	53.00
1-3. 1970-88	36.34	18.22	45.44

Source:: Pakistan Economic Survey, 1988-89, Statistical Supplement, Table 10.4, P. 147.

P All figures are annual average percentages of total imports.

chemicals. These products register a very small part of the total value of exports. Indeed, the value earned by petroleum and petroleum products manifested a secular downward slide after 1982, while the exports of cement and cement products completely disappeared after 1978(24).

Simultaneous examination of Tables 6-2-7, and 7-2-7, clearly suggests the reasons for the persistent balance of payments deficit of Pakistan noted in the preceding chapter. After almost four decades of huge inflows of development aid the country still exhibits a pattern of exports which largely consists of primitive low-tec products with high supply and low demand elasticities in the international market. The large share of the manufacturing sector in the import bill has not resulted in sufficiently diversifying and strengthening Pakistan's exports which would increase her competitiveness in the external market.

Another manifestation of the inefficiency of the manufacturing sector of Pakistan is to be found in its vast idle capacity. The latest study analysing this and other aspects is in progress at the Centre For Development Studies of the University of Glasgow. The author of that work has carried out a cross section analysis of 144 large scale manufacturing units in Pakistan for the year 1984-85. Her results suggest that only 44% of total capacity was being utilised(25). In our opinion, there are three possible explanations for the existence of such enormous

amounts of idle capacity. The first is the shortage of energy which is a crucially important and scarce input for the operation of most manufacturing units in Pakistan. Pakistan declared serious energy shortage problems in the 1970s after the 73' oil price hike. However, although a number of countries adopted energy-conservation strategies, Pakistan was not one of them. Failure to do so contributed to energy shortages which grew to become a major constraint to development in the 1980s.

The second reason for capacity underutilisation in the large-scale manufacturing sector of Pakistan is its failure to extend into international markets by becoming cost and quality competitive. The country's terms of trade for selected commodities are given for the last seven years of the period of our analysis, in Table 8-2-7.

These data indicate deteriorating terms of trade for each of the three listed groups. On average, the deterioration is less in manufactured goods, largely owing to the cost and quality competitiveness of the cottage industry in Pakistan. Machinery and transport equipment which represent the output of large manufacturing establishments registered the largest average deterioration, 34% over the seven year period. The figures for this group exhibit a fast downward slide for the last two years of analysis. Hence, it can be inferred that the large share of imports into the big manufacturing units has not been successful in

Table: 8-2-7

Terms of Trade
(Pakistan: 1981 to 1988)
[1980-81=100]

(a) No. Year	(b) All Groups	(c) Manufactured Goods	(d) Machinery & Transport Equipment
1. 1981-82	88.82	86.93	98.81
2. 1982-83	88.93	90.58	83.35
3. 1983-84	94.88	107.03	68.20
4. 1984-85	93.47	106.34	76.25
5. 1985-86	89.79	84.27	73.35
6. 1986-87	96.46	92.76	40.91
7. 1987-88	96.32	87.66	21.26
1-7. 1981-88	92.66	93.66	66.02

Source:: Pakistan Economic Survey, 1988-89, Statistical Supplement, Table 10.3 P. 145.

reproducing itself.

Finally, another explanation for the existence of idle capacity in the manufacturing sector is the small size of the internal market of Pakistan as a result of the backwardness and generally low incomes in the agricultural sector. Our analysis in the following section further highlights this point.

Section: 2-2-7

The Agricultural Sector

As mentioned in Chapter One, the resource endowment of Pakistan renders her a natural home for agriculture. Agriculture in Pakistan is a visible, well-recorded activity which impacts on the perceived well-being of almost all economic agents. Official policy of the government of Pakistan has consistently stressed the role of agriculture in the overall development of the nation. In practice, however, a clear consensus about the substance of agricultural policy has never been identified. As a result, the agricultural sector of Pakistan has generally been plagued by low levels of productivity. According to one estimate, the average farm productivity in Pakistan is just one-half to one-third of its potential level(26). In this section, however, we are mainly pursuing the following three issues.

(1) The structure of rural relations and land ownership in Pakistan.

(2) The effect of government policy on ownership

structure.

(3) The direct and indirect impact of policy measures and commodity aid, under PL. 480, on the agricultural sector.

In Pakistan traditional rural relations have divided landlords from small cultivators and the multitude of tenants and landless labourers. These last two groups are of necessity drawn into complex social, political, and economic relations with landlords in order to earn their livelihoods and gain a measure of security. The power of the landlords stems from the unequal distribution of land. Pakistan has a very large rural sector, spreading over 45,000 villages. According to the 1980 Census of Agriculture, the total farm area of the country is 19.54 million hectares(27). The number of agricultural farms is a little over two millions(28). The agricultural sector is still characterised by a two-tier system of land ownership, very large holdings and small farms. About 91% of farms are reported to be under 5 hectares and a further 6% are between 5 to 8 hectares. Thus, the proportion of farms over 8 hectares is only 3%, and small farmers owning/cultivating up to 8 hectares account for about 97% of all farms in the country. About 81% of cultivated area is operated by small owners(29). Large landlord families may hold more than 200 hectares of land. A large proportion of the rural population of Pakistan consists of family farmers, fractional holders and the landless. Family farmers utilise family labour and land to

meet their subsistence needs and for cash sales. They are classic peasant agriculturists. The fractional holders are those who cannot survive simply on the basis of cultivating their land. They must have other income from outside labour. The landless must find some means of securing access to work if they are to survive. The landlords acquire and wield power by virtue of the sway they hold over these vulnerable groups. The relation between landlord and tenant is feudal in the sense that it involves more than a simple economic tie, because land is held for prestige and power, rather than purely as an economic resource.

The first ever land reforms in Pakistan were legislated in 1959. When Ayub implemented this legislation in the 1960s the large landowners surrendered some land but did not suffer any real losses or diminution of power. They were able to disguise the extent of their holdings by passing title to family members. The Bhutto Government of the 1970s was much more committed to land reforms and began to implement stronger measures, though momentum was quickly lost(30). Zia's Government went as far as to cancel the land reforms which Bhutto introduced during the dying days of his Government; since that time these reforms have not even been considered, let alone implemented. The fact of the matter is that the landlords control the production of cotton, rice, and wheat. Each of these commodities is vital to the success of manufacturing

and the flow of exports. Agriculture is, thus, the backbone of the nation. Food self-sufficiency is a national goal, and cheap food is necessary to keep urban workers content and quiescent. Landed aristocrats are a conservative, stabilising force in Pakistan. The country's precariously balanced governments which face recurrent stresses from tribal, regional and religious turbulence, and also threats from across their borders, are unlikely to undermine the landlords who are pillars of support. Landlords have representation in national and provincial governments and have manipulated family connections within the civil and military elites.

The tax system of Pakistan plays a limited role in shaping economic behaviour and in redistributing income across groups, especially in the agricultural sector. Agriculture is largely exempt from income and land taxes. However, the importance of agriculture in the economy has made it imperative that the Government play an active role in shaping the determinants of agricultural performance; pricing, production, and export policies guide the fate of the sector. Policy-makers control the prices of major crops through various procurement policies and also regulate the prices and quantities to be distributed of vital inputs. The Government also participates directly in marketing, distributing and processing agricultural products, and in the production, import, and marketing of inputs: fertiliser, pesticides, tractors, and agricultural

implements. Thus, by its influence on prices and by direct involvement in marketing and distribution the Government has affected the sector's performance.

Both the agricultural producers and the manufacturers have vital interests in the pricing decisions of the government. The concern of the former is that output prices are high enough to ensure profitability. The large estate owners stand to benefit from favourable procurement prices because of the concentration of returns to land in their hands. Family farmers likewise want high prices and even tenants have some interest in the trickle-down effects of good farm prices. At the same time the landowning groups welcome low input prices in the form of subsidised fertiliser, water, pesticides, and above all credit. In contrast, manufacturers benefit from low food and raw material prices and high output prices, both of which are exactly opposite to agricultural wishes.

During the 1960s agricultural prices of some commodities were frequently held below economic levels in order to encourage development of the manufacturing sector through low-cost food and raw materials(31). No agricultural commodity was initially included in the bonus voucher scheme(32) and later, in 1970, only cotton was given a 10 percent bonus(33). On the whole, the pro-manufacturing biases of the Government in the 1960s led to price policies that imposed explicit or implicit taxes on agriculture and subsidised manufacturing(34). The

rationale for the pro-manufacturing bias was rooted in thinking of the time.

During the 1970s the rhetoric of Bhutto Government's policies provided incentives for the "continuation of agriculture as an attractive and profitable vocation"(35). But, in contrast to the Government's objectives and promises, the actual formation and implementation of its policies was marked by internal conflicts. On the one hand, the Bhutto government tried to fulfil its promise to its urban supporters to keep food prices below market levels. On the other hand, the government felt it was in its interests to support farm producers by allowing farm prices to rise to encourage production, raise profits, and enhance rural incomes. These two aims conflicted and could be reconciled only by subsidising food; that is, by setting up a two-price structure that required expenditures. Expenditures, however, had to come from revenue and this meant taxation or deficit. The Bhutto Government chose the latter course and ran increasingly large government deficits. These deficits were, in turn, partially responsible for the severe inflation of this period. This amounted to implicit taxation on groups unable to raise their money incomes in order to offset higher prices.

Within the agricultural sector there were further multiple complications of what appeared a simple objective. There was overall tension between the

Government's commitment to aid the poorest segments of the population and the inclusion in its support base of large landholders. For example, in order to improve the position of the smallest farmers, sharecroppers, tenants, and the landless, land reforms were initiated in 1972. But not wanting to lose the support of the landlord class, the PPP made sure that the reforms were mild and provided sufficient loopholes to permit actual holdings to persist undisturbed. Further, the Bhutto Government designed the Integrated Rural Works Programme to help the agricultural sector. This was a scheme to integrate all productivity and income-raising services: credit, marketing, and extension. But all these measures, including the input and output prices, largely helped the big landlords and the family farmers, while little was done for the landless agricultural workers.

The Bhutto Government also exercised monopoly power over the trading of two major crops of Pakistan, rice and cotton. The Cotton Trading Corporation was formed in 1973 and in the following year the Rice Trading Corporation was constituted. With the devaluation of 1972, an export duty of 35 percent was imposed on raw cotton, thereby giving exporters Rs. 5.40 for each dollar of exports as compared with the official average rate of Rs. 9.00 to the dollar. In June 1973 the export duty was raised to 45 per cent plus an additional 30 per cent on excess of over Rs. 1500 per bundle. Export duties were also imposed on rice. In

1972 the effective rate of return for rice exports was Rs. 6.30 per dollar. After the Government gained a monopoly over the rice trade the rate for producers declined to Rs. 2.70 to the dollar(36). With these heavy rates of taxation the Government allowed the farm prices of cotton, rice, and wheat to rise. But in spite of these measures to increase returns to farmers, prices of these commodities remained below free market domestic wholesale price levels(37). Moreover, the Bhutto Government followed agricultural pricing policies that reflected the weights of political groups at various times during its stay in office. The terms of trade for agriculture, after increasing by over 16 per cent in 1971-72, deteriorated during the following two years. They improved strongly in 1974-75 but slumped again in 1976-77(38).

In the 1980s the Zia Government was careful not to disturb the relationship between interest groups and between sectors of the economy. No land reforms were ever intended during this period. However, the overall approach of that government to agricultural policy was relatively pragmatic as compared to previous governments. For example, the private sector was encouraged to participate in agricultural activities formerly reserved for the public sector. Price incentives were increased for all crops and credit facilities were provided for small farmers. The performance of the agricultural sector after 1977 was uneven, given its dependence on weather

conditions. But, with the help of incentives, the production of major crops demonstrated an underlying strength, with the result that the economy achieved basic self-sufficiency in foodgrains in 1980-81.

Nonetheless, for the period of this study as a whole it may be concluded that to subsidise manufacturing and services activities Pakistan has sometimes directly, but often indirectly, taxed the agricultural sector through distorted incentives. The distortion in incentives is brought about either by sector-specific (direct) and/or by economy-wide (indirect) policies. The impact of the direct pricing policies is measured by the difference between the prices domestic producers receive and the prices they could receive if sector-specific distortions are removed. The impact of indirect policies on incentives is measured by the difference between the prices domestic producers receive and the same prices under the assumptions that equilibrium free trade exchange rate will prevail and that no trade distortions in the tradeable non-agricultural sector will be present. A recent study has estimated these coefficients for cotton and wheat in Pakistan for two periods, 1975-79 and 1980-84. Direct, indirect and total nominal protection rates (measured as percentage difference) for cotton were 12%, 48% and 60% for the first period while for the second period, these rates respectively were 7%, 35% and 42%. For wheat, these rates were 13%, 48% and 61% for the first period and 21%,

35% and 56% for the later period. In all cases levels of indirect taxation via real exchange rate and protection policies for non-agricultural commodities were greater than direct interventions(39). This penalising of agriculture certainly had a significant negative impact on production in the sector in view of the high price elasticity of supply of most crops. Recently, a study has been carried out in order to estimate the profitability of agriculture in Pakistan for the period from 1975-76 to 1985-86. The authors have analysed the costs and returns of major crops grown in the irrigated areas of the Punjab(40). Their findings suggest that, with the exception of cotton for a few years, net income per acre remained consistently negative for all crops throughout the study period(41). On average, the composite rate of growth of productivity of all important crops dropped by 35% during the 1975-76 to 1985-86 period as compared with the decade that preceded it(42).

The distorted incentives may be partially blamed on the availability of non-project commodity aid to Pakistan. The availability of these commodities enables the Government to determine the low procurement prices of the domestic output of agriculture. Their sale in the domestic market provides the Exchequer with part of the funds required to subsidise the output of the projects in the non-agricultural sector. In Table 9-2-7 we have listed the percentage share of various aid categories, for the

Table: 9-2-7

Share of the Aid Categories
(Pakistan: 1960 to 1988)^P

(a) No. Period	(b) Project Aid [■]	(c) Non-project Aid [■]			
		(ci) Non-food	(cii) Food	(ciii) BOP [‡]	(civ) Relief
<u>2nd Plan</u>					
1. 1960-65	50.50	17.54	31.96	—	—
<u>3rd Plan</u>					
2. 1965-70	59.52	25.07	15.41	—	—
<u>Non-plan</u>					
3. 1970-78	44.61	22.67	13.70	19.02	—
<u>5th Plan</u>					
4. 1978-83	58.15	16.40	5.28	9.09	11.08
<u>6th Plan</u>					
5. 1983-88	67.97	11.01	10.80	—	10.22
1-5. 1960-88	56.84	17.68	13.10	6.34	6.04

Source:: Appendix, Table 5-A.

^P All figures are percentages.

[■] Aid Disbursement.

[‡] Balance of payments support.

period of our analysis.

As shown in Table 9-2-7, about 31% of the total aid Pakistan has utilised has been in the form of commodities. By far the greatest part has come under the US Agricultural Trade Development and Assistance Act (PL.480). US commodity aid may have had a more direct impact on agricultural production via its effects on cultivators incentives. Commodities under PL.480 constituted 34% of total US aid disbursed to Pakistan up to 1988(43). Their sales in the country have been a major source of financing of public sector expenditures. Because of the risks associated with too much deficit financing, and the unpopularity of higher taxes, the Pakistan Government has had an interest in making PL.480 imports as large as possible in order to raise funds to finance its plans. Schultz maintains that US policy concerning the use of PL. 480 loans and grants is set against agriculture in the receiving countries(44). In his opinion, the uses of PL. 480 that would increase the export availability of surplus farm commodities are virtually prohibited, and so are investments that would significantly increase the production of surplus farm commodities(45). Wilcox in reporting on a discussion in Santiago, noted that "Staff members of FAO attending the conference expressed the view that there probably was more danger of serious adverse effects on the producers in the receiving countries from continued PL. 480 exports than on competitive producers in

other exporting countries. They are apprehensive that desirable, and in the long-run necessary, agriculture development in the receiving countries will not take place if PL. 480 exports are continued and expanded"(46).

Here we can do no more than speculate about the effects of PL. 480 imports on the performance of Pakistan's agricultural sector. Unfortunately, there are few data and no relevant studies, but one of the difficulties that is caused by the PL. 480 imports to the cultivators in Pakistan is the many serious price fluctuations that occur. If a programme were devised that would reduce substantially this kind of price uncertainty in agriculture, it seems likely that the effect would be to induce an expansion in agricultural production.

Furthermore, the supply of virtually all farm inputs, such as fertiliser, irrigation water, plant protection, better-quality seeds, has been inadequate in Pakistan compared with their requirements. In the early 80s' the use of fertiliser amounted to only 30% of what was needed, while the irrigation water supply was sufficient only to the extent of 60% of requirements, and plant protection was provided to only 10% of cropped area(47).

Non-availability of these resources was largely a problem for small farmers. Furthermore, the general poverty and illiteracy of the latter made it difficult to adopt new ideas and/or technology. Indeed, resources, even

if provided in sufficient amounts, are not effective unless satisfactory progress is made on the social front, particularly in rural support services. It is this important aspect of the economic growth question to which we turn in the following part.

Part: 3-7

The Progress on the Social Front
(Pakistan: 1960 to 1988)

It was observed in part one of this chapter that economic growth in Pakistan largely consists of the expansion of the services sector. However, this sector's high rate of growth does not include a sufficient expansion of the social services.

When a country with a largely primitive economic structure passes through the process of development and modernisation, consistent achievements on the social front can shorten the process of transition by changing the character of economic agents in a progressive manner that conforms to rational economic choices. At this point we would like to recall the three phased thesis of development put forward by the architects of two-gap models, who along with the other authors of the theory of aid and development recognised the first phase as being limited by the inadequacy of skilled manpower. We believe, that in a broader sense this implies that a large number of the inhabitants of a country are just unable to meet the requirements of the development process. This may

largely be blamed on poor living conditions and on isolation bred by ignorance and illiteracy, resulting in a ritual approach and attitude to life and work. The extent and the way in which this gap is filled determines the ability of the country to carry out an efficient investment programme of foreign and domestic saving with dividends of sustained and sustainable economic growth. Because the progressive character of the manpower of the country is easily adaptable to new economic realities, the economy is provided with a built-in adjustment mechanism, resulting in the most efficient allocation and reallocation of economic resources. Indeed, this was the key to the success of the Marshall Plan in Western Europe and Japan. Further, the more recent experience of South Korea amongst the developing countries who almost together embarked on the process of development provides another good example(48).

This part intends to analyse the process of social change in Pakistan in two sections. Section one describes the present situation in two of the most important social services in Pakistan, health and education. While section two attempts to analyse the contribution of foreign aid to the development of the social sector in Pakistan.

Section: 1-3-7

Health and Education Services in Pakistan

In the year 2000 the population of Pakistan will be greater than 130 million. Developments on the social front

are issues which concern the welfare of not only the 130 million, but also generations to come. In this section, we only wish to consider some evidence concerning the poor provision of health and education services to the masses of the country.

In Pakistan about 70 per cent of the population presently lives in rural areas where the distribution of health services, in particular, paints a very grim picture. The rural population is provided with only 23% of the hospitals, 34% of the Mother and Child Health Centres, 18% of the beds, 15% of the doctors, and 5% of the nurses(49). Thus, Pakistan has a health care system which is inaccessible to the vast majority of rural inhabitants. Furthermore, inaccessibility in a free market system is also determined by one's purchasing power. For that population for whom health facilities are geographically available, the price tag on purchasing health care may also make it inaccessible. Although government hospitals which provide free medical care exist in large cities, the increase in population growth and the demand for services has outstripped the supply. Thus, private medical facilities fill the gap, but they are certainly not equally accessible to all. Moreover, the role of Government has not been very positive in developing health facilities which are preventive-oriented. Government has shown a very clear bias to investing in high technology hospitals and medical colleges rather than in Basic Health

Units and Rural Health Centres.

Apart from old age, the main causes of death in Pakistan are: infective and parasitic diseases, fifty four percent; Malaria, eleven percent; death during birth, seven percent; and tuberculosis, six percent(50). The main killer of children is tetanus, followed by measles and dysentery. None of these diseases require grandiose hospitals with the "latest technology". They simply require steps to eliminate the disease at its source. Water and sewerage play a major role in this process. In Pakistan in 1983, 77 percent of the urban and 22 percent of the rural population had access to potable water, while 48 percent of urban inhabitants and 4 percent of rural inhabitants had any access to sewerage and sanitation facilities(51). Preventive measures such as inoculation also do not seem to reach the majority of the population. Of the 3 million babies born each year less than 1.5 million receive immunisation, and not all of them complete their immunisation programme(52).

Finally, In 1976 the Government of Pakistan spent 1.8 percent of GNP on the health sector. In the 80s' this ratio was down to 0.6 percent(53). This was indeed a substantial loss for the health sector, and the amount Pakistan was spending on health was almost one-ninth of the amount recommended by WHO(54). Further, that section of society living in the cities, i.e., the bureaucrats, the elite, the students, workers, and professionals, are

all strong enough to exert pressure on the Government to implement policies that can serve their interests. For this reason the Government spends 6 times as much on health services in urban areas in Pakistan as it does in rural areas(55).

A substantial portion of the population of Pakistan is illiterate, about 73.8 percent. If one were to look at the gender breakdown, then women are extremely disadvantaged, 84.8 percent of them are illiterate(56). Moreover, Pakistan is one of those few countries that are prominent in not achieving UNESCO's projected enrolment ratio at primary school level. The ratio even declined from 53 percent in 1979 to 44 percent in 1986, much below the required 68 percent(57).

One very important cause of this poor performance is the high degree of divergence in public expenditures on different levels of education. In Table 10-3-7 are listed public expenditures per student by level of education for four developing countries for the year 1985. The per student expenditures on tertiary education as compared to what were incurred at the primary level were only four times higher in Bangladesh in 1985. For Iran they were 9 times higher. Malaysia, on the contrary, incurred lower expenditures in higher education than at the primary level. In Pakistan, the former were 50 times greater than the latter.

Table 10-3-7 shows that for Pakistan, not only is

Table: 10-3-7

Public Expenditures on Education
(Per Student: 1985)

(\$US)

(a) No. Country	(b) Level of Education		
	(bi) Primary	(bii) Secondary	(biii) Tertiary
1. Bangladesh	14.81	30.76	57.12
2. Iran	344.35	636.85	3121.02
3. Malaysia	2822.85	471.09	2574.60
4. Pakistan	26.59	49.42	1333.32

Source:: Shamim A. Sahibzada and Mir Annice Mahmood, "Education in Selected Islamic Countries", Pakistan Development Review, Vol. 28, No. 4, Winter 1989, Appendix, Table 6, P. 823.

more spent on higher education as compared to primary education, there is also wide divergence between the two categories of expenditures. It goes without saying that a sound footing at the primary level of education democratises the whole educational system and greatly helps to improve the general character of the population in a manner which is conducive to sustainable growth. It can be inferred from Table 10-3-7 that in Pakistan relatively high levels of Government spending on tertiary education affected coverage at the primary and secondary level. Thus, because of insufficient resources, a lower number of students were enrolled than would otherwise have been the case.

It may, therefore, be concluded that Government policy in Pakistan has not adequately addressed the issue of improvement of social welfare. In the following section we will analyse the extent to which donors were concerned with the development of the social sector.

Section: 2-3-7

The Contribution of Foreign Aid

The figures in Table 4-2-7 show that the allocation of project aid to population welfare, education, and rural development was less than five percent of total disbursements during the whole period of analysis.

Although almost 70% of Pakistan's population lives in the rural sector of the country, the amounts of foreign aid allocated to the development of this sector were

small, negligible fractions of the total during the 2nd and 3rd Plan periods respectively and only about half a percent during the Nonplan period. The low priority treatment of rural development by donors might be due to the fact that agricultural research and human capital investment in order to improve human capabilities in this sector have been too readily neglected in many developing countries. But as far back as the early 1960s Schultz blamed low productivity of farm labour largely on an absence of specific factor inputs, such as research and education, rather than on a shortage of reproducible capital(58). In some of his later work, he shows that an integral part of the modernisation of the economies of high and low income countries is the decline in the economic importance of farmland and a rise in that of human capital skills and knowledge(59). Nonetheless, the average annual allocation in the Rural Development Programme for the 5th and 6th Plan periods shows a considerable improvement over the past years, probably because of the recognition by donors of the eminent bottlenecks in the economic system which may eventually turn the country into a defaulter. The basic concept of the Rural Development Programme in Pakistan is: that all aspects of rural life are interrelated and no lasting impact can be created so long as they are considered in isolation from each other. In practical terms it means that agricultural production, which is the most important

component of rural development, is related directly to the literacy of the farmers which, in turn, is related to factors such as health, nutrition, sanitation, communication and electric power(60).

The aims and objectives of the population welfare programme are inter-linked with rural development, and in most cases overlapping. The record of the allocation of aid to this sector is almost the same as for the rural development programme.

One very important development sector in Pakistan, scarcely addressed by aid donors is education. Figures in Table 4-2-7 show that this sector has the lowest annual average allocation of aid for the period as a whole. In our opinion, this record is regrettable for a country where the national literacy rate is only 26%, and the rate for women only 15 per cent.

Furthermore, whatever funds were available for education, for the most part they were used to finance higher education, very often overseas; the large number of recent US scholarships for Ph. D degrees under the Science and Technology Development Scheme are a case in point. Also, foreign aid has been used to establish or maintain the Centres of Excellence in selected disciplines in some of the universities of Pakistan. Here a question arises: how are the benefits and costs of these various schemes related to the various stages of development? At very low levels of income, the impact of a few highly trained

people can be very significant. Many African countries which suffer from severe shortages of skilled manpower occupations are cases in point. But an increase in the number of trained and highly-educated graduates beyond the level that is warranted by the extent of development results in unemployment. The educated usually insist on getting the jobs and salaries which they expect. The paradoxical situation of unemployed educated and trained people in underdeveloped countries, including Pakistan, is a common one(61). We have already produced evidence that public expenditures on higher education in Pakistan are very large, as compared with the expenditures incurred on primary education. In our opinion, there is an acute need in Pakistan for more funding of compulsory 'universal education' at the primary level. Funding at this level is mainly funding for literacy. At the secondary and higher levels, skills should approximately be matched to opportunities to work. Indeed, the supply of capital equipment, the demand for skilled labour and the demand for goods produced by the factors of production are required to match the supply of manpower with specific or adaptable skills.

Finally, our analysis in this chapter leads us to suggest that a fairly long period of foreign aid to Pakistan has not sufficiently changed the primitive character of the economy. There are still inherent weaknesses in each of the three main sectors of the

economy that are not conducive to generating a momentum of sustainable growth. The analysis in this chapter supports the conclusion that Government policy in Pakistan, has not been successful in carrying out efficient programmes for domestic and external resources. As a result, the present economic structure of the country does not appear to have sufficient potential to maintain the high rates of growth experienced in the past, if net external assistance is further reduced or stopped.

NOTES

1. See, S. Collins and W. Park, "Korea", Published in J. Sachs and S. Collins (ed.), "Developing Country Debt and Economic Performance", Vol. 3, NBER, University of Chicago Press, 1989.

2. Ibid.

3. The term "Dutch disease" was first used in mid-1970s and referred to the diverse effects on Dutch manufacturing of the Schlochteren natural gas discoveries of the 1960s via their impact on the Dutch real exchange rate. The appreciation of the currency consequent upon the gas discoveries was considered to have had a detrimental effect on Dutch manufacturing output and exports.

4. See, (i) M. Michaely, "Exports and Growth: An Empirical Investigation", Journal of Development Economics, Vol. 9, No. 3, Dec; 1981, (ii) Michael Roemer,

"Dutch Disease in Developing Countries: Swallowing Bitter Medicine", in M. Laundahl (ed.), "The Primary Sector in Economic Development, London, Croom Helm, 1985, pp. 234-52, (iii) Sweder Van Wijnbergen, (a) "The Dutch Disease: A Disease After All?", Economic Journal, Vol. 94, March, 1984, pp. 41-55, (b) "Macroeconomic Aspects of the Effectiveness of Foreign Aid: The Two-gap Model, Home Goods Disequilibrium and Real Exchange Rate Misalignment", Journal of International Economics, Vol. 21, August, 1986, PP 123-36, (iv) Jaime de Melo, "The Macroeconomic Effects of Foreign Aid: Issues and Evidence" in Jepma (ed.), North-South Cooperation in Retrospect and Prospect, London, Routledge, 1988.

5. See, Michaely, op. cit.

6. See, Stephen R. Lewis, "Pakistan: Industrialisation and and Trade Policies", Oxford University Press, London, 1970.

7. See, Stephen R. Lewis Jr. and Stephen E. Guisinger, "The Structure of Protection in Pakistan", in Bela Balassa(ed.), "Structure of Protection in Developing Countries", Baltimore: John Hopkins Press, 1971.

8. See, Lewis(1970) op. cit.

9. See, A. R. Khan, "Capital Intensity and Efficiency of Factor Use: A Case of Pakistan", Pakistan Development Review, Vol. X, Summer 1970, pp. 232-63.

10. See Lawrence White, "Industrial Concentration and Economic Power in Pakistan", Princeton University Press,

New Jersey, 1974; P.122

11. See Lewis and Guisinger, op. cit., P. 248.
12. See, White, op. cit., P. 123
13. See IBRD, "Pakistan Development Issues, Policies", Vol. 1, Washington 1978, P. 115.
14. See, "Industrial Policy Statement", Government of Pakistan, Ministry of Industries, June 1984.
15. Ibid.
16. Altaf, Z. Altaf, "Entrepreneurs in the Third World", Croom Helm LTD, New York, 1988, P. 29.
17. See, Ashfaq H. Khan, "Factor Demand in Pakistan's Manufacturing Sector", International Economic Journal, Vol. 2, No. 3.
18. See, Hollis B. Chenery, "Patterns of Industrial Growth", American Economic Review, Vol. 50, No. 4, September, 1960, pp. 624-65.
19. Ashfaq H. Khan, "The Two-level CES Production Function for the Manufacturing Sector of Pakistan", The Pakistan Development Review, Vol. 28, No. 1, Spring, 1989, pp. 1-11.
20. See, J. C. Sandesara, "Scale and Technology in Indian Industry", Bulletin of the Oxford University, Institute of Economics and Statistics, August, 1966.
21. See, G. Ranis, "Investment Criteria, Productivity and Economic Development: An Empirical Comment", Quarterly Journal of Economics, May, 1962.
22. See, F. Stewart and P. Streeten, "Conflict Between

Output and Employment Objectives in Developing Countries", Oxford Economic Papers, July, 1971.

23. See, "Pakistan Economic Survey, 1988-89, Statistical Supplement, pp. 148-53.

24. Ibid.

25. Rukhsana Kauser, "Employment Creation in the Large-scale Manufacturing Sector of Pakistan", Ph. D thesis in progress at Centre for Development Studies in University of Glasgow.

26. See, "The State of Pakistan's Economy: 1970-71 to 1979-80, Pakistan Institute of Development Economics, Islamabad, June 1980. P, 49.

27. See, Pakistan Economic Survey, 1988-89, op. cit., Table: 3.9, P. 49.

28. Ibid; Table 3.10.

29. Ibid; Table 3.9.

30. Bhutto himself belonged to one of the wealthiest Sindhi landlords and important Sindhi landlords had joined the PPP at its birth, along with some Punjabi landlords.

31. See, Stephen R. Lewis, "Economic Policy and Economic Growth in Pakistan", Cambridge, The M.I.T. Press, 1969, P. 89-96.

32. Under this scheme the exporters were allowed to retain a fixed percentage of their foreign exchange earnings. These were tradeables in the open market and the premium rates varied between 150 to 180 per cent, in practice

nearer the upper limit. This meant that the multiple exchange rates were in operation.

33. Cotton was subject to export duties between 1959 and 1967, the rates were lowered in 1964 and then abolished in 1967, See, Syed Ali Baqr, "A Brief Survey of Import and Export Duties, Trade Journal, Vol. VIII, No. 27, August 1973.

34. See Lewis(1969), op. cit., P. 94.

35. See, Zulfikar Ali Bhutto, Address to the Nation, March 1, 1972, Reprinted by the Government of Pakistan, Dept. of Film and Publication, Karachi, 1972, pp. 2-3

36. See, Gotsch Carl and Gilbert Brown, "Prices, Taxes and Subsidies in Pakistan's Agriculture", 1960-70, Washington, D. C., World Bank, April 1980, P. 172.

37. See, Sabiha Iqbal, "Exports, Politics, and Economic Development: Pakistan, 1970-1982", John Boulder, Colo, 1983, Table: 7.3, P. 155.

38. Ibid; Table: 6.11.

39. See, Ann. O. Krueger, et al., "Agricultural Incentives in Developing Countries: Measuring the Effects of Sectoral and Economy-wide Policies", World Bank Economic Review, Vol. 2, No. 3, 1988.

40. See, Bashir Ahmed and Ali M. Chaudhry, "Profitability of Pakistan's Agriculture", The Pakistan Development Review, Vol. XXVI, Winter 1987, pp. 457-68.

41. Ibid; Table: 3, P. 461.

42. Ibid; Table: 2, P. 459.

43. See, Pakistan Economic Survey, 1988-89, op. cit., Table: 11.1, P. 169.
44. T. W. Schultz, "Value of US Farm Surpluses to Underdeveloped Countries", Journal of Farm Economics, Vol. 42, 1960, pp. 1019-30.
45. Ibid.
46. W. W. Wilcox, Quoted in Schultz op. cit.
47. See, State of Pakistan economy, op. cit., P. 49
48. Virtually all observers credit the quality of Korean labour force as being a major permissive factor in enabling rapid growth; to a larger extent it was earlier aid effort that provided such a basis. Aid emphasis upon education, both in the 1940s prior to the Korean War, and again during the reconstruction, was crucial to building a foundation upon which later success of export-promotion was based.
49. See, S. Akbar Zaidi, "Health for All By the Year 2000: Can Pakistan Meet the Target", The Pakistan Development Review, Vol. XXVI, No. 4, Winter 1987, P. 474.
50. Ibid; P. 475.
51. Ibid.
52. Ibid.
53. Ibid.
54. Ibid.
55. Ibid.
56. See, Shamim A. Sahibzada and Mir Annice Mahmood, "Education in Selected Islamic Countries: A Comparative

Analysis", The Pakistan Development Review, Vol. 28, No. 4, Winter 1989, P. 805.

57. Ibid.

58. See, T. W. Schultz, "Transforming Traditional Agriculture", Yale University Press, 1964.

59. See, T. W. Schultz, "The Economics of Being Poor", Journal of Political Economy, August, 1980.

60. See, A. S. Bokhari, "Role of Social Welfare in Rural Development", Integrated Rural Development, Vol. 2, No. 2, April-June, 1979, pp. 32-8.

61. See, Paul Streeten, "The Frontiers of Development Studies", Macmillan, London, 1979, chap. 8, 'Economic Development and Education', pp. 129-53, for Pakistan specifically, see (i) E. R. Rado, "Unemployment Among the Educated in Pakistan", ILO, Geneva, October, 1976, (ii) Sabur Ghayur, "Educated Unemployed in Pakistan: Estimates of Imbalances in the Current Flows", The Pakistan Development Review, Vol. 28, No. 4, Winter, 1989, pp. 603-612.

CHAPTER: 8

Conclusion, Summary, and Discussion

Introduction

This last chapter of this study is divided into two parts. Part one concludes the major findings, while part two presents summary points of all the seven chapters and analyses their implications.

Part: 1-8

Conclusion

Our analysis of foreign assistance to Pakistan over the period 1960 to 1988 reveals a number of gaps between the theory and reality of foreign aid.

The behaviour of domestic saving in Pakistan does not indicate a one-to-one relationship, either positive or negative, with the inflow of foreign aid. Our analysis presents results that contradict some of the key assumptions of two-gap models, which expect capital inflow to increase directly the level of investment and to increase indirectly the rate of domestic saving by raising the level of income. Our analysis shows that over the whole period of study there was a limit to which increases in income produced an increase in domestic saving. At the beginning this positive relationship was observed over a short period, it ceased to hold in the 1970s, and during the last years of analysis it was reversed. Indeed, the basic assumption of the gap models regarding marginal saving was generally valid only during

the period of the 2nd Plan. It started to wane during the 3rd plan, and the Nonplan period registered negative marginal saving.

The estimated coefficients of the relationship between foreign aid and domestic saving in Pakistan for the period as a whole give some support to the views of aid critics who envisage a negative relationship between the two variables. But more detailed analysis of the subperiods presents a more complicated picture. During the 3rd Plan period, as compared with the 2nd Plan, domestic saving increased with a decrease in aid inflows. A similar relationship was observed for the 6th Plan period in comparison with the average of the 5th Plan years. For the Nonplan years we observe a downward trend in both variables. These observations refer to aid as a percentage of GNP. And though foreign aid as a percentage of GNP was declining, its absolute amount remained quite substantial throughout the period.

If a country is to achieve self-sustained growth, its national economic policy should result in increasingly greater mobilisation of domestic resources. Our results suggest that domestic saving in Pakistan has stagnated around ten percent of GDP over the whole period of analysis, while the average performance declined over successive policy regimes. Our specific analysis of domestic saving in Pakistan leads to the conclusion that various factors which inhibit and limit the mobilisation

of domestic resources are themselves links in a chain of causation. Insofar as these factors can exist both with and without inflows of foreign aid, they are not directly related to the latter. Nonetheless, our scheme of analysing the behaviour of public and private saving in different policy frameworks, provides a deeper insight into the economic and political context of the relationship between domestic saving and foreign aid.

Our results show that during the first Military Regime (1960-70) domestic saving increased from the low level of the early years of the decade. This performance was largely attributable to public saving. Despite several incentives offered to the private sector, the investors' response was not conducive to an increase in private saving as the 'big' industrialists largely relied on borrowing from the official financial institutions which were augmented by foreign aid. During the period of Civilian Rule (1970-78) the nationalisation policy of the Government came as a blow to private investors. Public saving also declined during this period, mainly because of inefficient public sector enterprises and increased expenditures on public administration and defence. In spite of opposition from the traditional donors to Pakistan to the Bhutto Government's overall economic policy, the Government did not have to bother about increasing efforts in order to domestically mobilise resources for public investment. The latter was largely

financed by the new sources of foreign aid which came from the Muslim countries of the Middle East and from the former Communist bloc. Insofar as these donors supported and sympathised with the Government's political and foreign policy, they never questioned its economic policy and performance. During the second Military Regime (1978-88), the economy grew rapidly, but our results show that the high growth rates achieved during this period were not the result of higher domestic accumulation. On the contrary, the saving average for this subperiod was the lowest of all the subperiods considered. The high growth rates were achieved by increases in aid inflows, remittances of workers from the Middle East, and by running down the infrastructure. Public saving became negative during this period as the Military Government greatly increased the size of the defence budget. Because Pakistan was strategically very important to its traditional donors (owing to the super-power rivalry in Afghanistan), they continued to finance aid requirements of the Government and did not strongly question the failure of economic policy to generate sufficient internal resources for productive investment.

Hence, our work provides substantial evidence and analysis to support the view that political rather than economic criteria for the allocation of aid during the 1970s and 1980s made the Pakistan Government complacent over the need for greater domestic effort for resource

mobilisation. And the lack of a coherent and well-defined economic policy caused increasing dependence on external help to maintain even the minimum level of the investment that was required to keep the country going.

Pakistan is now a heavily-indebted country and our analysis shows that the debt servicing capacity of the country is precarious. Our analysis of the contemporaneous values of foreign aid does not come to anything conclusive about the impact of aid on growth. But the study has involved sectoral analysis of the growth experience in different subperiods. This analysis shows that Pakistan has succeeded in maintaining high rates of growth during the whole period of the analysis, but the sectoral structure of her GDP does not exhibit a consistent pattern of expansion of output and employment in any of the subperiods. The share of agricultural output remained high throughout the period. Even in the 6th Plan period it amounted to a little over a quarter of the GDP and over 50% of the labour force was directly employed in that sector. Although the share of the manufacturing sector has increased over the period, it still amounted to less than 20% of the GDP during the 6th Plan period. Since the output of manufacturing is not cost-competitive and quality-competitive in the international market, this sector has not played any meaningful role in diversifying and strengthening exports. In the internal market, however, its expansion has been sustained by providing a

high degree of protection, in addition to several other policy-induced price distortions, particularly during the 2nd and 3rd Plan periods. Further, the manufacturing sector of Pakistan has been created in an inefficient manner and largely in isolation from the agricultural sector. Thus, Government economic policy has not been successful in enabling the country to realise its full agricultural potential. Not only is the structure of Pakistan's economy still comparatively simple; there is also little interaction between the different economic sectors. Hence, the aggregate performance of the commodity producing sector of Pakistan does not provide a strong base for the faster growing services sector which claims more than half of the gross domestic product of Pakistan. More importantly, the expansion of the services sector includes a large share of 'unproductive' services. This observation becomes more evident when the services sector is divided up into subsectors. Then it can be seen that public administration and defence combined form the second largest subsector after wholesale and retail trades. Indeed, the share of the former was marginally below the latter's and it increased over the subperiods. It registered the largest average for the 6th Plan period; over one fifth of the total share of services and over one tenth of GDP. Given the poor performance of the commodity producing sector, it is evident that the expansion of this sector was largely financed by foreign aid. Further, the

services sector does not include sufficient expansion on the social front, particularly in rural areas of the country. Given the low domestic saving rate and the persistent balance of payments deficit of Pakistan, the pattern of expansion of her gross domestic product is not conducive to sustaining high growth rates in the long run. Our analysis shows that in the long run Pakistan has structural economic problems that must be addressed by domestic action. In the immediate period, as long as political instability does not disrupt foreign financing, economic growth is likely. However, the question of debt service will present the most immediate obstacle to sustaining long run growth.

The general conclusion from this study should now be clear. Foreign aid represents real economic resources and, if it is provided and utilised in a consistent, systematic, phasing-out manner, it can have a positive impact on growth as well as on domestic saving. What essentially is needed is a sound macroeconomic framework. In its absence external resources, even if they are available in the most desirable form, are not effective enough. They do not spontaneously provide a solution to the problems of capital accumulation and economic development. Pakistan's experience with foreign aid shows that aid has not been successful in starting a momentum of self-sustaining growth in the country. On the donors' side, some failures come from pursuing political ends

without having full regard for the developmental objectives of aid. On Pakistan's side, the main reason for the ineffectiveness of aid lies in the economic policy environment within which aid was utilised. In other words, neither Pakistan nor the donors paid much attention to the requisites of development. At times, foreign aid was largely politically motivated, and development was a secondary consideration. Not surprisingly, there was much aid and little result. Our analysis shows that the required economic reforms and adjustments were not effectively promoted in Pakistan in any subperiod of analysis.

Pakistan is now challenged by urgent problems of development. Her experience with foreign aid carries some important implications for development policy, but there is no distinct set of policies that can be readily applied to the problems facing the country. Nonetheless, here we will suggest some directions in which such policy could usefully be developed.

Resources are desperately scarce in Pakistan. The achievement of sustainable growth requires optimal allocations to be made to different competing claims. Apart from the cost of civil service and Government ongoing activities, military expenditures in Pakistan absorb about 50% of Government revenue. The inevitable consequence is a large and continuing budget deficit, a fairly large part of which is financed by foreign

borrowing. Without a change in the existing pattern of expenditures, accumulation and incentives, an increase in foreign aid will have a limited effect and will not lead to a self-sustaining growth in investment. Greater mobilisation of resources should be called for and resources and abilities that are hidden, scattered, or badly utilised, should be enlisted. In our opinion, Pakistan at present has the following three broad options.

(1) It can cut expenditures on public administration and defence, so that domestic resources for productive investment are released.

(2) Setting aside the possibility of reducing the military budget, it can make considerable improvement in mobilising domestic resources for productive investment.

(3) It can formulate an overall policy package in which cutting unproductive expenditures and improving domestic accumulation are both included.

The problems facing Pakistan call for the best use to be made of total investible resources, i.e., for investment to flow wherever its rate of return is highest. This is an attractive scenario, but its limitations are not difficult to detect. Various ways of accommodating them can be suggested, but any further consideration of policy reforms takes us well beyond the scope of this study.

Summary and Discussion

The dilemma that major LDC borrowers face is well understood when we compare the aid-development theory of the 1960s with its actual achievements. This case study has focused on the accumulation and handling of foreign economic assistance by Pakistan.

Chapter One explains how Pakistan's large dependence on external financial and military support has its origin in the constraints placed on her by her regional position, the imperatives of domestic need, and by the availability of great-power partners. However, it makes sense to mention here that historically the importance of Pakistan to the great powers has been conditioned by the latter's broader security concerns. Indeed, without the presence of a perceived Soviet (former) threat to Central and West Asia, the US would not have forged its associations with Pakistan. The recurring American interest in Pakistan in the early Cold War years and again during the 1980s originated from US assessment of Soviet regional intentions, actions and influences, all of which were seen as pernicious. Pakistan's ties to the West, particularly to the US, have brought in large volumes of military and economic assistance.

Chapter One also presents a brief historical review of the economic performance of the country between 1950 and 1988. During this period the economic policy of the

country was shaped by three major regimes, Military, Civilian, and Military for most of the 60s', 70s' and 80s' respectively. The policy regimes all shared one common economic character, massive reliance on external assistance for financing the development programmes. It is observed in Chapter One that for the period between 1950 and 1988 the country managed to achieve annual average increases of 5.36 per cent in the GNP, 3.21 percent in agricultural output, and 7.94 per cent in the output of manufacturing (see Table 3-3-1). Nevertheless, these simple figures hide many economic facts investigated in the later chapters of this study.

Chapter Two reviews the literature on the macroeconomic approach to the impact of foreign capital inflows on the economic development of the LDCs. It highlights the debate over the effect on growth and saving rates of these countries when they receive economic assistance from outside. The importance of this debate for the present study is that it provides the crucial link with the problems analysed in the subsequent chapters.

The fundamental controversy of the debate revolves around the nature of the impact made by additional capital available by aid on key variables in the recipient country. In many ways this debate turns out not to be a debate about pure theory; rather it is focused on the assumptions of the different models and their relevance to the real world, and thus on what effects are most likely

to result from providing aid. There is, indeed, considerable common ground between foreign aid theory and the theory lying behind its criticism. It is agreed, for example, that income consists of consumption and saving, that investment is furthered by increasing saving, and that economic growth is positively expanded by raising the level of investment. What is at issue is how the insertion of foreign aid affects these relationships, and whether the effects result in a positive or a negative outcome.

The gap models assume that all capital inflows provide an addition to the recipient country's total investment resources, that this increase leads to a rise in the level of investment, and that a higher investment to GDP ratio raises the growth rate of the recipient economy. Three sorts of counter-assertions have appeared in the literature. The first and the strongest is that aid inflows necessarily lead to direct fall in domestic saving levels, so setting in motion a vicious rather than a virtuous circle. This causes a decline in saving and, hence, in investment, and leads to a lower growth rate. A second view asserts that no particular and necessarily predictable effect on domestic saving is to be expected from a capital resource inflow. A third is that these inflows create circumstances that bring about a decline in domestic saving, albeit indirectly.

Chapter Three analyses the statistical relationship between foreign aid, domestic saving and economic growth

on the data for Pakistan. The analysis is carried out by formulating single equation models for domestic saving and economic growth. The estimated coefficients for various forms of capital inflow in our final regression equations are quite instructive as to the relationship between foreign capital, domestic saving and economic growth. The positive but statistically insignificant relationship between economic growth and the various different forms of the current values of economic assistance illustrate the inability of pure statistical analysis to capture the relevant effects of foreign aid on the economic growth of the recipient country. Although the one-year-lagged values of the foreign aid variables produce positive and statistically significant coefficients of relationship with economic growth, the weak explanatory power of the estimated equation does not indicate that foreign aid is a serious contributor to economic activity. This result implies that economic growth in Pakistan has been largely determined by factors other than foreign aid. In our estimated regression equations for domestic saving, we get negative and significant coefficients of correlation between various forms of foreign aid and domestic saving. Also, the strong explanatory power of the estimated equation implies that, apart from factors not included in our saving model, foreign aid played an important role in determining the behaviour of saving in Pakistan. However, the estimated coefficients give us no information about

the nature of the negative relationship between the two variables. They do not tell us if saving increase with a decrease in aid, or vice versa. If the former is true then, a priori, foreign aid cannot have any adverse effect on Pakistan, since during the aid period the country can enjoy both high growth rates and high consumption levels, and once aid is reduced or withdrawn the domestic accumulation can be increased to sustain future growth. On the other hand, it is possible that the population in general, and key institutions in particular, might develop aspirations and habits towards consumption that are difficult to break at the end of the aided period, thereby causing a decline in the post-aid growth rate. Thus aid, could cause income to rise during the aided period, but lead to a reduction in the future growth rate. In any event, to make a convincing case about aid, one has to be clear about its long-run dynamic effects. The inability to capture these dynamic effects in our, and any other, statistical exercise renders the results only suggestive. Chapter Four and Five attempt to delve deeper into the foreign aid and domestic saving relationship. It is observed in Chapter Four that if a few early years are left out from the period under consideration, then no significant upward trend remains in the propensity to save in the country over the whole 28 years period (see Table 2-2-4). In particular, when we observe the average saving with a split time trend we find that during 1975 to 1988

the curve representing fitted values of average saving rates demonstrates a horizontal trend (see, Figure 3-2-4). However, this long-run constancy of saving rates at relatively low levels in Pakistan cannot be explained away in terms of long-term proportionality between saving and income, as hypothesised by the permanent income and other post-Keynesian models described in the literature. On the contrary, the observed near proportionality in Pakistan between saving and income over a long period is a case of stagnation in the rate of saving rather than a steady-state equilibrium. As the argument is developed in the Chapter Five, our analysis of this long-term result employs a course of reasoning that is completely different from that related to the processes hypothesised by the theories of saving behaviour, processes that bring about long-term proportionality between saving and income as conceived by these theories.

Chapter Four also lists the growth rate of the per capita income of Pakistan (see, Table 2-2-4), and records another interesting finding about the capital accumulation problems of developing countries, as conceived by the theories of vicious circle of poverty and by the critical minimum effort thesis. The figures listed in Table 2-2-4 and averages for the Plan and Nonplan periods do not support the circular relationship that runs from the low income levels to small capacity to save. It is found that domestic saving and per capita income both were at their

highest points during the 2nd and 3rd five year Plans. Per capita income falls to its lowest point in the Nonplan period, whilst domestic saving still remain respectable, by the standard of their previous performance. Indeed, on average, the latter is marginally below the level of the 2nd Plan period. During the 5th and 6th Plan periods whilst the per capita income recovers appreciably, the saving ratio declines, and records during the 5th Plan the lowest average value amongst the Plan and Nonplan periods. However, Nurkse believed that these theories appear a bit shaky, if development occurs as a process involving a series of changes combining the factors of production in a manner and in proportions that precipitate a 'demonstration effect' in society(1).

As for the assertions of the gap models, Chapter Four contradicts the validity of the key assumptions of these theories. As mentioned in Chapter Two the architects of the two-gap models of aid and development expected capital inflow to, directly increase the level of investment and indirectly increase the rate of capital accumulation, by raising the level of income and the rate of domestic saving. For the latter, we find almost no evidence during the periods covered by the 5th and 6th Five Year Plan. Indeed, over the whole period there was a certain limit to which increases in growth rate produced increases in domestic saving. The process stopped and it even reversed, once that limit was exhausted. Such a

scenario may be better accounted for in terms of the deviations from the static concept of the relationship of aid and development advanced by the aid proponents. For it may be remembered that two-gap analysis is based not so much on dynamic considerations of the behaviour of agents involved in the development of the recipient country as on the purely static considerations of the scarcity of capital, and the economic efficiency of the latter once it is provided. The evidence that we have listed and depicted in Chapter Four for Pakistan is largely a manifestation of failure of the strategy of two gap models. Also, in Chapter Four we find a scenario of relationship between foreign aid and domestic saving that provides a mixed picture regarding the assertions of aid proponents and views of the critics(see, Table 3-2-4 column [d]). Finally, the segregation of domestic saving into private and public components of the total provides good background evidence for analysing the effects of government policy on the behaviour of saving in Chapter Five.

Chapter Five provides further evidence and analysis to support the opinion that the behaviour of domestic saving in Pakistan does not indicate a one-to-one relationship, positive or negative, with the inflow of economic assistance, contrary to the assertions of proponents and critics of aid respectively. Indeed, the behaviour of domestic saving in Pakistan brings into

light some fundamental theoretical aspects of underdevelopment. One of the specifically problematic of these aspects is nature of the capitalistic development in LDCs. In Pakistan, we explain it in terms of the behaviour of industrial and finance capital and the failure of capitalists to complete the transition from merchants to industrialists. These factors, however, do not stand in a direct relationship with foreign aid, since they can exist both with and without the inflow of the latter. But the availability of foreign aid which augmented the funds at the disposal of government funding bodies, partially provided the investors with incentives to depend on borrowing rather than using their profits for reinvestment.

With the help of our analysis in Chapter Five, we are in a position to conclude that in underdeveloped countries like Pakistan, various factors that inhibit and limit the mobilisation of domestic resources, are themselves links in a chain of causation. This chain cannot be consistently incorporated in sophisticated theoretical manifestation of the two-gap models. Hence, these models present a substitution of interdependencies of investment income and saving for the necessity of the analysis of the individual inhibiting and limiting factors involved in the development process, of the individual developing countries. There is no doubt that for Pakistan, we find some evidence in favour of the assertions of two-

gap models during the first subperiod (1960 to 1970), but we have also have seen that various factors that inhibited and limited domestic saving during the second subperiod (1970 to 1978), were themselves legacies of the development strategy in the 1960s.

The broad conclusion of the analysis of the relationship between foreign aid and domestic saving in Pakistan is that external resources, even when they become available in their most desirable forms, are not enough. They do not automatically provide a solution to the problem of capital accumulation in underdeveloped countries, unless account is taken of the deficiencies in, or obstacles to, the development strategy of individual developing countries. In these countries the explanation of a characteristic deficiency or obstacle is provided by another, and that in its turn is explained by a third one and so on. Hence, without strenuous domestic efforts no solution is possible. This includes careful formulation of economic policy with mutually consistent targets, with the aim of gradually phasing-out the obstacles and the deficiencies inherent in the economic structure. An objective monitoring of the implementation of economic policy, essentially accompanied by a periodic evaluation of the degree of success is equally important. In the absence of a mutually consistent policy framework there is a strong possibility that any increase in national income, whether made by increased domestic productivity or by the

inflow of economic assistance will be used in these countries to satisfy the higher propensity to consume. The point is not that this is 'bad', but that it fails to contribute to the foundations of economic development for higher living standards in the future. High living standards essentially require investment in new industrial capacity which is important to economic development because it creates jobs, raises the level of income and results in greater output of goods for sale, both at home and abroad. Further, increasing levels of domestic investment indicate a vigorous expanding economy and help to attract foreign investment and finance. A well-conceived economic policy places the recipient country in a stronger position to choose from offers of foreign investment and finance that are most consistent with its long-run development priorities.

We have presented evidence in Chapter Five to show that lack of a coherent and well defined economic policy in Pakistan only resulted in increasing dependence on external help to maintain even the minimum level of investment that is critically required to keep the country going. In 1985, Pakistan entered a second phase of industrialisation. The heavy capital-intensive projects, undertaken by the PPP, were begun. The output of these basic industries, such as the steel mill, required absorption by investment in downstream engineering units. The development of the domestic capital goods sector

involved substantial investment and this imposed an urgent need to raise domestic resources by curtailing the consumption orientation of the society. But the country, on the other hand, became more and more inclined towards financing investment by economic assistance. The share of foreign saving in total investment was the largest during the second military Government, aid was financing a little over 40% of investment undertakings. Further, government saving is a good proxy for estimating the extent of the diversion of foreign aid for consumption. This saving financed about 78%, 49%, and 9% of public investment during the first military, the civilian and the second military regimes respectively (see Table 6-3-5).

Although it is difficult to say that the saving rate would have been any higher or lower in Pakistan if foreign aid had not been there, the political rather than the economic criteria that were used by the donors for giving aid during the 1970s and 1980s certainly made the government complacent to the need for greater saving effort. For example, during the 80s' funding from the World Bank entailed adoption of stringent conditions as part of the Structural Adjustment Loan (SAL). The critical feature of this programme was the exhaustive monitoring of policies by the World Bank. The Bank laid down detailed measures for the agricultural, industrial and energy sectors in addition to policy guidelines for public sector enterprises. The scale of the Bank's intrusion was

resented by the Government, and it decided in 1983 not to proceed with the second instalment of SAL in order to avoid the explicit and monitorable commitments(2). As described in this study, American aid after the Afghanistan crisis relieved the Government from pressure to follow the strict policy ruling of the donors.

The analysis in Chapter Six identifies two factors that explain why Pakistan did not experience a debt crisis in the 1980s, as did some other developing countries such as Mexico and Brazil. These factors are preferential treatment given to the military Government of General Zia-Ul-Haque by the Western bloc in the wake of the Afghan War and the phenomenal growth in the incomes of Pakistani workers overseas which they remitted back home.

Nevertheless, our analysis in this chapter shows that Pakistan is a heavily indebted country, while the debt servicing capacity of the country is precarious. Indeed, how foreign borrowings have been used has an important bearing on the ease with which a country repays its debts. There are two key issues. The first is that debt which financed private capital outflows can be extremely difficult to repay because it does not increase domestic resources. Instead, a few private citizens hold assets abroad, the counterpart to the country's external debt. To repay its liabilities, the government must mobilise and transfer domestic resources abroad. This is typically accomplished by cutting subsidies and increasing

taxes in order to improve the government budget, by depreciation of the real exchange rate and by reduction of real wages in order to increase competitiveness and to shift resources into the production of exports. Such borrowing may well lead to a deterioration in the standard of living and/or in the distribution of income. Since we do not have any data for Pakistan on capital flight, we were not in a position to explore this issue.

The second issue concerns the sources of current account deficit. The latter is the mirror image of the domestic saving investment imbalance. Our analysis in chapter six shows that, except for one year, Pakistan's current account of the balance of payments has always been in deficit (see Table 1-1-6). Also, the deficit generally continued to widen. Countries can run large current account deficits because of high investment which will pay-off through increased future productive capacity. They can also run large deficits with low investment when domestic saving are small, perhaps because of government's budget problems or because of a spurt in imports of consumer goods. To the extent that external borrowing goes to finance a current account deficit which reflects strong investments, particularly in the exports sector, a country should have little difficulty in repaying its obligations, though there may still be a "transfer problem"(3). But, countries that borrow abroad to make up for low domestic saving are likely to face the same difficulties of

repayment as those that borrowed to finance capital flight.

Our analysis in chapters Four and Five suggests that in Pakistan current account financing of debt, as analysed in Chapter Six, reflects small domestic saving in general and government's dissaving during the last five years of analysis, and not high investments. Since investment has not played a central part in debt accumulation, debt servicing capacity translated into the production of tradeables is regrettably poor.

Yet having said that, the debt profile of Pakistan cannot be described as an extreme case of a debt servicing problem, a situation encountered when a country finds that its debt obligations and its total commitments exceed the foreign exchange resources currently at its disposal. This is a crisis situation in which a country is in danger not only from its debt service obligations, but also from other kinds of contractual obligations, including payments for imports for which orders have already been placed. Countries that have depleted all their external reserves and exhausted possibilities for further short-term borrowing would face the prospect of a crisis of this type, if, for example, there was an unexpected shortfall in export earnings.

A second case, similar in many ways, is, however, of a less urgent nature. Here the situation is such that if imports were maintained at current levels, it could be

foreseen that a danger of default on debt service payments would arise in the immediate future. This would happen where anticipated external resources would not be sufficient to finance debt service payments without causing a disruptive reduction in imports beyond the minimum amounts needed to sustain a normal level of economic activity.

Although in Chapter Six we have analysed the foreign exchange reserves position of Pakistan and have listed its increasing import requirements, we find it unduly restrictive to limit the concept of debt service difficulties of the country to cases of present or imminent crisis as described above. We believe that beyond these restrictive concepts there is a wider concept which looks upon the debt problem both in terms of the critical point at which service payments are jeopardised and in terms of the overall development objectives to which the country is committed. Hence, debt service problems can pose problems for Pakistan not only in the extreme situation where its capacity to honour its obligations is in doubt, but also where these payments so reduce the external resources available to it that its ability to achieve its minimum economic and social objective is impaired. The concept of "minimum economic and social objective" is variously defined. We, however, choose to interpret it in terms of an overall growth rate which suffices at least to sustain per capita incomes at

existing levels. In the light of the analysis in Chapter Six, and on cautious assumptions regarding the means of future external financing, it appears that the pressure of the debt problem may increase in the 1990s, and that Pakistan may be faced with more difficult situations than it faced in the 1980s. Thus, even our limited notion of minimum social and economic goals, calls for vigorous efforts to improve debt management, and in particular, to maintain careful control over the accumulation of new debt so that new obligations are undertaken only for projects of high priority. Debt servicing requirements must be brought into a reasonable relationship with foreign exchange availabilities.

The debt servicing problems which we have analysed in chapter Six appear to have emerged against an overall background that explains the weaknesses in the type of growth which Pakistan experienced. Our analysis in Chapter Seven shows that inflows of foreign aid in Pakistan, have succeeded in generating reasonably high rates of GDP growth. But the structure of GDP does not exhibit a proportionate pattern of growth of output and employment. Such a pattern is essentially required to assure the sustainability of growth if net inflow of foreign aid is reduced or stopped. Although the impact which the designers of aid and development theory wished to achieve by the implementing the programmes of capital transfers was the self-sustained growth of the recipient country in

the longer term, they did not specify the pattern of growth achieved during the aid period which enables its impact to be measured and its progress monitored. The advanced economies are not only distinguished from underdeveloped economies by more complex structures, their patterns of output and employment also change radically as development proceeds. Another very important indicator of the level of development of an economy is found in the interaction between its various sectors. But we find in Chapter Seven that after a fairly long period of domestic effort that was assisted by large amounts of foreign resources, the structure of Pakistan's economy is still comparatively simple, and there is little interaction between its sectors.

The analysis in Chapter Seven shows that government policy in Pakistan has not been successful in enabling the full potential of the agricultural sector to be realised, while the manufacturing sector of the country has been created in an inefficient manner which has resulted in the existence of large amounts of underutilised capacity. We have explained some possible reasons for this. However, it might equally be explained in terms of insufficient backward and forward linkages with the domestic primary commodity producing sector, which overwhelmingly consists of agriculture. Our present reasoning is firmly founded on economic theory of interdependence between the production sectors(4).

Analysis made by a number of development economists in the 50s' and 60s' postulated that when agriculture emerges from its subsistence state and starts to specialise and produce goods for export, and when manufacturing develops under the impact of growth in the agricultural sector, then the two sectors of agriculture and manufacturing become very much interdependent. The manufacturing sector adds to the demand for goods produced by agriculture, and it absorbs surplus labour which may raise productivity in agriculture. The agricultural sector, in its turn, provides an outlet for manufactured goods out of rising real incomes, and contributes to development through the release of resources if productivity rises faster than the demand for commodities(5). This squares with the view of the World Bank that a "stagnant rural economy with low purchasing power holds back industrial growth in many developing countries"(6). The complementarity between the two sectors is being increasingly recognised in relatively recent models that attempt to determine the equilibrium terms of trade that balances supply and demand in both sectors(7). The basis of these models come from Kaldor(8).

Looked at in this light and considering the resource endowment of the country and the structure of Pakistan's economy, the manufacturing sector in Pakistan should have been developed in a manner that draws on the reservoir of labour in the rural areas and saves on imported raw

materials, with sufficient backward linkages with the output of domestic agriculture. Our analysis in Chapter Seven does not provide evidence of such a pattern of expansion.

Further, neither government policy nor foreign aid cushioned the rural sector by providing sufficient funds in the social sector. In our opinion, carefully targeted social expenditure can have a much higher total yield (including all secondary effects) than types of expenditure that result in some imposing visible structures whose effects on present and future output in other sectors of the economy are negative or zero. But these expenditures have long been neglected by both the aid donors and the governments of the recipient countries, perhaps because of the following reasons.

(a) Their direct output is not easily measurable.

(b) Their effects are widely diffused.

(c) Their effects are spread over a long time.

(d) They cut across the traditional distinction between investment and consumption, on which the theory of aid and development is based.

Furthermore, the operations of all these activities have little, if any, backward linkage with the donors' economies. In line with their self-interest, the donors choose arrangements that encourage the use of aid monies increasingly for trade promotion activities. For example, in Britain the Aid and Trade Provision (ATP),

instituted in 1977, uses aid money to lower British companies' commercial export costs(9). Any further discussion and elaboration of these associated aspects of foreign aid lies beyond the scope of this study, but we would like to mention that donors' economic self-interests do certainly have important direct and indirect influences on the investment decisions made in most of the recipient countries(10).

The experience of Pakistan raises interesting and important questions about the role of foreign assistance and economic policy for small, open economies in an uncertain world environment. The chronic balance of payments deficit of Pakistan is indicative of the country's persistent dependence on external help, while the ideas of theoretical models of foreign aid led to the belief that aid would only be needed temporarily. The ready acceptance of the assumptions of these theories is explained in part by the fact that the phenomena of development economics were derived directly out of the experiences and conditions encountered within developed countries. It is thus easy to see how powerful would have been the attraction of applying theory, currently in use in Western and industrialised countries, directly to the developing world.

The growth rate of the economy of Pakistan during the period of analysis can easily be ranked impressive, particularly in the 1980s. But, in retrospect, there are

several weaknesses in the pattern of economic growth achieved by Pakistan. There are two fundamental difficulties. First, Pakistan has not been successful in developing the self-sustaining growth that would have eased its burden of servicing its external debt. Second, the country has failed to shift resources toward the traded goods sector, as required both by its increasing debt burden and declining terms of trade. In more concrete terms its problems are poor returns from investment, difficulties in mobilising domestic resources to fund investment, and the maintenance of a trade regime that has not sufficiently encouraged exports.

All these problems have been analysed in this study in the context of government policy in Pakistan, and our study shows that the roots of Pakistan's present debt burden lie in the economic structure, and also in the political structure that has been built up since Independence. One thing which has not been analysed, however, is government corruption, because the impact of government corruption, rent seeking, and favouritism is more easily described than quantified. It is not sufficient, nor is it accurate, to say that the slide of Pakistan's economy into its present heavy indebtedness was largely the result of wholesale corruption in public bodies. But neither is it sufficient to describe corruption in Pakistan as having a marginal effect on economic activity. The intervention of the 1970s and the

monopolisation and acquisition of the military Government in the 1980s have changed the nature of the economy in Pakistan, weakened the efficiency and profit motivation of the participants, and postponed or made more difficult economic adjustment to an increasing adverse international environment.

1988, the last year considered in this study, was a watershed year in the history of Pakistan. Its security environment underwent sudden, dramatic changes as Soviet troops began to leave Afghanistan. A new detente between the super-powers began to take shape, eventually culminating in the demise of the Soviet Union in December 1991. Inside Pakistan the long tenure of General Zia-Ul-Haq's military regime came to an unexpected end on August 17th 1988, when Zia, his leading associates, and the US Ambassador to Pakistan died in a plane crash. In a remarkably calm succession, supervised by the new army leadership, the civilian government of the PPP, headed by Benazir Bhutto, replaced the military regime. This transformation, however historic, did not lead to radical changes in Pakistan's internal and external policies. Externally Pakistan was still highly dependent on the economic help of the West, while internally Zia's regime had corrupted and destroyed the key institutions of Pakistan. The military had become highly politicised, intimately involved in Government, and accustomed to the patronage flows that the eleven consecutive years of

military rule had created. The Benazir Government not only faced serious economic and political problems, it also had the challenge of living up to expectations about what a new Government could accomplish in the economic sphere. In August 1990, Benazir's government was sacked on allegations of inefficiency and heightened corruption. And, despite the mood of national euphoria that in November 1990 accompanied the present Government's assumption of office, headed by Nawaz Sharif, the problems that his Government faces are extremely difficult ones, involving both political and economic challenges.

The main economic challenge for Pakistan is the same as it has always been: to achieve and to sustain rapid economic growth in the longer term. In the 1990s this will be a much more difficult task than it was in earlier decades, since Pakistan now has the burden of servicing a much larger debt, and because with the end of the Cold War, obtaining external capital will be much more difficult than before. Given the analysis in this study, we fear that if the clustered shocks of the 1980s (higher oil and reduced commodity prices, higher world real interest rates, and recession in the industrialised countries) are repeated in the 1990s, the country would quickly plunge deeply into a debt crisis. Any debt crisis would affect Pakistan not just through the difficulty involved in shouldering the current debt burden, it would also affect her ability to grow from under that burden.

The necessity of achieving economic growth is particularly acute because of the momentum of population growth in Pakistan, at 3.1% per year, the highest in South Asia and one of the highest in the world. The population of the country reached a figure of 110 millions in 1988-89, and growing at the current rate it will be more than 130 millions by the turn of this century. Under the pressure of such population growth, the demand for primary products will also increase by a sizeable margin. An idea of the impending problems that will be produced by this alarming situation can be formed from the projected requirements of wheat, which have been estimated to be 22 million tons by the year 2000(11). To meet this expected demand for wheat, its production will have to increase by 70% above the existing levels, which means an annual yield growth rate of over 4.5 percent. But during 1949-50 to 1984-85, this rate has only grown by 2.53 percent per annum. Supplies of other basic essentials would also be required to be increased by similar margins to meet their increased demand(12).

Given the low rate of domestic mobilisation, severely limited access to additional external finance would be for Pakistan a serious constraint on the rate of investment and economic growth. The current account deficit is not the only source of need for external finance. In addition, Pakistan will either have to make or to reschedule amortisation payments on its due external debt, and also

achieve a balance of payments surplus that is sufficient to enable reserves to grow along with imports. The country at present faces the serious task of designing the short-term macroeconomic stabilisation packages which are not only credible, but are also consistent and coherent with the economic policy objectives of sustained growth. However, there are no "quick fixes" for the economic, political and social problems that are firmly rooted in the structure of the economy and society of Pakistan.

The internal and external challenges that Pakistan now faces are particularly important in the context of the recent changes that have taken place in the world's geographic and political map. The developments in Eastern Europe, the reunification of Germany, the Maastricht treaty of the EEC, and the demise of what was once USSR, are not only rapidly changing the post-War geographical order of the world, they have also smashed the old order, along with its political and economic divisions and preferences. The New World Order is still vague and narrowly defined. In the wake of the resurgence of Nationalist sentiments, and in some cases even underground movements in Western Europe, and the potential secessionist threat in the newly formed Commonwealth of Russia, it is extremely dangerous to predict the course of world events. However, it would be naive if we were unable to identify the donors' future preferences, since the nuclear power status of the Baltic countries and many

members of the Russian Commonwealth makes them the obvious future preference for conventional donors. Many other Eastern European countries need massive help in the process of transition. These prospective recipients, together, need something even more conspicuous and effective than the Marshall Plan in order to rebuild their shattered economies and feed their populations. In our opinion, the criteria of need or performance will probably be largely replaced by the criteria of appeasement and cultural affinity. One thing is clear though, unless something dramatic happens, Pakistan will not rank very highly in a favourite list of her traditional donors' new political and economic preferences.

NOTES

1. See, Ragnar Nurkse, "Problems of Capital Formation in Developing Countries", Oxford University Press, 1953.
2. See, Omar Noman, "The Political Economy of Pakistan: 1947-85", KPI Limited, London, 1988, PP 168-9.
3. Keynes, in an article which introduced the term 'transfer problem' argued that a country required to make a fixed transfer of purchasing power to another should suffer a secondary burden in the form of a further decline in its purchasing power due to an induced deterioration in its international terms of trade. This

secondary burden might be so large as to reduce the value of traded-goods production in the transfer-making country to an amount less than the required transfer. Ohlin argued in response that a secondary benefit, or terms of trade improvement, was likely to occur. This debate still goes on in economic circles. See, J. M. Keynes, "The German Transfer Problem", *Economic Journal*, No. 39, PP 1-17, 1929.

4. See, A. Hirschman, "Strategy of Economic Development", New Haven: Yale University Press, 1958.

5. See, (i) W. A. Lewis, "Economic Development With Unlimited Supplies of Labour", *Manchester School*, May 1954, (ii) B. F. Johnston And J. Mellor, "The Role of Agriculture in Economic Development", *American Economic Review*, September 1961, (iii) D. Jorgenson, "Testing Alternative Theories of the Development of a Dual Economy", in Irma Adelman and E. Thorbecke (ed.), "The Theory and Design of Economic Development", John Hopkins University Press: Baltimore, 1966

6. See, World Bank, "World Development Report", 1979.

7. See, A. P. Thirlwall and D. Vines, "A General Model of Growth and Development on Kaldorian Lines", Mimeo, University of Kent.

8. See, N. Kaldor, "Equilibrium Theory and Growth Theory", in M Baskia (ed.), "Economics and Human Welfare: Essays in Honour of Tibor Scitovsky", Academic Press, New York, 1979.

9. More generally, the use of mixed credits, which reduce the effective interest rate on project loan to developing countries by combining normal export credits with aid in grant or very soft loans, has expanded in recent years; see, W. Ryrie, "Managing an Aid Programme", IDS Bulletin, Vol. 17, No, 2, April 1986.

10. The arrangements, their inconsistencies and adverse effects on recipients countries are discussed in J. Toye and G. Clark, "The Aid and Trade Provision Act(ATP): Origins, Dimensions and Possible Reforms", Development Policy Review, Vol. 4, No. 4, 1986.

11. See, Bashir Ahmed and Ali Muhammad Chaudhry, "Profitability of Pakistan's Agriculture", The Pakistan Development Review, Vol. XXVI, No. 4, Winter 1987, P. 457.

12. Ibid.

APPENDIX

Table: 1-A

Foreign Aid Commitments
(Pakistan: 1951 to 1988)

(\$US Million)

(a) Year	(b) Project Aid	(c) Non-project Aid	(d) Total
1951-52	43		43
1952-53	12	94	106
1953-54	70	18	88
1954-55	45	55	100
1955-56	91	99	190
1956-57	77	53	130
1957-58	137	97	234
1958-59	129	156	285
1959-60	93	143	236
1960-61	323	156	479
1961-62	238	191	429
1962-63	354	291	645
1963-64	345	181	526
1964-65	442	390	832
1965-66	369	168	537
1966-67	282	346	628
1967-68	210	351	561
1968-69	473	183	656
1969-70	248	307	555
1970-71	616	257	873
1971-72	72	71	143
1972-73	139	404	543
1973-74	425	843	1268
1974-75	722	393	1115
1975-76	534	417	951
1976-77	641	470	1111
1977-78	613	350	963
1978-79	1064	331	1395
1979-80	1002	656	1658
1980-81	591	382	973
1981-82	887	733	1620
1982-83	1115	472	1587
1983-84	1580	409	1989
1984-85	1804	507	2311
1985-86	1810	484	2294
1986-87	2035	591	2626
1987-88	1903	784	2687

Source:: Pakistan Economic Survey, 1988-89, Statistical Supplement, Table: 11.2, P. 171.

Table: 2-A

Gross National Product
(Pakistan: 1949 to 1988)^P

(Millions)

(a) Year	(b) Gross National Product (Rupees)				(c) Population
	(bi) Aggregate	(bii) Agriculture	(biii) Manufacturing	(biv) Services	
1949-50	12380	6595	961	4815	35.31
1950-51	12863	6768	1042	5034	36.18
1951-52	12636	6155	1123	5328	37.07
1952-53	12852	6166	1235	5422	37.98
1953-54	14153	7105	1396	5634	38.91
1954-55	14464	6948	1569	5906	39.87
1955-56	14958	7093	1727	6108	40.86
1956-57	15407	7254	1821	6294	41.87
1957-58	15811	7393	1889	6474	42.90
1958-59	16670	7689	1968	6959	43.95
1959-60	16803	7711	2018	7027	45.03
1960-61	17624	7695	2278	7595	46.20
1961-62	18683	8171	2581	7872	47.53
1962-63	20008	8597	2870	8493	48.90
1963-64	21322	8813	3196	9234	50.31
1964-65	23299	9276	3514	10488	51.76
1965-66	25079	9318	3816	11859	53.26
1966-67	25853	9829	4032	11907	54.79
1967-68	27636	10982	4289	12251	56.37
1968-69	29425	11478	4659	13176	58.00
1969-70	32339	12574	5187	14419	59.70
1970-71	32664	12188	5521	14871	61.49
1971-72	33566	12611	5590	15135	63.34
1972-73	35954	12821	6078	16713	65.89
1973-74	38623	13357	6464	18438	67.90
1974-75	40188	13074	6498	20177	69.98
1975-76	41940	13659	6588	20807	72.12
1976-77	43696	14004	6707	21484	74.33
1977-78	48354	14399	7392	23676	76.60
1978-79	51270	14845	7984	25154	78.94
1979-80	54888	15826	8803	26857	81.36
1980-81	57863	16405	9739	28621	83.84
1981-82	61851	16992	11079	30635	86.44
1982-83	67069	17637	11858	33161	89.12

Table: 2-A, Continued.....

(Millions)

(a) Year	(b) Gross National Product (Rupees)				(c) Population
	(bi) Aggregate	(bii) Agricult- ure	(biii) Manufact- uring	(biv) Services	
1983-84	69892	16571	12792	36279	91.88
1984-85	75586	18600	13828	39187	94.73
1985-86	80903	19788	14872	41879	97.67
1986-87	84733	20224	15991	44702	100.70
1987-88	88887	21124	17201	47293	103.82

Source:: Pakistan Economic Survey, 1988-89, Statistical Supplement, Table: 2.2, PP 24-5.

P At constant factor cost of Pakistan__base year is 1959-60.

Table: 3-A

National Income Accounts
(Pakistan: 1959 to 1988)^P

(a) Year	(b) GNP	(c) GDP	(d) Consumption	(e) Investment			(f) Public Savings	(g) GDP Deflator ^{¶¶¶}
				(ei) Gross	(eii) Net [■]	(eiii) Public		
1959-60	17831	17854	16517	2416	1880	1080	870	100.00
1960-61	18839	18864	17588	2761	2563	1079	364	103.97
1961-62	20038	20065	18185	3176	2966	1580	1078	102.29
1962-63	21538	21586	18767	4046	3797	2420	1466	102.16
1963-64	23036	23070	19900	4453	4311	1863	1693	107.44
1964-65	25115	25176	21912	5422	5108	2387	1888	112.15
1965-66	27053	27100	23493	4977	4638	2097	1683	115.29
1966-67	28175	28223	24992	4958	4280	1986	1391	125.95
1967-68	29757	29780	26592	4363	4108	1873	1546	129.80
1968-69	32034	32063	29028	4163	3723	1758	943	128.96
1969-70	35670	35668	30967	5215	4681	2289	2115	133.88
1970-71	36148	36220	31776	5104	4486	2237	1072	140.23
1971-72	36818	36747	32371	4794	4229	2028	750	148.78
1972-73	39336	39155	33830	4834	4278	2193	1085	172.37
1973-74	41422	41238	36773	5117	4680	2987	2281	213.64
1974-75	42828	42570	38991	5397	4704	3193	651	261.18
1975-76	45242	44531	40092	6512	6512	4408	539	292.75
1976-77	47518	46223	41750	7235	6957	4656	915	323.97
1977-78	52597	49922	45796	7189	6932	4602	2527	353.08
1978-79	55387	52321	49691	7169	6747	4452	1507	372.54
1979-80	60025	56873	53565	7335	6906	4413	1041	411.61
1980-81	63677	60812	56116	7583	6729	4087	1417	456.15
1981-82	67508	64669	58724	9087	7698	4893	1532	497.60
1982-83	73107	69013	61998	9892	8766	5408	269	527.27
1983-84	76826	72902	66266	10341	9199	5480	58	577.82
1984-85	82415	78844	72306	11082	9835	5765	-1041	611.47
1985-86	88908	85028	77934	11708	10460	6150	-740	643.47
1986-87	92953	89647	81918	13131	11877	7043	-1820	678.38
1987-88	97138	94417	86572	12952	11687	6767	-2342	710.30

Source: From column (b) to (e), Pakistan Economic Survey, 1988-89, Statistical Supplement, Table: 2.2 and 2.3, PP 24-6; for column (f), various issues of Pakistan Economic Survey, the column has been calculated as the difference between the government total revenue and its non-development expenditures.

^P At constant market prices of Pakistan base year is 1959-60.

■ Exclusive of changes in stock.

¶¶¶ GDP deflator of Pakistan.

Table: 4-A

**Domestic Interest Rate and Composition of Net Capital Inflow
(Pakistan: 1959 to 1988)**

(a) Year	(b) Real Rate of Inter- est ⁰ (%)	(c) Foreign Aid* (\$US million)			(d) Home Remitt- ances ¹ (RS. m- illion)	(e) Excha- nge Rate ²	(f) GDP ³ Deflator
		(ci) Grants	(cii) Loans	(ciii) FDIP			
1959-60	4.96	134.52	69.67	17.57	-23.00	4.78	100.00
1960-61	5.70	149.74	73.93	16.96	-25.00	4.78	102.40
1961-62	6.64	208.70	149.94	14.22	-27.00	4.78	105.50
1962-63	7.07	265.02	276.29	14.19	-48.00	4.79	108.40
1963-64	5.49	217.69	290.53	0.00	-34.00	4.81	111.70
1964-65	5.52	792.97	306.78	16.60	-61.00	4.78	114.80
1965-66	6.55	159.41	243.70	11.10	-47.00	4.81	119.00
1966-67	4.24	212.98	375.61	14.50	-48.00	4.75	122.00
1967-68	6.30	192.56	337.28	25.00	-23.00	4.81	129.30
1968-69	7.54	69.09	382.80	17.20	-29.00	4.79	135.90
1969-70	6.73	37.89	204.04	23.00	2.00	4.80	144.00
1970-71	6.20	123.72	215.94	1.00	-72.00	4.79	152.90
1971-72	6.53	44.51	29.37	16.00	71.00	11.03	161.80
1972-73	3.96	43.43	79.60	-1.00	181.00	9.90	174.70
1973-74	-7.53	66.16	391.72	3.00	184.00	9.90	195.50
1974-75	-10.11	120.61	485.86	21.00	258.00	9.90	217.60
1975-76	1.59	111.52	471.72	6.00	711.00	9.90	235.80
1976-77	0.50	122.63	644.65	13.00	1295.00	9.90	254.20
1977-78	3.77	104.24	675.05	23.00	2675.00	9.90	273.80
1978-79	4.76	341.11	586.06	48.00	3066.00	9.90	296.50
1979-80	0.44	228.38	623.84	45.00	3152.00	9.90	327.40
1980-81	-5.18	357.27	624.85	91.00	2815.00	9.90	356.50
1981-82	-3.62	359.50	409.11	57.00	2839.00	12.84	377.20
1982-83	3.16	251.19	439.56	36.00	4094.00	13.50	390.80
1983-84	-4.02	757.36	313.54	160.00	3924.00	15.36	414.20
1984-85	-0.87	384.42	457.95	201.00	3572.00	15.98	431.20

Table: 4-A Continued.....

(a) Year	(b) Real Rate of Inter- est ^Ø (%)	(c) Foreign Aid* (\$US million)			(d) Home Remitt- ances ^{††} (RS. m- illion)	(e) Excha- nge Rate ^{‡‡}	(f) GDP [■] Deflator
		(ci) Grants	(cii) Loans	(ciii) FDIP			
1985-86	2.68	497.86	512.52	191.00	3880.00	17.25	445.40
1986-87	3.70	458.34	177.36	187.00	3306.00	17.45	457.90
1987-88	3.39	651.91	1266.70	132.00	2721.00	17.60	470.30

Source:: For column (b) and (d), Pakistan Economic Survey, 1988-89, Statistical Supplement, Table: 7.7, P. 117, and Table: 2.1, P. 23, respectively; for column (c), IMF, Balance of Payments Statistics, Year Book, Various issues between 1960 and 1990; for column (e) and (f), IMF, International Financial Statistics, Year Book, 1990.

- Ø Corrected for inflation using the GDP deflator of Pakistan, base year is 1959-60.
- * Nominal values of net inflows.
- † Foreign direct investment.
- †† At constant market prices of Pakistan, base year is 1959-60.
- ‡ Ruppe/dollar exchange rate.
- GDP deflator of industrial countries constructed by using the average inflation rate of the block.

Table: 5-A

**Foreign Aid Disbursements
(Pakistan: 1960 to 1988)**

(\$US Million)

(a) Year	(b) Project Aid	(c) Non-project Aid	(d) Total
1960-61	160	182	342
1961-62	202	102	304
1962-63	244	257	501
1963-64	267	274	541
1964-65	336	370	706
1965-66	367	166	533
1966-67	331	292	623
1967-68	401	328	729
1968-69	389	205	594
1969-70	323	241	564
1970-71	365	247	612
1971-72	281	128	409
1972-73	100	255	355
1973-74	170	328	498
1974-75	286	690	976
1975-76	389	675	1064
1976-77	449	511	960
1977-78	518	340	856
1978-79	599	349	948
1979-80	808	662	1470
1980-81	676	296	972
1981-82	536	566	1102
1982-83	744	557	1301
1983-84	695	481	1176
1984-85	903	354	1257
1985-86	1055	473	1528
1986-87	1006	392	1398
1987-88	1223	601	1824

Source:: Pakistan Economic Survey, 1988-89, Statistical Supplement, Table: 11.2, P. 171.

Table: 6-A

The output of Mining and Services Sector
(Pakistan: 1959 to 1988)^P

(RS. Million)

(a) Year	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
1959-60	70	427	87	952	2105	160	837	1048	1411
1960-61	81	612	99	1059	2251	176	858	1062	1478
1961-62	86	596	99	1031	2427	191	888	1103	1537
1962-63	96	700	122	1142	2665	213	916	1134	1601
1963-64	113	897	142	1176	2935	232	943	1244	1665
1964-65	122	1029	172	1588	3166	320	976	1465	1732
1965-66	133	1079	197	1688	3440	355	1006	2293	1801
1966-67	133	1039	207	1761	3621	400	1039	1962	1878
1967-68	137	1037	224	1856	3754	447	1067	1912	1954
1968-69	141	1317	251	1965	4020	485	1099	2008	2031
1969-70	157	1357	639	2026	4457	579	1112	2080	2169
1970-71	156	1390	741	1981	4566	635	1149	2133	2276
1971-72	159	1163	780	2029	4666	640	1188	2278	2391
1972-73	161	1346	903	2359	4933	826	1231	2599	2516
1973-74	180	1490	1068	2469	5621	879	1275	2983	2653
1974-75	181	1754	949	2578	5794	1006	1321	3972	2803
1975-76	175	2094	985	2608	5894	1039	1369	3854	2964
1976-77	206	2076	1143	2653	5875	1124	1418	4135	3060
1977-78	212	2248	1244	3029	6454	1256	1469	4657	3319
1978-79	221	2371	1366	3275	6867	1337	1522	4906	3510
1979-80	250	2644	1531	3495	7378	1312	1577	5209	3711
1980-81	283	2749	1698	3776	7882	1197	1634	5761	3924
1981-82	306	2836	1777	4042	8723	1436	1794	5844	4183
1982-83	319	3175	1916	4356	9271	1762	2053	6169	4459
1983-84	326	3727	2249	4821	9611	2105	2355	6658	4753
1984-85	401	3838	2345	5156	10611	2196	2595	7377	5069
1985-86	484	4086	2709	5546	11373	2325	2732	7707	5401
1986-87	510	4512	2859	5960	12094	2458	2876	8186	5757
1987-88	548	4820	2927	6322	12836	2508	3028	8715	6137

Source: Pakistan Economic Survey, 1988-89, Statistical Supplement, Table: 2.2, P. 24-5.

^P At constant market prices of Pakistan _____ the base year is 1959-60.

(b) The output of mining and quarrying sector.

(c) Construction.

(d) Electricity and gas distribution.

(e) Transport, storage and communication.

(f) Wholesale and retail trade.

(g) Banking and insurance

(h) ownership of dwelling.

(i) Public administration and defence.

(j) Other services.

Table: 7-A

Accounts of the External Sector
(Pakistan: 1959 to 1988)

(\$US Million)

(a) Year	(b) Debt Transaction		(c) Trade Transactions ^Ø	
	(bi) Debt Outstanding ^p	(bii) Service Payments [‡]	(ci) Exports	(cii) Imports
1959-60	145	11	160	379
1960-61	171	17	114	457
1961-62	225	31	114	470
1962-63	408	47	210	588
1963-64	661	62	226	626
1964-65	1021	62	239	772
1965-66	1325	74	253	605
1966-67	1696	96	273	762
1967-68	2099	108	346	699
1968-69	2532	158	357	640
1969-70	2959	176	338	690
1970-71	3425	182	420	757
1971-72	3766	122	591	638
1972-73	4022	193	817	797
1973-74	4427	197	1026	1362
1974-75	4796	248	1039	2114
1975-76	5755	249	1137	2067
1976-77	6341	311	1141	2325
1977-78	7189	327	1311	2810
1978-79	7792	437	1710	3676
1979-80	8658	584	2365	4740
1980-81	8765	603	2958	5409
1981-82	8799	491	2464	5622
1982-83	9312	634	2694	5357
1983-84	9469	727	2768	5685
1984-85	9732	788	2491	5906
1985-86	11108	906	3070	5634
1986-87	12023	1101	3686	5380
1987-88	12913	1117	4455	6391

Source: Pakistan Economic Survey, 1988-89, Statistical Supplement, P. 172 and P. 144 for column (b) and (c) respectively.

^p Total debt outstanding at the end of each calendar year.
[‡] Includes both principal and interest payments
^Ø Goods and non-factor services.

Table: 8-A

**Allocation of Project Aid
(Pakistan: 1960 to 1988)**

(\$US Thousand)

(a) Year	(b) Agric- ulture	(c) Manuf- actur- ing	(d) Water& power	(e) Trans- port & Commu- nicat- ion	(f) Popu- lati- on Welf- are	(g) Educ- ation	(h) Rural Devel- opment	(i) Misce- llane- ous
1960-61	8597	31846	24433	20581	915	0	0	73396
1961-62	8474	29306	35301	35510	148	1693	0	91431
1962-63	5851	120418	19490	56412	352	1964	672	38811
1963-64	2491	174373	23677	49066	2035	2992	396	12187
1964-65	12506	82345	37442	49544	1126	1934	1291	149561
1965-66	9851	144605	95659	96204	10168	2894	422	7583
1966-67	26997	135938	61551	64116	7647	936	0	33757
1967-68	12691	152958	122344	98715	2284	2101	0	9285
1968-69	17398	131696	122061	79647	7237	2790	0	28072
1969-70	35521	134082	74560	61352	2510	3142	0	11849
1970-71	51961	86438	67624	80421	2502	2592	987	72259
1971-72	6606	77237	52441	56101	1358	3047	991	83148
1972-73	43706	6127	36362	10756	181	401	26	2304
1973-74	6274	21025	51174	89728	4340	1496	262	4740
1974-75	22296	63557	112276	65659	2009	2105	289	16987
1975-76	8117	159071	166752	33388	4636	11251	0	5801
1976-77	32633	170683	48230	79782	28526	12585	762	76062
1977-78	67034	188124	116346	54926	7358	7029	15660	59538
1978-79	50268	152460	157668	101700	4264	4485	2673	125192
1979-80	54408	168847	60353	307964	9734	6120	151329	48978
1980-81	62952	163635	193017	198348	12225	11214	0	35017
1981-82	85932	97203	134534	159254	8885	4277	0	45601
1982-83	62756	171704	252514	66244	27689	21955	10586	130196
1983-84	156539	196740	243710	40793	21175	6150	1680	28455
1984-85	66890	215713	302103	170322	40685	5917	13091	88744
1985-86	80907	152750	458196	182894	53801	24382	15985	86210
1986-87	182112	89504	327266	129272	22322	22441	5560	227629
1987-88	153868	121194	430202	178255	60036	39501	137992	101473

Source:: Government of Pakistan, "The Effectiveness of Aid to Pakistan", Islamabad, March 1990, Table: 10-Z.

Table: 9-A

Composition of Labour Force
(Pakistan: 1963 to 1988)

(Million)

(a) Year	(b) Labour Force					
	(bi) Total	(bii) Unem- ployed	(biii) Employed			
			(biii-a) Total	(biii-b) Agricul- ture	(biii-c) Mining & Manufac- turing	(biii-d) Services
1963-64	16.40	0.16	16.24	9.82	2.21	4.21
1964-65	16.65	0.18	16.47	9.80	2.30	4.73
1965-66	16.91	0.21	16.70	9.78	2.40	4.52
1966-67	17.17	0.24	16.93	9.75	2.51	4.67
1967-68	17.44	0.27	17.17	9.73	2.61	4.83
1968-69	17.71	0.31	17.40	9.71	2.72	4.97
1969-70	18.11	0.36	17.75	10.13	2.76	4.86
1970-71	18.70	0.33	18.37	10.58	2.80	4.99
1971-72	18.94	0.39	18.55	10.63	2.40	5.52
1972-73	19.61	0.37	19.24	10.86	2.54	5.84
1973-74	20.12	0.36	19.76	10.99	2.66	6.11
1974-75	20.64	0.34	20.30	11.12	2.80	6.38
1975-76	21.54	0.46	21.08	11.44	2.95	6.69
1976-77	22.48	0.59	21.89	11.76	3.11	7.02
1977-78	23.46	0.73	22.73	12.09	3.28	7.36
1978-79	24.49	0.87	23.62	12.43	3.46	7.73
1979-80	25.07	0.92	24.15	12.72	3.47	7.96
1980-81	25.65	0.95	24.70	13.01	3.48	8.21
1981-82	26.27	1.00	25.27	13.32	3.49	8.46
1982-83	26.91	1.06	25.85	13.63	3.50	8.78
1983-84	27.45	1.05	26.40	13.63	3.61	9.15
1984-85	28.00	1.04	26.96	13.63	3.73	9.59
1985-86	28.05	1.02	27.03	14.60	3.62	8.79
1986-87	29.60	0.90	28.70	14.13	4.08	10.52
1987-88	29.93	0.94	28.99	14.83	3.72	10.47

Source: Pakistan Economic Survey, 1988-89, Statistical Supplement, Table: 1.9, P. 15.

Table: 10-A

**Public Administration and Defence
Claims on the Government Revenue
(Pakistan: 1960 to 1988)**

(Rs. Million)

(a) Year	(b) Total Revenue	(c) Defence ^P	(d) Public Adminis- tration ^P
1960-61	2122	1112	392
1961-62	2317	1109	417
1962-63	2046	954	361
1963-64	2830	1157	441
1964-65	3301	1262	447
1965-66	3798	2855	465
1966-67	4475	2294	461
1967-68	4704	2187	493
1968-69	5774	2427	526
1969-70	6665	2749	658
1970-71	6021	3202	807
1971-72	6926	3726	675
1972-73	8407	4440	819
1973-74	11955	4949	1118
1974-75	14385	6914	1564
1975-76	17791	8103	1876
1976-77	20609	8121	2112
1977-78	25454	9668	1120
1978-79	29861	10102	1440
1979-80	37948	12585	1634
1980-81	46349	15221	1802
1981-82	48537	18631	2062
1982-83	55857	23224	2528
1983-84	68445	26798	3976
1984-85	73105	31866	4122
1985-86	84879	35606	4634
1986-87	98037	41335	7133
1987-88	94757	47015	5098

Source: Pakistan Economic Survey, various issues.

^P Total allocation.

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