1. Introduction

Foreign aid flows to developing countries began to assume substantial proportions in the early 1950s. Now, some twenty years later, there is clear evidence of widespread unease about the results of these massive flows and their potential for accelerating economic development in the decades ahead.

The 'aid condition'

The Pearson Report has placed the problem in stark perspective:

> International support for development is now flagging. In some of the rich countries its feasibility, even its very purpose, is in question. The climate surrounding foreign aid programs is heavy with disillusion and distrust...In the last years of this decade, the volume of foreign official aid has been stagnant. At no time during this period has it kept pace with the growth of national product in the wealthy nations...In much of the developing world [too] there is a sense of disillusion about the very nature of the aid relationship...We have reached a point of crisis.[1]

This is the broad context in which any new study of foreign aid impact must be rooted.

To be sure, the picture is not entirely bleak. In a number of donor countries, such as Canada and West Germany, there appears to be a firm resolve to strengthen and expand foreign assistance programmes. International agencies, such as the World Bank (IBRD) and the United Nations Development Programme (UNDP), are playing an increasingly important role in the search for new directions in aid policy. Even in the United States – where the spirit of disenchantment runs especially deep – there has been a stream of prestigious reports testifying to continuing US concern with problems of aid and development.[2] And yet, despite all this, the blunt fact remains that the overall 'aid condition' is one of malaise; that total foreign assistance stands far below minimum needs in the developing countries; that, in the main, its terms have become harder and more restrictive; and that aid commitments by the United States, much the largest source, have been declining markedly over the past five years.[3]

[1] L. B. Pearson et al., *Partners in Development: Report of the Commission on International Development* (New York, 1969), pp. 4–5.

[2] See, for example, J. A. Perkins et al., 'Development Assistance in the New Administration: Report of the President's General Advisory Committee on Foreign Assistance Programs', mimeo (Washington, D.C., 25 October 1968). And see: Committee for Economic Development, *Assisting Development in Low-Income Countries: Priorities for U.S. Government Policy* (New York, September 1969), and R. A. Peterson et al., *U.S. Foreign Assistance in the 1970s, A New Approach: Report to the President from the Task Force on International Development* (Washington, D.C., 4 March 1970).

[3] The above comments on the international climate of aid refer primarily to the non-socialist donors, which have accounted for the bulk of foreign assistance since 1950. While aid

In considerable measure, the malaise is the product of 'uncertainty and confusion about the nature and purpose of foreign aid. Such uncertainty affects the degree of political support that aid policies receive in donor countries, it obstructs co-operation and co-ordination among donors and strains relations between donors and recipients.'[4]

To disentangle the array of donor motives is no easy task.[5] A reasonable first step is to focus on three goals sought by aid-giving countries: security and commercial gain for themselves, and economic development for the recipients. That is to say, the donors are basically motivated by strategic, commercial and humanitarian considerations, respectively. And the strategic element has loomed largest with the super-powers (the United States and the USSR), commercial factors with the other big powers, and humanitarian factors with the smaller countries.[6]

But this is hardly the full story. For one thing, the security motive is a composite of narrow political advantage and long-run world stability. Secondly, the development motive has been an important theme throughout the aid history of leading donors like the United States and Great Britain. Thirdly, the commercial or profit motive has been far from negligible in the case of smaller countries like Italy and Denmark. Ex-colonial powers like France have placed heavy stress on the narrower forms of political security. There are also the international agencies, ostensibly geared to development, but seldom immune to pressures linked with other goals.

The basic point is that for most donors it is a matter of close interaction among complex, sometimes conflicting, objectives. Frustrations have arisen, inevitably, from a variety of sources; the frequent failure to win political friends and favours; the elusiveness of expected gains from trade and private investment; the search for dramatic development results in programmes dominated by non-developmental goals; the clash between limited success abroad and growing sensitivity to problems of poverty at home. Perhaps most serious of all has been the general tendency, among donors and recipients alike, to make hasty judgments on development performance – judgments that typically derive from inadequate appreciation of foreign aid impact.

It is very difficult, indeed, to promote such understanding through an overview of assistance programmes in the underdeveloped world as a whole. The more solid, though less rapid, route is through in-depth analysis of aid experience in particular developing countries – followed, of course, by a synthesis of the lessons from that experience. The present study of Pakistan is designed as an

from the communist countries has risen substantially during the past decade, the sketchy information available on their recent programmes does not seem to warrant taking a different view of the general aid picture. In this connection, see M. I. Goldman, *Soviet Foreign Aid* (New York, 1967), ch. 11. Socialist assistance to Pakistan will be noted in various parts of the present study.

4 G. Ohlin, *Foreign Aid Policies Reconsidered* (Paris, 1966), p. 13.

5 See *ibid.* ch. 2; R. F. Mikesell, *The Economics of Foreign Aid* (Chicago, 1968), ch. 1; *Pearson Report*, ch. 1, for a detailed analysis.

6 For the view that 'politico-military' issues have been at the heart of U.S. aid to Pakistan, see M. Ayoob, 'U.S. Economic Assistance to Pakistan, 1954–1965', *India Quarterly*, April–June 1967.

effort in this direction. It proceeds on the basis of two fundamental assumptions: that economic development is the most meaningful aim of foreign assistance, and that aid can play a significant role in the development process.

'Foreign aid' defined

Chronic underdevelopment, whatever its roots, is necessarily a condition in which the market mechanism – price and profit signals, supply and demand responses, the appropriate economic institutions – is either very weak or virtually nonexistent. Foreign assistance becomes relevant, in this setting, as a device for helping to push the particular economy off 'dead centre'. Consequently, '*aid, properly speaking, refers only to those parts of capital inflow which normal market incentives do not provide*'.[7] And *official* foreign aid – the prime subject of concern here – involves 'a transfer of real resources or immediate claims on resources (for example, foreign exchange) from one country [or group of countries] to another which would not have taken place . . . in the absence of specific official action designed to promote the transfer by the donor country'.[8]

Furthermore, it is not only a question of official transfers beyond the range of market forces. There is also the definitional requirement that the specific forms of transfer be development-oriented, i.e., that they represent direct *economic* aid. This means the exclusion of such items as military support and famine relief, while acknowledging their quantitative importance, and even their substantial capacity for indirectly influencing the rate and pattern of the receiving country's economic development.

What, then, should 'foreign economic aid' embrace for the purposes of this study of Pakistan? There are, in fact, a large number of alternatives from which to choose. Neil Jacoby, for example, defines total US aid allocations as comprising all dollar aid programmes and aid-generated local currency used to finance development.[9] But quite apart from including military assistance, this definition raises the issue of whether local 'counterpart funds' have any real impact on economic development. Hans Singer argues that they are neutral at best because, on the one hand, they are equivalent to the receiving government printing the money and, on the other hand, they permit investment in submarginal projects.[10] This view can be challenged on several grounds: investment of funds absorbed from consumers (by government sales of commodity imports) is not fully analogous to investment financed by printed money; where the inflow of commodity aid is continuous, a once-and-for-all increase in the stock of money may be investible without inflationary effects; to assume that any project which was submarginal before the generation of local currency will continue to be so afterwards, is to say that all opportunities for new capital

[7] P. N. Rosenstein-Rodan, 'International Aid for Underdeveloped Countries', *Review of Economics and Statistics*, May 1961, p. 109.
[8] Mikesell, *Economics of Foreign Aid*, p. 194.
[9] N. H. Jacoby, *United States Aid to Taiwan: A Study of Foreign Aid, Self-Help, and Development* (New York, 1966), ch. 4.
[10] H. W. Singer, *International Development: Growth and Change* (New York, 1964), ch. 15.

formation have been permanently exhausted. Be that as it may, the compelling consideration here is that the development content of counterpart funds remains an open question complex enough to merit intensive treatment elsewhere.

Frederic Benham distinguishes three concepts of economic aid: the UN definition, that is, official grants and net long-term lending for non-military purposes; a much broader, 'donor countries' definition, including private investment and export credit; and Benham's own definition, the UN approach excluding all public lending made on commercial terms.[11] By contrast, the Organization for Economic Co-operation and Development (OECD) measures the 'net flow of official financial resources': cash grants and grants in kind, including technical assistance; sales of commodities against local currencies; government lending (net of repayment of principal) for periods exceeding one year; and grants and capital subscriptions to multilateral aid agencies, as well as net loans from those agencies.[12]

For the most part, the present study will use the OECD-type definition. It has obvious shortcomings, among them the failure to separate the 'aid' component from foreign transfers which impose a burden of repayment on the recipient. But this problem can be mitigated through aid calculations based on 'discounted present value'.[13] And it is a matter of recognizing the fallibility of all such definitions, while judging the OECD approach to be a reasonable compromise between comprehensiveness and analytical soundness.

Scope of the study

It is striking that very little intensive effort has been devoted to defining the central problems of foreign assistance, analysing the aid-giving process, and gauging the economic impact of aid on the recipient countries.[14] Merely to mention this task is, of course, to appreciate how formidable and sensitive an undertaking it is; this helps to explain the reluctance of governments and scholars to plunge deeply into foreign aid analysis. But the issues are no less vital for being complex. It is time to meet them 'head on' by subjecting foreign aid to careful economic assessment on a wide variety of fronts.

There are cogent reasons for making Pakistan a focal point of discussion.

[11] F. Benham, *Economic Aid to Underdeveloped Countries* (London, 1961), ch. 2.

[12] OECD, *The Flow of Financial Resources to Less-Developed Countries, 1961–1965* (Paris, 1967), ch. 8. The OECD figures are chiefly concerned with assistance provided by member countries; coverage is brief for the Sino-Soviet countries (the USSR, Bulgaria, Czechoslovakia, East Germany, Hungary, China, Poland and Rumania), for other non-OECD countries, and for the multilateral aid agencies.

[13] This is attempted in Chapter 3 below. In 1967, OECD itself began to calculate the grant element in foreign aid; see OECD, *The Flow of Financial Resources, 1961–1965*, ch. 6 and annex 1. More recently, OECD has distinguished between 'official development assistance' and 'other official flows'; the former characterized by 'concessional terms and development orientation, the latter having trade financing or reserves management as its primary aim'. OECD, *Development Assistance: Efforts and Policies of the Members of the Development Assistance Committee, 1969 Review* (Paris, 1969), p. 43.

[14] See, for example, S. H. Robock, *Brazil's Developing Northeast: A Study of Regional Planning and Foreign Aid* (Washington, D.C., 1963).

In the first place, it is among the oldest and most populous of the new states that have emerged since World War II. Secondly, it has a virtually unbroken record of large-scale and varied economic assistance from abroad. Thirdly, Pakistan provides a vivid illustration of industrial growth in the face of serious economic, social and political obstacles, and with acute problems still to be solved. In addition, it has shown a high degree of political stability during the years associated with its most rapid economic development.[15] Pakistan has a long tradition of overall planning based on a mix of private enterprise and state initiative. Then, too, pertinent statistical and other economic data are comparatively abundant and reliable.

One of the most remarkable features of Pakistani economic development has been the tremendous growth of the industrial sector in a country which, at the time of Partition, had practically no industry worth mentioning. Both government and private business played key positive roles in this process: the latter mainly through heavy reinvestment of profits in expanded output, the former through a sustained incentives policy for increased exports and import substitution. Both, by the same token, bore a considerable responsibility for shortfalls in Pakistan's economic growth, and for the persistence of gross inequities in the distribution of personal and regional incomes.

How and how far foreign aid has affected Pakistan's industrial performance is the fundamental question for this study. As already pointed out, the task is by no means simple. For one thing, there are difficult conceptual problems: defining foreign assistance, distinguishing it from other kinds of international transfer, determining its complementary and competitive effects on domestic investment, deriving meaningful criteria for appraising foreign aid results. And there are parallel difficulties of measurement and statistical testing. Subject to such constraints, the analysis proceeds in terms of the history of aid flows to Pakistan; their interaction with economic growth and planning in the country; the role of foreign aid in the balance of payments and external indebtedness; the reciprocal links between aid on the one hand and income, employment, investment and the structure of Pakistani industry on the other. Emphasis is also placed on the assistance programmes of selected donor countries and institutions, with a view to explaining the aid-giving process and tracing its effects on various segments of Pakistan's industrial activity. An attempt is made to assess costs and benefits of particular foreign-aided projects and, where appropriate, to evaluate such projects in relation to the economy at large. Perhaps the real measure of analytical success will be the ability to provide new signposts for improved public policy in the field of development assistance.

Clearly, this is a substantial undertaking. Considerations of logic and

[15] This, of course, is not to overlook the grave political disturbances that Pakistan experienced in late 1968 and early 1969 (and again in early 1971, after the time of writing). Nor is it to ignore the substantial economic gains recorded in the year 1968/9, despite the disturbances. But the fact remains that Pakistan registered its most impressive economic advance during the first half of the 1960s, when relative political stability prevailed. See K. B. Sayeed, 'The Performance Profile of the Government of Pakistan', unpublished mimeo. (McGill University, Centre for Developing-Area Studies, 1971.)

manageability dictate that certain issues, however interesting and important, be discussed only in subordinate fashion. Such is the case with private foreign aid and investment, agricultural aid, and technical assistance programmes. Each of these topics is a world unto itself and could not be embraced without a massive extension of an already sizable effort. This is also true of aid impact on donor countries: it is the effects on Pakistan as a recipient nation which are of overriding concern here.

Nor are these the only limits imposed on the scope of this study. In particular, there will be no detailed analysis of foreign aid effects on Pakistan's economic infra-structure – power, transportation, communications, natural resource development. The regional implications of the aid inflows will not be treated in any real depth. And reference to socio-political aspects of the inflows will be brief.

In the concluding chapter, it will be emphasized that there is justification – conceptual as well as practical – for leaving such gaps; that it is reasonable to expect them to be filled by other studies in the aid field. But this does not alter the fact that the gaps are very significant indeed, and that the present effort has to be seen as a first-stage, partial approach to aid impact on Pakistan.

2. Towards a theory of foreign aid

Any systematic approach to foreign aid, however partial, must be placed in broad analytical perspective. This chapter explores the role of aid in the growth process, with a view to evaluating the particular experience of Pakistan.

The theory of foreign aid remains quite imperfect. And its application to Pakistan will be less than complete. Consequently, it can hardly be expected that direct, one-to-one links will be drawn between theory and performance. Essentially, what this chapter provides is a fitting-together of certain key variables in the aid–growth relationship, as well as some broad guidelines for assessing the role of aid in Pakistan's industrial development. The framework will have served its basic purpose if it helps to produce a reasonably clear picture of aid effects on Pakistani industry.

Ideally, one should identify every unit of development assistance, determine its direct impact and measure its multiplier effects over time. The real contribution of aid would be viewed in relation to individual consumers and producers, and the extent of aggregate change brought about by aid would be an interesting corollary to these more significant welfare effects. To learn, for example, that the per capita income of a developing country had grown by 100 per cent, without realizing that the condition of the lowest income groups had deteriorated in the same period, would mean being misled on the basic question of economic and social change. Given the empirical constraints, it is natural that distortions of this kind should, in fact, occur. What proves surprising is that most of the literature dealing with the relationship of foreign aid to the development process has been concerned only with the broadest economic results of such assistance.

In addition, considerable woolliness derives from dubious assumptions implicit in the various theories of development. Perhaps the most dangerous assumption is that capital is *the* key to growth.[1] From this it follows that since developing countries are too poor to generate all their own savings, inflows of external capital provide the missing link. The oversimplification becomes evident whenever the development problem is defined solely in terms of producing a level of capital formation sufficient for self-sustained growth. Kenneth Galbraith, by contrast, argues that there are elements just as crucial to development as is foreign capital. And S. M. Fine believes that while some conditions for a satisfactory rate of economic progress 'can be conferred by foreign assistance... perhaps the most critical components must emerge from the society itself'.[2]

[1] In this connection, see M. Friedman, 'Foreign Economic Aid: Means and Objectives', *Yale Review*, June 1958.

[2] See J. K. Galbraith, 'A Positive Approach to Foreign Aid', *Foreign Affairs*, April 1961; S. M. Fine, 'Economic Growth in the Less-Developed Countries', *OECD Observer*, August 1963, p. 26. See also the discussion of prerequisites to development in G. Myrdal, *Asian Drama: An Inquiry Into the Poverty of Nations*, 3 vols. (New York, 1968).

Whether capital inflows play a major role in the growth process, has, indeed, become a matter of intensive debate. This is no less true of private inflows than of official foreign assistance.[3]

The 'take-off' analysis: pre-1914 experience

Kenneth Berrill and A. K. Cairncross regard foreign investment as relatively unimportant in the take-offs experienced by the presently advanced economies.[4] With the usual reservations about conclusions based on inadequate data, Berrill has examined the historical role of foreign capital in the context of two general assumptions: that for most advanced economies, two or three decades can be identified in which certain strategic sectors grew significantly; and that the appropriate take-off periods are those suggested by W. W. Rostow.[5] Foreign capital is observed to have been a very minor part of total capital supply in the periods of take-off before 1914. However, Berrill is careful to note that the limited quantity of foreign capital does not take into account the role of foreign technology, which was important for countries like Japan.

In these terms, Britain, France and Germany are said to have achieved industrialization without foreign borrowing. Similarly, Finland and Japan were able to pass through the take-off period in the absence of foreign capital. Denmark and Sweden relied on external capital only in the late stages of the take-off. Berrill is sceptical about finding a take-off period for Canada, Australia, New Zealand and the United States. But he settles, nevertheless, on 1843–60 for the United States and 1896–1914 for the three other countries; and he concludes that even in those four cases, 'the really heavy foreign investment is after the take-off'.[6]

In essence, both Berrill and Cairncross consider the inflow of foreign capital a result, rather than a cause, of rapid growth as far as the pre-1914 experience is concerned.[7] But Berrill's rather casual treatment of public utilities detracts from the validity of his thesis, since it understates the significance of foreign investment in such enterprises during the take-off stage. Furthermore, both writers neglect the impact of technology and access to foreign markets, two basic components of foreign capital inflow. Perhaps most important of all, the pre-1914 focus is on private foreign capital, and on its automatic response to

[3] See R. F. Mikesell, *The Economics of Foreign Aid* (Chicago, 1968), chs. 2–3.

[4] K. E. Berrill, 'Foreign Capital and Take-Off', in *The Economics of Take-Off into Sustained Growth, Proceedings of a Conference held by the International Economic Association*, ed. W. W. Rostow (London, 1963); A. K. Cairncross, *Factors in Economic Development* (London, 1962), ch. 3.

[5] There has, of course, been extensive criticism of the Rostow take-off in the literature. See, for example, S. Kuznets, 'Notes on the Take-Off', in *The Economics of Take-Off into Sustained Growth*.

[6] Berrill, 'Foreign Capital and Take-Off,' p. 295.

[7] 'While foreign investment undoubtedly speeded up the development of these countries, it is more accurate to think of it as accompanying and reinforcing their growth than as preliminary to it...It was a rapid growth in output, more than anything else, that created a shortage of capital...and made it necessary to have recourse to foreign borrowing.' Cairncross, *Factors in Economic Development*, p. 43.

investment opportunities in a dynamic setting; whatever the relevance of this cause–effect relationship for private capital flows, it is quite clear that they differ sharply enough from foreign aid to rule out any simple extension of causal reasoning from one to the other.

Foreign aid and the problem of causality

In fact, foreign assistance must, by definition, have an independent capability for influencing economic growth in the underdeveloped countries. There is nothing automatic about its response to growth needs; and there is much that originates with policy objectives set by the donor. The real question, therefore, is not whether such a causal role exists, but how it is exercised and how far.

No easy answers are to be found, since this is part of the general problem of causality in an interconnected social system. One is led, inevitably, to a host of further aid questions which are hardly more lacking in complexity. Can the rate of economic growth accelerate in the absence of foreign assistance and, if so, for how long? Is it possible to maintain a steady growth rate without continuing aid inflows? Is foreign assistance a necessary condition for getting the growth process under way? What are the most significant contrasts in the role of aid in different countries and at different periods of time? What kinds of impact does economic assistance have on social and political development in the receiving country? To what extent, if any, are the positive effects of aid offset by adverse influence on domestic savings, industrial production and other key variables?

Thus the problem of foreign aid causality is very intricate indeed. The absence of one important input may preclude the possibility of growth. Its presence makes progress possible, but an evaluation of its role is extremely difficult in the context of outputs emerging from a combination of interdependent and simultaneously applied inputs.

The dilemma is well illustrated by considering the inflow of external resources as 'virtually a separate factor of production'.[8] This implies the use of a production function to determine the marginal productivity of the foreign aid factor. Suppose, for example, that one fitted a Cobb–Douglas type of production function.

$$O = \gamma K_D^{\alpha} L^{\beta} E^{\theta},$$

where O is output, K_D is domestically generated capital, L labour, and E foreign assistance. It would have to be assumed that K_D and E were independent of each other during the period under consideration. But it is far from evident that this should be so (except, perhaps, for the pure dual economy); and it would take a great deal of convincing to refute the judgment that the closest linkages prevail between domestic and foreign capital. Nor is this all; for there is the equally important assumption of relative constancy in the shares of capital and labour; and the validity of that assumption is open to serious

[8] H. B. Chenery and A. M. Strout, 'Foreign Assistance and Economic Development', *American Economic Review*, September 1966, p. 679.

question. In any event, the most accurate measure of the marginal productivity of external resources, θ, would still leave the specifics of foreign aid impact untouched.

The truth is that one can hardly exaggerate the conceptual and quantitative gaps in this field. Nevertheless, a variety of significant analytical efforts continues to be made, particularly on the 'macro' front. The discussion turns now to these advances in foreign aid theory.

The aggregate aid models

The macro approach is strikingly reflected in the aggregate aid models which have appeared with increasing frequency over the past decade.[9] Each model has its own unique characteristics, to be sure. But most of them have a number of important features in common: assuming economic growth to be the only objective of foreign assistance; abstracting from the social and political aspects of the development process; providing an analytical framework for determining how much aid a developing country will require; recommending the policies which such a country should follow in order to achieve a target rate of growth; suggesting or implying broad criteria for evaluating past aid programmes. The Fei–Paauw and Chenery–Strout models give a reasonably representative picture of major strengths and weaknesses in this econometric system.

Fei–Paauw

This is basically an investigation of the quantitative links between external assistance and the mobilization of domestic savings. The authors construct a revised Harrod–Domar model and apply it to a group of thirty-one countries receiving the bulk of United States development aid. 'Self-help', in the form of increased domestic savings, is viewed as the overriding prerequisite to outside assistance; that is to say, the prime test of whether a country should receive aid is its readiness to undertake the 'domestic austerity efforts' necessary 'to achieve self-sufficiency in finance'.[10]

By way of first approximation, the model expresses required investment (I/Y) as a function of the capital–output ratio (k), the target rate of growth of per capita GNP (h), and the population growth rate (r). Thus $I/Y = k(h+r)$; substituting this into $I = S+A$, where S is domestic savings and A is foreign savings, gives $h = (s-rk)/k+a/k$ where s is the average propensity to save and a the aid–income ratio. For fixed values of s, r and k, the target growth

[9] See, for example, H. B. Chenery and M. Bruno, 'Development Alternatives in an Open Economy: The Case of Israel', *Economic Journal*, March 1962; Chenery and I. Adelman, 'Foreign Aid and Economic Development: The Case of Greece', *Review of Economics and Statistics*, February 1966; Chenery and A. MacEwan, 'Optimal Patterns of Growth and Aid: The Case of Pakistan', *Pakistan Development Review*, Summer 1966; N. H. Jacoby, *United States Aid to Taiwan* (New York, 1966), appendices E–G; J. Vanek, *Estimating Foreign Resource Needs for Economic Development: Theory, Method, and a Case Study of Colombia* (New York, 1967).

[10] J. C. H. Fei and D. S. Paauw, 'Foreign Assistance and Self-Help: A Reappraisal of Development Finance', *Review of Economics and Statistics*, August 1965, pp. 261, 263.