

FOREIGN ECONOMIC ASSISTANCE TO PAKISTAN 1988-99

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CERTIFICATE

Certified that the dissertation "**Foreign Economic Assistance to Pakistan: 1988-98**", Submitted by **Jeevan Prakash Mohanty** in partial fulfillment of the requirement for the Award of the degree of **Master of Philosophy** has not been previously submitted in any other university.

We recommend that this dissertation may be placed before the examiners for evaluation.

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**Dedicated
to
My Parents**

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CHAPTER I

INTRODUCTION

Economic Aid to developing countries can be traced back to the Truman doctrine of late 1940s. Foreign Economic Assistance a virtual synonym for Aid refers to resources on concessional terms or in the nature of grants that are transferred or channeled to the developing countries on a commercial basis. It is provided with the main objective of promoting the economic development and welfare of the developing world. Aid embraces humanitarian assistance and emergency relief in a positive sense. By its very definition the sole motive behind aid is altruism. Aid is hailed as a correct step in the world wide fight against hunger, misery and despair, but sometimes it is viewed as an action that will almost surely retard economic development of the developing countries.

Foreign Aid plays a vital role in initiating and accelerating the pace of economic development by supplementing domestic resources. It is provided with the main objective of promoting the economic development and welfare of the developing world. It plays a vital role in a developing country in maintaining the macro-economic trends. It helps to bridge saving investment gap. It supplements local resource, which help to promote development. Further it helps to bridge the export and import gap of a country, which are highly essential to tackle balance of payment problem.

Thus it also helps relieving shortage in foreign exchange and resources.

1.1 Types of Aid

Foreign Aid began to be an important facet of international relation in the 1950s, in the following years it grew in importance both as quantities of aid flow increased and as international attention focussed more and more on the developing country's poverty. As time went on, an increasing number of countries became donors and multilateral institutions were set up and those institutions expanded their operations substantially to receive funds from a range of donors and to provide aid to a range of recipients.

There are four main types of foreign economic aid. First, category which are project and non-project in nature are long term loans which have to be repaid in foreign currency but are usually repayable over a longer period. These loans do not impose an excessive repayment burden on the developing countries. The second category of economic assistance, which involves grant element in the form of funds needed by a developing country to purchase essential commodities (food and medical supplies). For the most part such aid is given only to developing countries with low per-capita income levels. The third category assistance involves, the assistance from consortium countries, which are the

sale of surplus products to a country on soft term. The non-consortium sources basically involve bilateral aid. They are given on channeled through a country-to-country basis. The fourth type of aid, although not strictly a capital flow, is technical assistance given to developing countries. Apart from this bilateral aid, there are international development finance organizations on lending institution which provide multi-lateral aid for the primary purpose of economic development in developing countries. The World Bank provides loan for the long term structural adjustment. The International development agency, which is a wing of World Bank provides loan on soft terms spread over long period. The international monetary fund provides short term assistance for balance of payment support. These loans/assistance provided by international lending institutions are regarded as having advantageous in financial terms from a developing country's perspective.

Pakistan's experience of foreign aid over the past five decades has not been at all satisfactory. The country has accumulated enormously large foreign debt without having developed the socio-economic infrastructure necessary to sustain the growth process. The composition of external flows of Pakistan has been changing slowly but perceptibility with a reduction in the availability of concessional assistance. The profile of external liabilities have worsened seriously over time and is the chief cause of foreign

exchange difficulty after mid 1996. Not only heavy but also changing terms of debt are going to make it harder for Pakistan to get out of debt trap.

Pakistan began receiving foreign economic assistance from the commencement of Colombo Plan in 1950. The first technical assistance agreement was signed with the US in 1951. The first project loan was obtained from the World Bank in 1952. Since then, Pakistan has continued to receive foreign economic assistance in ever increasing quantities. However, in the earlier years economic assistance was mostly on grant basis. Since 1960s, the composition of total assistance received has changed in favour of loans. The terms of loans have also tended to become harder with the passage of time. There was massive increase in the flow of economic assistance after 1960. This was accompanied by a precipitate fall in the ratio of grants to total foreign assistance received by the country. While the ratio of grants to the total foreign assistance in the pre-plan period was 67.5 percent and in the first plan period 59.4 percent, it fell to 14.5 percent in the second plan and 8.9 percent in the third plan period. Upto 1971, Pakistan had received commitments of total assistance amounting to \$7,100 million.

Political turmoil in the country in 1971 created a serious debt-repayment situation for Pakistan. This led to resumption of

aid by consortium countries in 1972-73. The steep rise in crude oil prices put huge amount of foreign exchange surplus fund at the disposal of the oil rich petroleum exporting middle-east countries. Pakistan exploited this situation and from the period of 1974-75, these countries began to forge ahead among the principal aid givers to Pakistan. Bhutto's policy of nationalization was also appreciated and it helped Pakistan to mobilize funds from World Bank project assistance programme. The period from 1977 saw changes in the economy. Zia's policies were basically pro-private. There was rise in assistance from consortium multilateral assistance at US initiative. First five years of Zia regime was a testing time for Pakistan because, Pakistan by changing economic policies took time to infuse faith in donors. But the last five years of his regime witnessed dramatic rise in project aid, which helped Pakistan to strengthen its infrastructural base. During 1980s, through the effects of IMF various programmes established specific quantitative monetary and fiscal targets that the government had to adhere to as condition for the loans it received. The increase in IMF's credit was conditional on the recipient countries in most cases. After the year 1982 when an IMF stand-by facility was acquired, pressure started to mount for reducing budget deficit. Under instructions from the Bank and the Fund, the government substituted non-bank borrowing for both falling short-term external credit and domestic borrowing from the World Bank. In the first month of its

office, Benazir administration in 1988 ratified an agreement with IMF which committed it to medium term programme for the period of 1989-91. Pakistan thus embarked on a never-ending adjustment process in which the IMF agreement has been followed by structural adjustment facility and several other sectoral agreements. These agreements commit the government to meet quarterly the macro-economic targets set by the IMF. During the period from 1988-89, there was an increasing trend of commitments. Perhaps the total amount of commitments was the highest between the year from 1983-84. The amount of commitments increased at an average annual rate of 10.50 percent during the period of 1983-84 to 1988-89. During those year the share of consortium and non-consortium aid was remarkable. Similarly, the amount of disbursement was higher, during the period of 1988-89 than last years disbursements. The consortium group contributed the highest relief assistance. During the year of 1989-90, the commitments also have reflected an increasing trend. Disbursement declined due to decline in the food aid. During the year of 1989-90, the share of project aid was low and non-project aid was increased. During the period 1990-91, various grants like assistance in total commitment declined. This year also witnessed decrease in project aid and increase in non-project aid. During the period of 1991-92, there was an increasing trend in commitment and non-project was given more importance.

The Nawaz Sharif's period from 1994 onwards was marked by a lots of change in the economic scenario of Pakistan. The major change was seen in external-financing composition. There was severe cut in long-term financing composition. Interest rates were jacked up and concessional credit schemes reduced. Since Pakistan is having a low elasticity of substitution between domestic and foreign resources, its dependence on foreign assistance has increased over the years. The stabilization effort received a serious set back due to increasing expenditure by the government. A declining trend was witnessed in aid flow and the commitments reached at a lowest level in the year of 1992-93. However commitments rose again in the year between 1994-95 due to Pakistan's adherence to conditionalities of the donors. The gross disbursement also fell from the year 1991 till the year 1994. But in the year of 1995, disbursement picked up and continued thereafter. The commitments showed an increasing trend between the year from 1996 to 1998. The element of project aid in the total disbursed amount has been increasing till the year 1988. The share of non-project aid on the other hand, which showed an increase during the first two years of nineties has not been able to maintain the trend.

CHAPTER II

TRENDS IN GROWTH, SOURCE AND COMPOSITION OF AID

Aid is equivalent to a gift, something given up for nothing by the donor. The above definition excludes commercial transactions taking place between the supplier and the receiver. Aid equals the value of the grant-equivalent embodied in the resource transfer. Aid is given on more favourable terms than those prevailing in the market.

The history of economic thought regarding foreign aid is peculiar. The phenomenal success of Marshall Plan in the late 1940s and 1950s led many to believe that similar transfers to developing countries would permit their comparably spectacular transformation. That belief had two intellectual underpinnings. The first was Harrod-Domar model, which extended the Keynesian emphasis on investment to include its capacity increasing effects. The second was the Profession's the then prevailing emphasis on physical capital and the view that the shortage of capital largely accounted for poverty of the developing countries.¹

An official flow in the form of aid flow from one country to another takes place whenever the government of the originating

¹ H.W. Singer, Neclamber Hatti and Rameshwana Tandon, *Aid and External Financing in the 1990s*, 1991, p. 39.

country provides command over resources to the other without a current commercial deal. An aid flow could consist at one extreme, of a loan at market or near-market rates of interest. It could also be an outright grant of convertible currency.

‘Official development assistance’, the other name for aid can take a variety of forms. It might consist of loans at terms more favourable than available commercially. It might be food aid, or a grant or loan that has to be spent in the donor’s home market. It is also known as tied aid.

In the early days of assistance aid was aimed mainly at meeting material needs or closing identified gaps in a country’s investment or balance of payments requirements.² In particular, until the mid-1960s, gap filling of one sort or another was in vogue. The form of resource transfer varied, and often combined transfers of food, capital goods or pure transfers of foreign exchange. In some countries, USAID programmes were aimed at filling the gap between domestic savings and investments.

By the end of the 1970s, reform of macro-economic policies increasingly began to appear as an element in aid strategy. This was a direct response to the balance of payments and debt difficulties many developing countries experienced following the oil price shocks of the 1970s and their excessive dependence on

² Seiji Naya, *The role of US Economic Aid in promoting development*, 1988, p. 11.

recycled petrodollars borrowed from commercial banks. The flexible dynamism of a few outward oriented countries led to an appreciation of a new role for external aid-that of supporting structural adjustment and situation adeptness through institutional and policy reform. As a result, the World Bank initiated dialogues with a number of countries that ultimately led to structural adjustment loans for developing countries.

Types of Foreign Aid

Foreign Aid received by Pakistan may be broadly divided into tied and untied aid. Most aid has been tied to both source and utilization with the result that a variety of goods and services have been purchased on credit at uncompetitive prices. Out of the total foreign economic assistance contracted by Pakistan upto December 1980, 91 percent was tied to specific projects or commodities and was also combined to purchases from donor countries.³ The remaining 9 percent was in the form of 'unrestricted' balance of payment support, out of which only certain country-to-country loans can be, termed untied aid.

Besides balance of payment support, the major types of aid received by Pakistan may be classified as project, commodity, food and technical assistance. Under these four types of economic assistance, various kinds of commodities for utilization in different

³ Ibid, pp. 296-297.

projects and sectors of the economy have been supplied to Pakistan either on credit or under grant agreements. In general, all these four types of aid are of the tied nature as purchasers have been tied to specific projects on commodities which in most cases have been supplied by the donor countries themselves.

Amongst the different types of aid, the share of project assistance has been the largest and has increased consequently from the first plan period. Project assistance in aid allocated for particular developmental ventures like irrigation projects or large industrial and communication networks which require a substantial imported component. Besides the imported component, there is also a local finance component of a particular project which has to be covered by raising the necessary resources domestically. Since major donor countries like the USA have traditionally preferred to finance a specific number of projects, they may come to gain control over a large proportion of development expenditure. This type of project aid imposes a financial burden on the recipient country because of the monopoly position such aid confers on donors.

Commodity assistance, the second largest component amongst the different types of aid received by Pakistan has allowed some degree of flexibility to the country by not being tied to utilization although in most cases it is tied to source. As commodity

assistance is not generally tied to long gestation projects, the government in view of the country's underutilized capacity, has on the whole preferred commodity over project assistance so that project can be increased in the short to medium term.

Under commodity assistance, which is allocated between the public and the private sector, are included commodities ranging from industrial spare parts to various kinds of consumer goods. However, commodity assistance as a ratio as total aid has decreased in a steady manner.⁴

The third largest component of aid received by Pakistan is commodity assistance under PL-480 provided by the USA through the sale of surplus agricultural commodities. These commodities ranging from wheat to edible oil, have been purchased by the Pakistan government from the US government and were paid for in Pakistani rupees till 1967 and in rupees and dollars after 1967. The allocation of these funds termed as 'aid' between different activities has been the prerogative of the US government.

Since a sizeable proportion of the US controlled counterpart funds have been allocated as grants and loans to the Pakistan government, the US government has played an important role in influencing the country's development pattern through control over

⁴ Ibid, p.299.

counterpart funds. Counterpart funds were higher during the initial years but subsequently their share has fallen.

Although technical assistance has comprised a small proportion of total foreign economic assistance, this type of foreign aid, because it covers the services of foreign experts is of greater significance.⁵ A large number of experts have come to Pakistan under the guise of various aid programmes. Experts under the title of the 'Harvard Advisory Group' played an extremely important role in the formulation of Pakistan's second Five Year Plan. Foreign technical experts generally accompany particular projects which are a part of the project assistance provided to the recipient country.

Pakistan's Principal Sources of Foreign Aid

As most aid is tied to source, the source structure of foreign aid also points towards the recipients aid-determined import structure. The more diversified the sources of aid, the less the recipient country's dependence on any one source.

Pakistan's sources of aid have been divided into three major groups:

1. Consortium
2. Non-consortium
3. IMF Trust Fund

⁵ Ibid, pp.300.

The aid-to-Pakistan consortium has provided aid to Pakistan through both bilateral and multilateral arrangements. The consortium comprises most of the major West European countries, the USA and Japan under the overall sponsorship of the World Bank. Aid under consortium arrangements has comprised the largest share of total aid disbursed by the three major sources.⁶ However, the share of consortium aid has declined from 98 percent in the first plan period to about 59 percent in 1988-89. Meanwhile, the share of consortium multilateral institutions in total aid has increased from 18 percent during the first plan period to 23 percent in 1978-79. On the other hand, the share of bilateral consortium aid in total has declined over the year.

Thus given the terms and conditions imposed by certain groups of countries/agencies that lend to Pakistan shows a change in the relative shares of the different sources. It also gives us an idea of different sources and financial costs associated with receiving aid.

The decline in the overall share of consortium aid in total aid during the seventies was caused by the emergence of the Islamic countries as an important source whose share was as high as 46

⁶ Ibid, p.301.

percent in 1973-74. Similarly, the share of Non-consortium countries increased during Third Plan period.⁷

The largest share in total aid upto 1969-70 was that of the USA although its share declined during Second Plan period. The decline in USA's overall share in total aid contracted during the seventies was compensated for by the emergence of Iran as Pakistan's principal donor. The entire aid from Iran was in the form of cast foreign exchange loans. Amongst the non-consortium countries, the share of the people's republic of China in total aid contracted was the largest within the non-consortium countries group. Moreover, the entire amount of Chinese aid during this period was in the form of grant assistance. During the Third Plan, the Soviet Union replaced China as the largest donor. The USA by virtue of its financial control over consortium multilateral financial institutions and the IMF, still retains the top position in the hierarch of Pakistan's major donor countries in terms of both bilateral as well as multilateral aid.

Role of Foreign Aid in Pakistan

Foreign Aid played a key role in the economic development of Pakistan and occupied a critical position in determining the strategy and the pace of economic development of the country in its

⁷ Ibid, p.302.

five decade of existence. Since 1972, aid has helped more in sustaining the economy than in its development.⁸

The planning of development expenditure and investment pattern was, during the first three plans conditioned by the availability of foreign aid. Secondly, the aid was used in the earlier stages for the legitimate purposes of financing the import gap on development account but later it came to be increasingly used for maintaining current consumption. Thirdly, commodity aid was used to remove imbalances and meet shortages in critical areas of the economy. Fourthly, grants received for specific development projects like the Tarbela dam materially made a significant contribution towards development of agriculture and other sectors of the economy. Lastly, by making possible imports of fertilizers, steel and other important agricultural and industrial inputs, aid helped both agricultural and industrial production to grow at rates that would otherwise have been simply unattainable.

From 1955 to 1998, Pakistan witnessed a different types of regimes. Moreover, aid inflow in case of Pakistan depended mostly on the personal efforts of state heads concerned. Because, there has been a trend, that military regimes have showed excellence to mobilise more resources than their non-military counterpart. From 1955 to 1980, mostly Pakistan was under military role, despite of

⁸ B.M. Bhatia, Pakistan's economic development, Freedom to Bondage, 1989, p. 192.

that aid inflow was comparatively higher. But it saw a declining trend when a democratically elected government took charge. It is because of changes in policy imperatives of the donors and their strategic interests. However, change in the attitude of donors was seen due to Pakistan's internal problems as well as heavy dependence on aid.

The terms of loans and credits, however, softened gradually during the 1960's and the 1970's as compared with the terms in the 1950's, while during the 1980s and first six years of 1990s (1990-96), these have somewhat been hardened. The rate of interest, which was about 4.6 percent during the 1950s, declined to 3.3 percent during the 1960s and the 1970s and again increased during the 1980s and 1990s. The repayment period of loans and credits obtained during the 1950s was 21 years with a grace period of 2 years which improved to 30 years with a grace period of 7 years during the 1960s, and it remained around 25 years with a grace period of 6 years during the 1970s. Repayment period however increased to 28 years including a grace period of 7 years during 1980s but declined to 23 years including a grace period of 7 years during the 1990s.⁹

⁹ Ibid., p. 96.

TABLE 2.1

COMMITMENTS AND DISBURSEMENTS OF LOANS AND GRANTS (BY TYPE)

US \$ million

	Project Aid		Non-Project Aid								Total	
	Commts**	Disbs***	Non Food		Food		BOP		Relief		Commts	Disbs
			Commts	Disbs	Commts	Disbs	Commts	Disbs	Commts	Disbs		
I. Pre Plan												
1951-52	43		-				-	-	-	-	43	
1952-53	12		-		94		-	-	-	-	106	
1953-54	70		9		9		-	-	-	-	88	
1954-55	45		39		16		-	-	-	-	100	
Sub Total-II	170		48		119		-	-	-	-	337	
II. 1st Plan												
1955-56	91		67		32		-	-	-	-	190	
1956-57	77		52		1		-	-	-	-	130	
1957-58	137		62		35		-	-	-	-	234	
1958-59	129		91		65		-	-	-	-	285	
1959-60	93		103		40		-	-	-	-	236	
Sub Total-II	527	406*	375	244*	173	192*	-	-	-	-	1,075	842*
III. 2nd Plan												
1960-61	323	160	96	11	60	171	-	-	-	-	479	342
1961-62	238	202	126	8	65	94	-	-	-	-	429	304
1962-63	354	244	91	98	200	159	-	-	-	-	645	501
1963-64	345	267	85	130	96	144	-	-	-	-	526	541
1964-65	442	336	301	173	89	197	-	-	-	-	832	706
Sub-Total-III	1,702	1,209	699	420	510	765	-	-	-	-	2,911	2,394
IV. 3rd Plan												
1965-66	369	367	109	109	59	57	-	-	-	-	537	533
1966-67	282	331	209	179	137	113	-	-	-	-	628	623
1967-68	210	401	194	146	157	182	-	-	-	-	561	729
1968-69	473	389	153	171	30	34	-	-	-	-	656	594
1969-70	248	323	216	158	91	83	-	-	-	-	555	564
SubTotal-IV	1,582	1,811	881	763	474	469	-	-	-	-	2,937	3,043
V. Non Plan												
1970-71	616	365	124	186	133	61	-	-	-	-	873	612
1971-72	72	281	6	79	65	49	-	-	-	-	143	409
1972-73	139	100	307	161	97	94	-	-	-	-	543	355
1973-74	425	170	94	181	139	117	610	30	-	-	1,268	498
1974-75	722	286	120	183	113	97	160	410	-	-	1,115	976

1975-76	534	389	241	155	146	160	30	360	-	-	951	1,064
1976-77	641	449	111	211	140	112	219	188	-	-	1,111	960
1977-78	613	516	206	143	73	95	71	102	-	-	963	856
Sub Total-V	3,762	2,556	1,209	1,299	906	785	1,090	1,090	-	-	6,967	5,730
VI. 5th Plan												
1978-79	1,064	599	190	213	55	50	86	86	-	-	1,395	948
1979-80	1,002	808	121	161	55	21	419	419	61	61	1,658	1,470
1980-81	581	676	182	103	73	66	16	16	111	111	973	972
1981-82	887	536	320	174	110	89	10	10	293	293	1,620	1,102
1982-83	1,115	744	174	299	120	80	-	-	178	178	1,587	1,301
Sub Total VI	4,659	3,363	982	950	413	306	531	531	643	643	7,233	5,793
VII. 6th Plan												
1983-84	1,580	695	166	149	88	177	-	-	155	155	1,989	1,176
1984-85	1,804	903	161	125	196	79	-	-	150	150	2,311	1,257
1985-86	1,810	1,055	186	93	163	246	-	-	135	135	2,294	1,528
1986-87	2,035	1,006	331	205	130	57	-	-	130	130	2,626	1,398
1987-88	1,903	1,223	390	219	230	218	-	-	164	164	2,687	1,824
Sub Total VI	9,132	4,882	1,234	791	807	776	-	-	734	734	11,907	7,183
VIII. 7th Plan												
1988-89	1,979	1,262	663	537	392	542	146@	146	132	132	3,312	2,619
1989-90	2,623	1,312	201	386	258	287	217@	217	140	140	3,439	2,342
1990-91	1,935	1,408	346	451	134	136	50	50	111	111	2,576	2,156
1991-92	2,219	1,766	43	316	322	284	-	-	105	105	2,689	2,471
1992-93	1,204	1,895	182	232	454	309	-	-	57	57	1,897	2,493
Sub Total-VI	9,960	7,643	1,435	1,922	1,561	1,558	413	413	545	545	13,913	12,081
IX. 8th Plan												
1993-94	1,822	1,961	411	318	329	251	-	-	19	19	2,581	2,549
1994-95	2,714	2,079	3	234	279	258	-	-	29	29	3,025	2,600
1995-96	2,219	2,151	57	21	395	383	-	-	10	10	2,681	2,565
1996-97	1,351	1,821	1	1	405	409	-	-	2	2	1,759	2,233
1997-98 (E)	1,172	1,550	1,551	1026	597	625	-	-	2	2	3,322	3,203
Grand Total	40,772	31,432	8,891	7,981	6,967	6,777*	2,034	2,034	1,984	1,984	60,648	50,216
% of Total	67.2	62.6	14.7	15.9	11.5	13.5	3.3	4.0	3.3	4.0	100.0	100.0

Source: Economic Survey 1997-98, Economic Affairs Division, Government of Pakistan

** Commitments

*** Disbursements

- nil

* Disbursements during 1951-52 to 1959-60

@ IMF(SAF) Loan

E Estimated

Plenty of economic aid was provided by the US to Pakistan for its economic growth and development. US aid to Pakistan can be divided into two periods i.e. pre-consortium and the consortium period. In the pre-consortium period, upto December 1961, \$1,728.95 millions were allocated to Pakistan by different countries, the UN and its specialised agencies and the Ford Foundation.¹⁰

In the consortium period, from 1962 to 1965, \$1,818.7 million was pledged in foreign aid to Pakistan through the Pakistan consortium. But after 1965 the consortium aid experienced a decline due to certain strategic calculations like Indo-Pak war and soviet mediation to solve the dispute. US the highest donor also took declining interest, and it amounted to lower assistance to Pakistan. Since, Pakistan always branded as an pro-US country other consortium countries found it unessential to supply large amount of aid to Pakistan and their contribution in consortium aid was also minimised. Thus US became the major supplier of consortium aid and the share of US in consortium pledges amounted to \$925.0 million. Thus the American aid share of the total foreign aid to Pakistan from both the consortium and non-

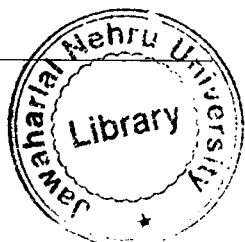
¹⁰ Attan Chand, *Pakistan in Search of modernization*, 1992, p. 304.

consortium sources during the consortium period was 46.4 percent, a considerable decrease from the pre-consortium period.¹¹

The US aid, a by-product of international political scene, increased from a mere \$12 million in 1948 to \$67 million in 1955, immediately after Pakistan joined the military pacts formally and continued to increase in the years to come and reached to \$380 million and \$377 million during 1963 and 1964 respectively. By 1964, foreign aid inflows were almost 9 percent of the GNP. The expansion in foreign aid during the first half of the sixties was necessitated by the increase in the level of gross domestic investment which could not be financed entirely by domestic savings. Towards the latter half of the sixties foreign aid slowed down to 2.81 percent.

After the creation of East Pakistan Bhutto as the premier of West Pakistan took certain initiatives to mobilise more assistance for Pakistan. His pro-democratic stance was applauded by the western democratic world and it resulted in more supply of aid to Pakistan. Bhutto's era saw the rise in internal mobilisation of resources which helped to fill the saving investments gap. Thus aid inflow increased again in the first half of seventies growing from 3.61 percent of the GNP in 1970 to 11.10 percent in 1975, although gross foreign aid inflows remained almost static at around

¹¹ Ibid.



US \$1 billion per annum.¹² Foreign aid inflows as a proportion of the GNP fell to about 5 percent of the GNP by 1980.

At the onset of Fifth Plan in the year 1978-79 project and non-project aid was in greater flow as compared to other plans. Project aid were aimed at some specific projects and non-project aid catered to the need of food commodity as well as Balance of Payment relief. The year 78-79 was marked by greater inflow of assistance but it could not keep up the same trend. It started declining steadily and during the year 80-81, it was half of the amount which was provided during 78-79. But again in 82-83 towards the end of Fifth Plan, foreign aid inflow was raised by 25 percent as compared to previous year.¹³

But Sixth Plan which started in 83-84 and continued upto 87-88 did not witness any decline in aid inflow. That period under Zia's regime saw a marked rise in the multilateral aid flow. Zia's masterly foreign economic policy and good economic ties brought more foreign capital into Pakistan. Throughout the plan period, every year witnessed 5 to 10 percent increase in aid flow.

Seventh Plan started in the year 88-89, that year was marked by some historic developments in Pakistan. A democratically elected government came to power in Pakistan. Since this

¹² Viqan Ahmed and Rashid Amjad, *The management of Pakistan's Economy since 1945-82*, 1995, p. 290.

¹³ *Economic Survey 88-89*, Economic Affairs Division Ministry of Finance Pakistan, p. 167.

development was widely applauded all over the world, the multilateral as well as bilateral agencies started following a liberal policy towards Pakistan. The year 89-90 saw almost doubling of the aid inflow to Pakistan which stood at \$3,242 million as compared \$1,979 million of the year 88-89.¹⁴ During the 7th Plan from 1989 onwards a steady rise was seen in foreign capital inflows. This period also saw a huge gap between commitments made by the donors and the disbursement of fund. As 1990s saw the age of reform and liberalization, the donors started attaching harder terms and conditionalities with the assistance. Grant element in the assistance was almost missing.

The commitment of foreign aid continued to increase to \$3.439 billion till 1989-90. A declining trend was witnessed thereafter and commitments reached a lowest level in 1992-93, reflecting a fall 44.8 percent over 1989-90. However, commitments again rose in 1994-95, but their trend could not last for long. Then after 94-95, commitment faced a downward trend during 95-96 and also in 96-97. The commitments for 1997-98 are estimated to go up again to \$3,322 million.¹⁵ In total commitments, the share of consortium sources is almost two-third and rest is from Non-consortium sources and Islamic countries.

¹⁴ Economic Survey 89-90, Economic Affairs division, Ministry of Finance, Govt. of Pakistan, p. 183.

¹⁵ Ibid., p. 96.

The disbursement of aid as a proportion of total commitments with some fluctuations has declined over time. The gross disbursement fell from 104 percent of total commitments in the Third Plan period (1965-70) to 65 percent in the Sixth Plan period (1983-88). But it rose to 87 percent during Seventh Plan period (1988-93) and further to 99 percent in 1993-94. The ratio fell thereafter to 86 percent in 1994-95 but it again picked upto 96 percent in 1995-96 and 127 percent in 1996-97. It is expected to fall again to 96 percent during 1997-98 due to higher commitments.

The element of project aid in the total disbursed amount has been increasing over the years. The share of project aid during 1996-97 was 81.5 percent which is expected to decline to 48.4 percent in 1997-98. The share of non-project aid on the other hand is likely to increase from 18.5 percent in 1996-97 to 51.6 percent during 1997-98 due mainly to higher disbursement of non-food aid. Flow of project aid was not effective because they are of a long-term nature in projects, they did not want to recede from the agreement. But non-project aid which come in the guise of food commodities mainly were adversely effected due to sanctions imposed by donors aftermath of the Kargil crisis.

Table 2.2
Debt Servicing and Net Transfers

Year	Gross Disbursements*	Debt servicing**	Net Transfers (N.T.)	(in \$ million)
				NT as % of Gross Disbursements
1990-91	2044	1316	728	36
1991-92	2366	1513	853	36
1992-93	2437	1648	789	32
1993-94	2530	1746	784	31
1994-95	2571	2042	529	21
1995-96	2555	2136	419	16
1996-97	2231	2265	34	(-) 1
1997-98	3201	2416	785	24

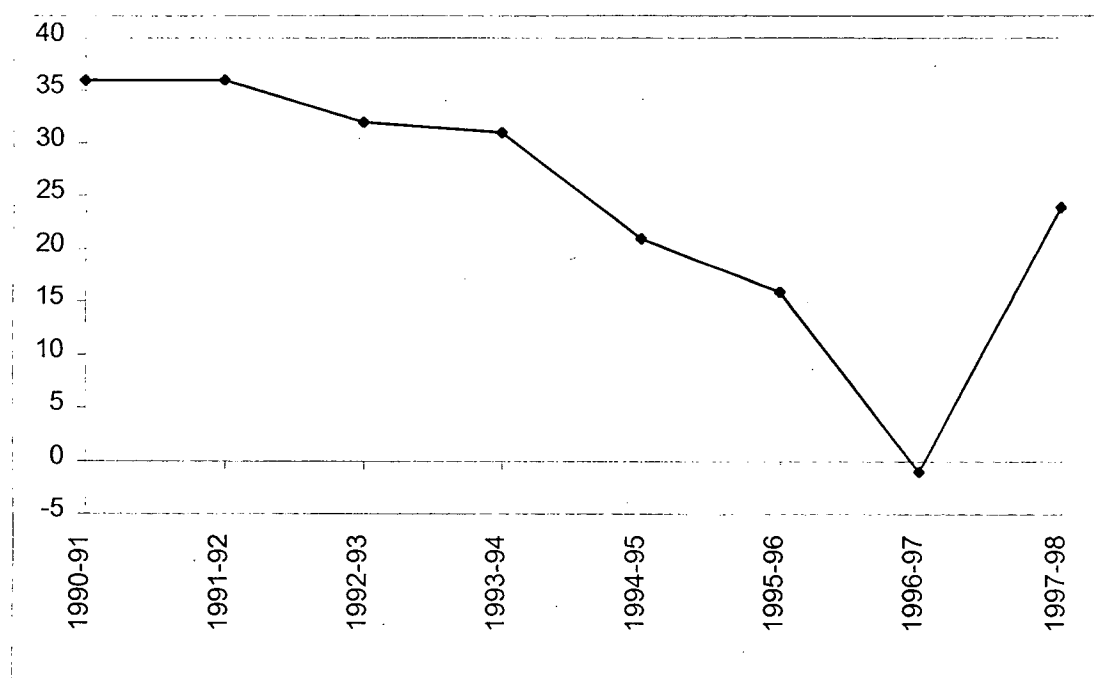
Source: Economic Affairs Division

* Excluding relief assistance for Afghan refugees.

** Excluding interest on short-term borrowing and IMF charges.

Figure 1

Net transfer of Foreign aid as percent of gross disbursement



The period from 1990-98 saw a dramatic change in the world political and economic scenario. By the prescription of World Bank and IMF. Most of the aid receiving countries were forced to bring about adjustment in their internal policies. Thus Pakistan was not an exception to it. The developed countries had already started minimising assistance, and multilateral aid had a major role at that time. Multilateral donors like IMF and World Bank set certain conditionalities before the developing countries to meet. More stress was given on internal mobilisation of resources. Net transfers saw a fluctuating trend. In 1991-92 it was highest, which stood at \$853m. But in 1996-97 it was only \$34m. Apart from this in 1992-93 and 1993-94 it saw a steady decline. In 1994-95 and 95-96 it was half of the amount given in 1991-92. But again 1997-98 the net transfer had a meteoric rise as compared to 1996-97. The gross disbursing also had a fluctuating trend. It basically depended upon donor attitude. It saw a steady rise and fall during subsequent years from 1990-98, the gross of disbursement was quite higher which stood at \$3201m. Most of the disbursement was meant for debt servicing. Over the years from 1990-98, debt servicing as a percentage was higher. This shows Pakistan's over dependence on aid and simultaneous transfer of funds for debt servicing to avoid balance of payment problem.

Assistance from IMF

The IMF Trust Fund loans, signifies the increase in the IMF's importance as a source of aid. IMF's aid has been in the form of loans with no grant element to Pakistan. By virtue of being a member of most western aid consortium, the IMF occupies a pivotal position in the sphere of international financial transactions and thus has influenced the aid-giving policies of a large number of western countries/agencies. Moreover, since IMF credit is, in most cases, conditional on recipient countries, adopting certain policies, the IMF can greatly influence the pace and pattern of their economic development. IMF provides loans through the Extended Fund Facility which keeps very stringent terms. Whatever the merits and demerits of the IMF policy package, the IMF has surely come to exercise significant control over domestic economic policies.

The burden of excessive dependence on foreign aid has been caused largely by a combination of two factors. Firstly, the shift in the composition of aid from grant to hard loan over time, taken up a relatively large share of the aid for debt servicing thereby reducing the amount of net aid available for financing imports and investment.

Second, the terms and conditions attached to tied credits have imposed both economic as well as political costs on the country. The higher prices charged by suppliers in donor countries

coupled with their control over economic policies have weakened the effectiveness of foreign aid as an agent of structural change on Pakistan.

During the period 1988-89 IMF Trust fund loans in the guise of structural adjustment facility was extended to Pakistan. Though the amount was meagre, it helped in averting the balance of payment problem. Due to financial reforms undergoing and the disintegration of former Soviet Union, multilateral assistance was made highly conditional in the sense, Pakistan was asked to minimise its debt burden. IMF showed a hesitant attitude towards bailing out Pakistan from the debt crisis. Since, the previous funds allocated to Pakistan were not utilized in a proper way, the multilateral bodies started minimising the amount and simultaneously released funds under various sub-heads. During the year 1991-92, IMF's allocation through structural adjustment facility was nil. During the Sixth Plan period, the share of grant and grant like assistance was 23 percent, but during Seventh Plan period it fell to 16 percent. The share of grants which was 9 percent during 1996-97 is likely to decrease further to 6 percent of total commitments in 1997-98.¹⁶

¹⁶ Economic Survey 1997-98, Economic Affairs Division, Ministry of Finance, Pakistan, pp. 95-96.

CHAPTER III

PAKISTAN'S EXTERNAL DEBT PROBLEM

According to classical theory of under-development, lack of capital was always regarded as one of the main causes of the backwardness of the developing countries. For that reason, recourse to foreign credit and investment was viewed as a normal element of economic policy in the countries of the developing world. However, bilateral credits with former metropolitan power or aid from international bodies, as well as loans from the World Bank or the international development association were considered to be the prime ways of injecting capital into the developing countries. Until the end of the sixties, it would have been unthinkable for countries like Pakistan to become the leading borrower on the international capital markets, or for the amounts borrowed to reach today's levels; this was so for several reasons:

- the weakness of the economic structures of Pakistan and its consequent lack of creditworthiness.
- the erratic fluctuations of its external earnings and its foreign exchange reserves, which made it even harder for Pakistan to repay what they had borrowed.

- its limited capacity, for the absorption of capital, lack of qualified personnel, lack of infrastructure and lack of skilled labour etc.

If the foreign debt of the countries of the developing world continues to grow at its present rate, then they are gradually going to find themselves increasingly cornered in their dealings with the international capital markets and therefore with the industrialised countries and also with the two principal bodies for international financial intervention. Moreover, one can not fail to be struck by the coincidence between, on the one hand, the sudden renewal of the international credit mechanisms and their expansion to the developing world, on the other hand, the dislocation of the international monetary system.

“It is tempting to revert to certain classics of Marxism, particularly to Hobson, Hilffending, Lenin and Rosa Luxemburg to show that the current expansion of the international credit mechanisms signals the beginning of a new phase of imperialism which has been generated by the capitalism of the industrialised countries.¹”

¹ H. Magdoff: *The Age of Imperialism: The Economics of US Foreign Policy*, pp. 67-115, 1969.

3.1 Causes of Rising Debt

In a less developed economy like Pakistan, saving is normally too low to allow the warranted rate of investment. The country therefore, borrows funds from external sources to bridge the investment-saving gap and make investment possible. If the borrowed funds are not utilised effectively, enough savings will not be generated to a level to repay the debt. Indebtedness will then attain unmanageable proportions that may adversely affect the process of growth.

“The logic of debt acquisition is reinforced by theories of life-cycle consumption, where an individual on house-hold may maximize the welfare derived from a given life-time income by going into debt at certain stages in the life cycle; it is much the same for developing countries like Pakistan.”²

Country borrowing funds from external sources for bridging investment-saving gap and making investment possible, which is followed by a “dual gap” approach. The proponents of the “dual gap” approach are of the view that, it is not the existence of the investment-saving gap alone that compels a country to borrow from abroad. There is also an import-export gap or foreign exchange gap that needs to be bridged to activate the process of development.

² Ed-Graham Bind, Third World Debt. The Search for a Solution (1989, London), p. 1.

The external causation argument suggests that debt problems are not primarily caused by domestic mismanagement but rather by exogenous factors beyond the control of domestic governments. External factors include deteriorating income terms of trade caused by falling growth in the demand for primary products and rising interest rates caused by the stance of macro-economic policy in the developed countries.

External debt is a combination of long-term debt, short-term debt and the IMF credits. Long-term debts form the main components of total debt. It is either a public or publicly guaranteed debt or a private non-generated debt.

A particular amount of debt may be burdensome for one set of countries, but the same amount may not be burdensome for another set of countries. In fact, debt burden is a relative concept. It is assessed in relation to the country's national income, export earnings or its foreign exchange reserves because if a country has large export earnings or a large national income, it would be easy for it to service its debt. On the contrary, even a small debt may prove burdensome if the country's foreign exchange earnings are poor.

Generally speaking, external indebtedness is not so much of the total liabilities of a country but a continuous flow of new loans and outflows of foreign exchange to service previous debts.

Indebtedness of developing countries is the cause of accumulation of deficits, forcibly arising out of the balance of payments deficits of these countries. Debts are part of capitalist function, based on international and monopolistic conditions in which capital accumulates and reproduces.

The external availability of technology and capital is now accepted as desirable on the theoretical as well as policy basis. A good number of developing countries decided to resort to foreign borrowing in the recent past not only to cover the current account deficits, but also their balance-of-payments and budget deficits. While the total foreign debt of developing countries has grown recently because of the growing demand for resources the excess supply of money in world markets has also been an important reason for the growth in debt.

The governments of developing countries often resort to foreign financing in order to expand or maintain social programs or infrastructure investments. The performance of official enterprises is another reason for the growth of foreign indebtedness. A number of factors explain the presence of such enterprises in developing countries, notably: First, general political considerations that cost the state in the role of sole promoter of strategic sectors of the economy, Second, in some cases "national security" considerations are adduced; Third, the political propensity to nationalize certain

activities that used to be in the hands of foreign capital; and lastly, considerations of regional development in extremely backward regions.

Foreign indebtedness is also generated whenever the private domestic sector borrows from abroad and if the government acts as an underwriter. Growing foreign exchange requirements of transnational firms tend to deepen the crisis of indebtedness. The growth of the official foreign debt has affected a large number of developing countries because of heavy burden of serving this debt.

3.2 Backdrop of the Present Debt Crisis in Developing Countries

Hence, it would be pertinent to refer to the factors responsible for the debt crisis of early 1980s among the developing countries like Pakistan.

“Due to the first oil shock of 1973-74, the balance of payment position of the non-oil producing donor countries worsened. Their ability to lend as well as to replenish the IDA’s resource pool was badly affected and weakened the flow of multilateral and bilateral resources. The flow of ‘official development assistance’ as percentage of total official lending dropped from 67 percent in 1970 to 60 percent by 1980.³ This means that the share of non-

³ Ishrat Husain-Pakistan, *The Economy of an Elrutit State*, (Karachi 1999), p.305.

concessional official loans got larger and resulted in greater interest burden on the developing borrowers.

The debt problem would not have been serious had there been regular flow of loans and the borrowing countries could have got new loans to repay the older ones. The supply of funds with the international banks was squeezed all of a sudden. Moreover, in the absence of proper screening of projects the loans in many cases proved bad debt losses. The borrowing countries began defaulting on the loans. As a sequel of these facts, the banks went for an abrupt cutback in lending. So the borrowing countries did not get loans for servicing of past loans and the debt problem turned grave.

Apart from the activities of the international banks, it was the transition from inflation to disinflation that aggravated the problem of indebtedness. Funds were borrowed in the 1970s, when inflation was high and real interest rate was low, or in some cases negative, but during the 1980s when the industrialised countries adopted restrictive monetary policies, disinflation began to appear.

The deteriorating terms of trade of the net oil importing developing countries during 1980-82 caused the debt crisis. The lower cost of borrowing motivated the developing countries to jack up expenditure and to borrow more when the export prices fell during the 1980s, the borrowing countries suffered severely and found it difficult to repay external loan.

Defective policy of the developing countries was evident in improper foreign exchange rate management policy. Structural economic rigidities too, especially in the low income countries came in the way of policy changes designed to overcome indebtedness. These rigidities manifested in lack of economic diversification, a concentrated export base, high population growth, lack of basic facilities and poor living conditions etc. They adversely affected the incentive to save and invest and to generate the income necessary for repaying debt.

In the 1990s, after the break up of the erstwhile USSR, the economy of most of the countries coming out of the USSR bondage was so weak that their trade with the rest of the developing world came to be at the lowest ebb. The export earning of most developing borrowers declined and this eroded their repaying ability. The financial crisis in East Asia adversely affected the debt repaying capacity of countries not only the countries slipped into the crisis but also many others that were indirectly affected by the crisis.

3.3 Pakistan Case/Case Study of Pakistan

Pakistan is one of the group of developing countries which have relied heavily on external sources of financing for its development. A combination of propitious factors has enabled Pakistan to attract a relatively high level of external resources in the past (more than 10 percent of GDP), but it is becoming clear

that this level is untenable over the long run. The costs of this heavy dependence on external resource flows have started manifesting themselves in various forms.

Pakistan in its present geographical form emerged as a separate political entity after 1971. But during the period 1947-58, Pakistan's GDP growth rate was 3.1 percent per annum. Foreign resources flows were insignificant and mainly provided for technical assistance. The 'heyday' of Pakistan's economy remain the decade of the 1960s, when the GDP growth rate averaged 6.8 percent annually. The investment rate reached a peak of 23 percent in 1964-65 and foreign resources financed almost half of this investment."⁴ The separation of East Pakistan, the two oil shocks and a fundamental change in the economic philosophy of Pakistan accentuated pressures on the external finances of the country in 1970s. Since 1970 the external debt liability of every Pakistani has risen from Rs. 300 to Rs. 1,750.⁵ Physical infrastructure such as irrigation, electricity, roads, highways, telecommunications, railways and other capital assets being financed by external resources rose the debt burden. Saving rates have remained low not much above the level in the 1960s and the trade gap has widened.

⁴ Ibid, pp.301-202.

⁵ Anwar S. Dil, Political Economy of Pakistan, 1970, p.249.

Here our concern would be to analyse the present debt situation spanning from 1989 to 1999. Towards the close of 80s and at the onset of 1990s, Pakistan's debt situation has been consuming more than half of the country's annual revenues. Thus high current account deficits have become more problematic in the 1990s than in previous decades.

“The 1990s have been characterized by a series of important shifts in the nature of capital flows to the Pakistani economy, the implication of these changes for the country's debt profile are equally important.” Major change seen in the composition of external financing-away from bilateral grants and concessional financing. This shift, motivated by changing political orientations and “donor fatigue” on the supply side, has led to a sharp increase in Pakistan's interest and debt service cost over the 1990's.”⁶

A second key shift has been in the composition of debt stock. Total debt stock has risen sharply, from \$3.1 billion in 1970 to almost \$10 billion in 1980, to \$30 billion at the end of 1995. To tackle the problem of rising debt, the Prime Minister's National debt Retirement programme was introduced to involve the public to capitalise on their patriotism and enthusiasm, where it was hoped that the public will help ease the burden of debt upon the

⁶ Pakistan; The Economy of an Elitist State, 199, pp-304.

government, by reaching well into their own pockets and contributing to the government funds.

“Given the excessive debt that has accumulated over the last few years, it is not likely that any recourse to patriotism will result in more than a miniscule amount being pocketed and the ‘debt’ “burden” or “problem” is unlikely to go away for a long time to come.”⁷

If the question of debt burden is to be considered, the fiscal deficit forms an important part of the equation. Deficit has been negative for the last few years in Pakistan. In order to cut the fiscal deficit and be as close to the 4 per cent target proposed by the IMF and endorsed by the caretaker government between November 1996-February 1997, Pakistan’s development expenditure will be no more than 3.4 per cent of GDP, down from a peak of 9.3 per cent a little over a decade ago.

Pakistan’s external debt cannot be discussed in isolation from its macro-economic policies and performance. The revenue base is inelastic, relying mainly on international trade taxes on a limited range of commodities. Government consumption expenditure has almost doubled in the last ten years, while development expenditure has been cut drastically. Public sector deficits in the 1980s were financed through a combination of

⁷ S. Akbar Zaidi, *Issues in Pakistan’s Economy*, 1999, p. 247.

concessional external borrowing. The recent liberalization of the foreign exchange regime and the auctioning of government debt will eliminate the implicit subsidy enjoyed by the government so far.

In order to alleviate its fiscal deficit and improve efficiency in the use of resources, the government has embarked upon an ambitious privatisation programme. This has partially relieved the government's burden by providing over \$2 billion in revenue. These proceeds have been generated by the sale of profit-making enterprises. The choices in the use of the privatisation sale proceeds will have a bearing on the debt situation too. If these proceeds are used to pay off high cost external debt, there will be net savings in the fiscal account. While privatisation represents an important short-term, stop-gap measure, more comprehensive fiscal reforms will be needed to address Pakistan's high fiscal deficits and consequent reduction in the debt burden.

“Pakistan's domestic debt has grown to higher proportions and was 44.2 per cent of GDP at the beginning of the year 1994-95, and it was equal to the foreign debt. Thus, the total debt was equal to 88.4 percent of GDP.”⁸ Debt servicing tends to be high with foreign debt repayment and interest on foreign debt. The proponents are of the view that high interest payments each year are causing a huge drain on Pakistan's economic resources. Thus Pakistan must retire some of its debt it is to deal with problem of

⁸ S. Akbar Zaidi- Issues in Pakistan's Economy, 1999, p. 248.

high deficits and low growth and other repercussions. In this regard, it would be better that proceeds from privatisation should be earmarked for debt retirement.

The government of Pakistan has implemented a large number of reforms in different sections of the economy to deal with the debt crisis.

Let us examine the case for the structural adjustment programme of 1988, which is a major step by the World Bank to help countries deal with their debt problem.

The overall perception by the World Bank and IMF of their policies in Pakistan seems to be mixed. The Savings/investment balances are significantly less than those targeted under the 1988 programme. Large fiscal deficits persist and are a source of financial instability. The new structural adjustment programme, which began in 1993 initially for one year, and then subsequently ran from 1994 to 1997, has features that, are quite similar in principle to the 1988 programme. The 1994-97 programme was halted by second Benazir Bhutto government in 1995, but her government was forced to go back some months later and agree to a stand by loan on stricter term.

The general proposition put forward by the IMF/World Bank in order to convince governments that they ought to apply for structural adjustment loans is that their countries are in a bad

economic state. They are told that there are major structural problems, the balance of payments is in critical deficit, the budget deficit is high, inflation is rampant and the growth rate of the economy is too low and unsustainable in the long run.

Structural-adjustment programme has been particularly successful in Pakistan. The opening up of the stock markets to foreign investors and the launching of “Pakistan Fund” have already produced very positive results. “National Debt Retirement Scheme” introduced in 1997 under the Prime Minister-ship of Nawaz Sharif has yielded good results. The debt problem has been eased to some extent due to large FDI inflows, because Pakistan is now less dependent on loans provided by multilateral bodies. The macro-economic reforms in Pakistan has enabled it to manage the debt problem in a lighter manner.

Table 3.1
External Debt Position of Pakistan Compared to India

Countries	Debt (US \$ Billion)		Debt Service Ratio		Debt Servicing as percentage of GNP	
	1970	1983	1970	1983	1970	1983
Pakistan	3.1	9.8	23.5%	28.1%	1.9%	3.4%
India	7.9	2.12	22%	10.3%	0.9%	0.7%

Source: World Development Report, 1985.

Table 3.2
Rise in Pakistan's Debt Stock

1970	1980	End of 1995
\$ 3.1 Billion	\$ 10 Billion	\$ 30 Billion

Source: Economic intelligence unit, Pakistan-1995

A high level of external debt has come to occupy almost a permanent place in the development policies of Pakistan. For quite some time to come, considering the present conditions of the world markets and the patterns and attitudes of the developed countries, some substantial gap will always remain in the balance of payments of the country. With this gap and the increasing service charges on the existing debt the volume of external debt even with all the care and restraints will continue to rise.

3.4 Trends in External Debt

The financing of external debt is linked up with the functioning of the banking system. Creation of external debt is directly related to the expansion of the imports of the country. The creation of additional debt would be accompanied by the expansion of international trade. In addition to the creation of external debt, there is the inflow of private capital in the country. With the increase in external debt, the problem of paying the interest charges on the debt acquires great significance. The debt obligations have to be accepted because today for the developing economies which rely heavily on foreign aid the opportunity cost of default is very large. The confidence of the creditors has to be kept up and this needs not merely a record of satisfactory economic progress but also timely payment of the interest charges and loan repayments.

Table 3.3
External Debt

(in \$ million)

	90-91	91-92	92-93	93-94	94-95	95-96	96-97	97-98
Disbursed & Outstanding Debt*	15,471	17,361	19,044	20,322	22,117	22,275	23,145	24,545
Debt Servicing**	1,316	1,513	1,648	1,746	2,042	2,136	2,265	2,416
- Principal	782	921	999	1078	1294	1346	1520	1700
- Interest	534	592	649	668	748	790	745	716
Debt Servicing as % of FEE as of GDP	13.7	13.4	15.3	16.2	16.5	16.7	17.6	18.1
- Outstanding Debt	34.0	35.6	36.8	39.0	36.3	34.5	37.5	38.4
- Debt Servicing	2.9	3.1	3.2	3.3	3.4	3.3	3.7	3.8
As % of Export Earnings								
- Outstanding Debt	252.3	251.5	279.5	298.7	271.8	255.8	278.2	283.3
- Debt Servicing	21.5	21.9	24.2	25.7	25.1	24.5	27.2	27.9

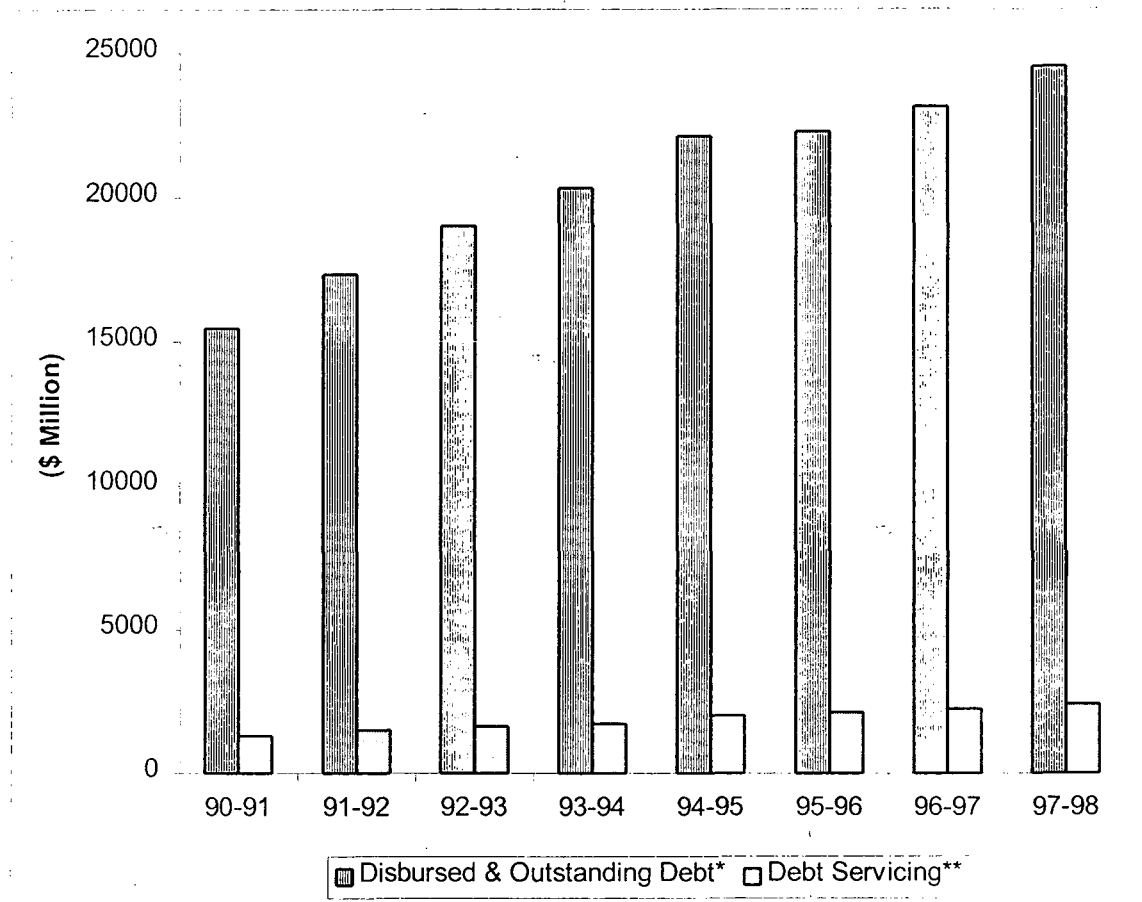
Source: Economic Affairs Division & Economic Adviser's Wing

* Regular debt (payable in foreign exchange only). Medium and long term.

** Excluding interest on short term borrowings and IMF charges.

Figure 3.1

Debt Outstanding and Service Payments during 1990-98



The debt burden can be reduced by selective external borrowing. The problem of servicing of external debt is significant even from the aspect of making some changes and formulating the future policies of external borrowing. The debt service ratio depends not merely on the total volume of the debt and the rate of interest at which the debt is raised but also on the terms of the loans acquired by the country. Some external loans may be partly or fully repayable in local currency and this would reduce the burden of

repayment of the debt. The burden is related to the composition or the maturity pattern of the debt. The maturity pattern determines the debt servicing and this is significant because many a times country is not free to determine the maturity pattern of its external debt which is largely influenced by the policies and preferences of the creditor countries. When the country is not able to repay, there arises the need for the rescheduling of the loans or the granting of moratorium.

With the increasing external debt, the quantum of service charges go on increasing. Increasing need for imports also contributes to this burden of increasing debt and service charges. The export earnings are low in the context of two requirements, payments for imports and the payment of service charges. There are also fluctuations in export earnings which are partly the result of fluctuations in internal production or external market demand and partly the result of fluctuations in prices, especially of those products which are largely exported by the developing economies. These conditions create the problem of frequent foreign exchange crises and larger short-term borrowing either from the banks or organisations like IMF.

The expanding external debt of Pakistan has led to the creation of various problems in the working of internal economy. This external debt largely in the form of foreign assistance has

acquired a permanent place in the international transactions of the developing economies and also has been linked up with the internal development policies. With the expansion in volume of debt, the role of public foreign capital has become more significant in relation to the problems of economic growth in the developing economies.

The foreign aid which began in a philanthropic or humanitarian tone, is acquiring a definite economic role in the process of development and it is from this aspect that the problem of external debt have to be viewed. In spite of all the problem and difficulties arising out of foreign aid, external debt has played an active role and helped the development process in many developing countries.

There is an existence of some inflationary potential in the process of creation of external debt. External debt is considered to be a temporary phenomenon in the international transactions of a country. The problem of debt servicing are more difficult in the case of external debt due to the need for the creation of export surplus and thus have a significant influence on the formulation and implementation of policies in the debtor countries.

The creation of external debt by and large has been helpful in the process of economic growth of Pakistan and the situation in relation to debt servicing is quite a difficult one at present. The

difficulties arise out of certain basic conditions existing in a developing economy and the limitations of the policies adopted in the economy. The policies of the Pakistani government under the plans have also contributed to the difficulties. The policies of the creditor countries are also responsible for the present situation.

It is in this context that the future policies of debt creation and debt management have to be carefully analysed and formulated.

CHAPTER IV

CONDITIONALITIES OF AID AND ITS SOCIO- ECONOMIC IMPACT

Foreign aid, by definition, represents an intervention in the recipient country. In the 1990s, aid donors have increasingly made official development assistance otherwise known as aid, conditional on political and administrative reforms in recipient countries. To define, conditionality is an instrument by which strategic objectives are pursued. Aid, in its many and varied forms is relatively a new phenomenon, dating back to the late 1940s and early 1950s. This is basically traced to the Marshall Plan, which involved huge financial transfers from the US government to a war-ridden Europe after World War II. This generosity of US was coupled with enlightened self-interest in creating external environment for economic interests and the security interests in the emerging bipolar world.

Aid, from the very beginning, became an instrument in the international power play between the emerging superpowers in the bipolar world system that evolved after world war II. During the late 1940s and early 1950s, western powers were quite open about the fact that containing communism in the third world was the primary purpose of aid. At that time, the United States posed as the most

generous aid giver not only in absolute terms but in relative terms as well. However, it was not only the west which used aid as a foreign policy instrument, the USSR and Eastern bloc used aid extensively, targeting it at strategically important governments.

In the 1950s and early 1960s, a large number of newly independent nations changed the face of the United Nations, bringing with them a concern for world poverty and the development needs of the South.¹ This event made the development issue a top priority of the international agenda. In turn, this created a feeling among the superpowers to the prevailing needs of the South. Thus development aid emerged as the primary mechanism designed to address the task. Most donor governments have given high priority to poverty alleviation, seeking to contribute to lasting improvements in the lot of the worst-off. Social justice has been the main justification and core objective of development aid, especially for the most aid providers.²

During the 1960s and 1970s, a large share of aid-from bilateral and multilateral sources alike was directed towards projects within a variety of areas and sectors and with a broad range of purposes. Projects were extensive both in terms of scope and financial input, and some programmes, which included several single projects, such as sector programmes, may have many of the

¹ Stokke olav, *Aid and Political Conditionality*, (ed.), 1995, p-6.

² *Ibid*, p-19.

characteristics associated with a project. For the projects, which involved a large number of activities contradicts the recognition of development as a holistic process. Sectoral programmes added greater value because they were aimed at certain activities, which were having immediate results.

4.1 Preface to Aid Conditionality

During the formative years, when bipolarism became the buzzword, to set the recipients on respective sides, superpowers started attaching conditions to aid given by them. This phenomenon was identified with the tradition of 'Realpolitik' in the cold war setting. Quite a few conditions were associated with policy objectives within the donor society which competed with the developmental ones. Others were associated with the objectives set for aid, typically expressed in the project aid concept and others again associated with more lofty developmental objectives, such as poverty alleviation or even the promotion of social justice.³

The definition of aid conditionality is a controversial one. The key element in it is the use of pressure, by the donor, in terms of threatening to terminate aid, or actually terminating or reducing it, if conditions are not met by the recipient. "The definition places the emphasis on coercive aspects of denial of aid resulting from non-compliance on the part of the recipient government to demands for

³ Op.cit, p-7.

reform.”⁴ Foreign aid is used as a lever to promote objectives set by the donor which the recipient government would not otherwise have agreed to. The donor may set the pursuit of such objective, by the recipient, as a condition for entering into an aid relationship on expectations of the recipient’s progress towards meeting these objectives may be expressed beforehand and followed up afterwards.

The roots of today’s conditionality clearly demonstrate that different types of aid conditionality apply at several levels and that it may have quite different objectives. It is also apparent that the current trend is towards increasing conditionality with an even higher degree of political interference. However, donor countries have not been identical in their approach, whereas the major powers have directly or indirectly, pursued policies involving conditionality at a high level of political intervention throughout the aid age.⁵

4.2 Aid Conditionality as a Strategy

Most donors pursue many and sometimes conflicting values and interest at the same time. However, important core values of certain kind are involved, which are considered significant by donor. Balance of power is the decisive factor in an interaction

⁴ Peter, P, Waller-Aid and Conditionality, 1994, p-12.

⁵ Olav Stokke, - Aid and Political Conditionality, 1993, p-13.

between a donor and a recipient government which involves the various agendas of aid conditionality.⁶ In the above context of power play, bilateral donors have slim probability of threatening the recipient of withdrawing aid or even of an actual withdrawal or freezing of aid.

4.3 Levels of Conditionality

Aid conditionalities are applied at several levels and that it may have quite different objectives. It is also apparent that the current trend is towards increasing conditionality with an even higher degree of political interference. However, donor countries have not been identical in their approach, whereas the major powers have, directly or indirectly pursued policies involving conditionality at a high level of political intervention throughout the aid age. Attaching conditionalities represents a recent trend which was more vigorously pursued during late 1980s and 1990s.

The first and foremost objective pursued by the donors as a conditionality are the pressure for democratic reform and the introduction of a multi-party system and free and fair elections as well as improved human rights. Some also include the good governance agenda in general. Secondly, some donors demand for an open economy and for the removal of traditional mechanisms of state interventions into the domestic market and those determining

⁶ Roger C. Riddell, 'The Ethics of Foreign Aid, 1986, P-43.

inter-state economic transactions. They include, too, prescriptions for a reduced role of the state in the economy in terms of owning and running productive enterprises.

Sometimes donors also attempt to change national policies and priorities of the recipient, which involve economic policy of the recipient country and also human rights and good governance in the recipient country. Mostly attempts are made by donors to change specific policies within an area or a sector. Sectoral policies may have a national bearing involving taxes and prices. Another kind of condition attached on the recipient which refers to some programme or project. Generally, conditions attached to projects are in the nature of institutional contributions. These above conditions determine how the recipient uses its own funds. The selection of project activities and technology influences policies and priorities at the recipient side.

Lastly, administrative conditions also apply, involving procedures for the transfer of resources, accounting, reporting, evaluation, privileges enjoyed by technical cooperation, personnel and project/programme related imports etc.

4.4 Objectives of Aid Conditionality

In a development assistance relationship, some objectives are legitimate which are directly related to the development agenda.

Some objectives relate to donor's interests and values, and they link to developmental objectives set for aid, which are quite indirect in nature.

The particulars of the development agenda have changed over the years. In the 1960s and 1970s, economic and social development and poverty alleviation held a prominent position. During most of the 1960s, the main concern was economic growth. Aid was targeted more directly to improve the lot of the poorer segments of the population. Thus aid was assumed to affect the welfare of poor people. But in the mid 1970s, basic human need emerged as the focal point for aid. Several bilateral donors targeted part of their aid to vulnerable social groups, children, women or the poorest groups in general. In 1973, at the annual meeting of the World Bank, the president of the Bank identified the poorest 40 percent of the population as the target group. A revival of this concern, after the pre-occupation with macro-economic structural adjustments in the 1980s, is reflected in the focus on human development in the 1990s, driven by the United Nations Developments Programme.⁷

⁷ Mosley, Paul, Jane Harrigan and John Toye, *Aid and Power. The World Bank and Policy Based Lending*, Volume 1 and 2, 1991.

4.5 Generations of Conditionalities

First generation of conditionality focussed on economic reform and came in the wake of the growing economic crisis of many Third World Countries. The sources of 1970s and 1980s economic crises were many and varied which includes-increase in the price of petroleum on which the economy of non-oil exporting countries had become dependent. The prolonged recession in industrial countries and the deteriorating terms of trade for raw materials wit heavy debts and increasingly onerous debt-servicing as a result of rising interest rates as well as continuously deteriorating productivity, terms of trade and market opportunities – the economic situation of the developing countries became desperate. The financial institutions abandoned their ‘open purse’ policy and insisted that loans were paid back as quickly as possible. In this situation the International Monetary Fund (IMF) designed for short-term stabilisation of balance of payments crises. Under this, the countries grappled with the problem had to observe certain conditions before the IMF would agree to assert with short-term credits.

“According to IMF analysis, the crisis of individual world countries was caused by excessive government spending, resulting in budget deficit and inflation, over-valued currencies, disproportionate imports in relation to exports; and insufficient

attention to factors on the supply side. The prescription accordingly was to correct these areas of neglect. The domestic policy of individual countries had to be reformed. Economic reform was made a condition of assistance through structural adjustment loans.”⁸ The World Bank joined forces with the IMF, the main bilateral donors and in the second half of the 1980s like minded governments also fell into line with few other sources of finance, debt-ridden Third World Countries had little choice to accept the conditions.

“The politics of IMF and World Bank under the first generation of conditionalities involved

- (i) Resource mobilisation measures to facilitate the development effort.
- (ii) Changes in key policies designed for the industrial and foreign trade sectors.
- (iii) Suitable pruning – picturing of the government’s budget deficits.
- (iv) The subsidy to fertilizer/agro sector to be ended by 1985.
- (v) The price of gas would be raised to 2/3rds of the international price of finance by 1988, a condition which

⁸ Fahy John. C. Aid and IMF Conditionalities: A Critical Assessment, 1984, P-241.

was largely satisfied by the drastic fall in oil prices in 1986.

- (vi) Prices of agricultural inputs would be revived upwards sharply.”⁹

“As the years raced on, the developing countries being starved of funds approached IMF for extending more fund to the government. Then IMF prescribed some criterion under which loans were given.

- (i) A depreciation of the rupee by 20%.
- (ii) Future competitiveness in exports to be maintained by periodic downward adjustments in the value of the rupee.
- (iii) A policy of further liberalization of imports thereby exporting the domestic manufacturing sector to a more competitive environment.
- (iv) Restructuring of the taxation system to shift taxation from imports – custom duties to domestic production and consumption – excise duties and sales tax.

⁹ Shahid Kardar, Political Economy of Pakistan, 1987, P-273.

- (v) Transformation of the industrial sector through deregulation and privatisation, greater reliance on market forces and a progressive elimination of price controls.”¹⁰

Towards the end of 1980s systemic transformation in Eastern and Central Europe and the disintegration of the erstwhile USSR triggered off second generation conditionality. More emphasis was given to political reform as a condition for aid. In the emerging world order, with the competition between east and west for political influence and strategic positions, western governments felt freer than before to pursue basic concerns vis-à-vis the governments of the South.”¹¹

There are inter-linkages between the first and the second generation of aid conditionality. Structural adjustment programmes prescribed under first generation conditionality had produced results in terms of economic recovery. This achievement was well-recognised in the IMF and World Bank. But under second generation conditionality, economic reform was sought to be combined with reform of the political and administrative systems. The new forms of conditionality was hailed as an ideological device

¹⁰ Fany, John. C., *IMF Conditionality, a critical assessment*, 1984, P-267.

¹¹ Olav Stokke, *Aid and Political Conditionality*, 1995, P-9.

seeking to replace the vision of socialism with that of capitalism world wide.¹²

Conditionalities attached to development assistance is primarily associated with state-to-state relations and international agency-to-state relations involving development assistance. The donor sets certain conditions to be met by the recipient as a pre-requisite for entering into an aid agreement or for keeping up aid. However, it may also affect official development assistance channelled through NGOs and the private sector in general. Actors within the private sector and NGOs of a donor country may set conditions for involving themselves in activities in a recipient country.

4.6 Conditionalities Applied in case of Pakistan

Pakistan started receiving aid from the early part of 1950s. Its acceptance of aid from donors under liberal conditionality to hardened provides a true history of Pakistan's over-dependence on aid.

During the mid 1950s to late 1960s the dominant aid philosophy was humanitarian, philanthropic and altruistic. At that time population was generally supportive of a humanitarian mission. At that time main focus or objective of aid was economic

¹² Banny Gills, *Low Intensity, Democracy*, 1993, P-54.

growth, fighting poverty to improve international peace, international security and national image abroad. At that time there was greater flow of bilateral aid than multilateral aid and moreover, aid was predominantly untied in nature. Most importantly, there were virtually no explicit conditionality attached to aid at that time.

But late 1960s to mid 1970s brought another face to aid conditionality. It was marked with donors enlightened self-interest with the dominance of philanthropic attitude towards recipient. The objective was growth with equity: meeting basic needs of the poor. This period saw a balance between multilateral aid bilateral assistance. Social justice as a conditionality was attached implicitly to the aid programme.

From mid 1970s to mid 1980s, self interest started growing. Growth and economic liberalisation became the main agenda, mostly aid provided by donors were tied in nature. Bilateral aid was gaining ground and taking the place of multilateral aid. Explicit conditionalities were prescribed by the Bretton Woods institutions - they were Economic Policy Reform: liberalisation and privatisation. Tied aid held a dominant position. As a bold step some bilateral donors converted some aid into grants.

From mid 1980s to the 1990s onwards, the philosophy of aid conditionality was totally changed. The clarion was co-operation for

development and mutual benefit. The public opinion was supportive of this trend. Main objectives during this period was economic and political liberalisation. Bilateral tied aid was increased to maintain the supremacy of the western bloc. The dominant conditionality during this period was political reform, democracy and human rights.

“During 1970, IMF was the first donor agency to express concern about the rapidly rising prices in Pakistan following the first oil shock in the early 1970s. While accepting that inflation and imbalances in the external payments position were likely to be due to severe exogenous shocks, the IMF considered that the government’s failure to enforce monetary stability or to fix the currency at a realistic external value has accentuated price instability in the country.¹³ IMF experts appeared to believe that exogenous shocks could be absorbed by Pakistani economy and that exports and imports would adjust to changes in the world market conditions, provided the government took certain measures: it should

- Refrain from undertaking deficit budgeting.
- Set external value of the currency on the basis of realistic assessment of its purchasing power.

¹³ P. Gotur, *Economic Reform Measures and the Poor in South Asia*, 1991, P-39.

- Offer a positive rate of interest to counteract incentives for a 'flight from money'.

In order to qualify for IMF loans, Pakistan agreed to these conditions and received the support necessary to tide over the temporary difficulties.

However, when these measures failed to resolve the economic problems of the country, the World Bank, acting as the co-ordinator of the donor community, insisted on the adoption of a structural adjustment programme in order to improve macro-economic management.

The most important aspects of the structural adjustment programme of 1988 in the case of Pakistan were

- Privatisation.
- Total withdrawal of subsidies.
- Increase efforts to mobilise more resources by reforming the tax reform.
- Emphasis on the implementation of development projects financed by donors rather than undertaking projects in the hope of implementing them with government support.
- Liberalisation of trade through measures such as the abolition of tariff protection.

These programmes were initiated in the early 1980's. They were extended and streamlined few years later, when the government launched a medium term programme at the behest of the IMF under the structural adjustment facility and again during early part of 1990's under the scheme of Enhanced structural Adjustment facility. The programmes appear to have been designed to accelerate the growth process in the country.

The World Bank and IMF presented a list of reforms and targets that the structural adjustment programme of 1988 hoped to achieve. By that time the government of Pakistan had implemented a large number of reforms in different sectors of the economy. By 1988, Pakistan had managed just a 5.5 percent annual increase at the end of structural adjustment programme. GDP had increased marginally because public gross fixed capital formation had fallen.

“The overall perception by the World Bank and IMF of their policies seems to be mixed. They feel that some positive developments have taken place especially in the case of pricing policies, trade liberalisation, export promotion and some public sector reform.”¹⁴

According to William McCleary of the World Bank, Pakistan experienced a period of rapid growth and in flows of foreign capital which had raised the standards of living broadly across the

S. Akbar Zaidi, Issues in Pakistan's Economy, 1999, P-321.

population. He continues that reforms in Pakistan have been sustained because of the government's incremental and flexible approach and because continued strong economic performance has made it obvious for Pakistan to experience a reversal.¹⁵

The new structural adjustment programme which began in 1993 initially for one year and then subsequently ran from 1994 to 1997, has features that are quite similar in principle to the 1988 programme.

According to Shahrukh Rafi Khan, the impact of structural adjustment programme as applied to Pakistan has impacted particularly the labour and the poor which seems to be severe. Because, structural adjustment programme aimed at cutting of subsidies and downsizing of the unskilled labour force. It aimed to capital intensive technology, tied with projects. This policy of World Bank created huge unemployment in Pakistan. The general sales tax and subsequent inflation hurt the poor low-waged labours.¹⁶

"In 1997, Nawaz Sharif government announced a large number of supply-side measures, such as cuts in income tax, a huge reduction in maximum tariff rate from 65 to 45 percent, with a reduction in tariff slabs. In 1997, the government signed yet another agreement with IMF, which was of worth US \$ 1.6 billion

¹⁵ Ibid. P-321.

¹⁶ Ibid. P-322.

was composed of an Extended Fund Facility and an Enhanced Structured Adjustment Facility.”¹⁷

An examination of the political processes from the early years of Pakistan’s existence show that numerous important political and governmental decisions were influenced by the relationship with bilateral donors especially Washington. Subtle pressure from donors and suggestive decisions has changed the course of history in Pakistan on more than one occasion. From the time of India Pakistan war in 1965 until the Soviet invasion of Afghanistan, Pakistan remained in United States ‘disfavour’. Other multilateral agencies too, were not enthusiastic about providing aid to Pakistan in this period. After this period IMF intervened in Pakistan’s policy option. This trend continued for a long time. Simultaneously due to two oil shocks the debt problem of Pakistan was rising. The 1990’s saw a reform era in Pakistan. The bilateral donors to further their strategic interest attached huge conditionalities to be met by Pakistan in order to avoid the assistance. Thus the bilateral donors have not shown any eagerness in providing a helping hand to Pakistan in the crises and problems. Other way round they have attached hard conditionalities to satisfy their personal ego and interest.

¹⁷ Ibid. P-323.

4.7 ECONOMIC IMPACT OF AID CONDITIONALITIES

“The circumstances under which aid conditionalities are laid down by donors and the institutional and policy environments in which projects and programmes are undertaken makes the use of aid limited.”¹⁸ Bilateral assistance to Pakistan has been very substantial, mostly these assistance have been provided to further strategic interest of the donors. But, in Pakistan’s case, aid contributed to the country’s development by helping to overcome bottlenecks in manpower, infrastructure, technology and foreign exchange availability. More specifically, among the donors, US policy advisers were influential in setting the stage of Pakistan from its outward orientation in development strategies.

The policy prescription by bilateral and multilateral donors has handicapped Pakistan’s initiative towards growth. In all sectors, the economy has been marginalised due to the rising debt crisis. Every time Pakistan enters into agreement with donors for some sort of assistance to come out of the crises. Due to these effects the indigenous technology, manpower has been marginalised to a greater extent. Policy prescriptions by donors for undergoing tough exercise to cut down expenditure have routed the economic base of Pakistan. Still Pakistan has been grappling with the problem of debt, unemployment, poverty, lack of economic

¹⁸ Seiji Naya, *The role of US Economic Aid in Promoting Development*, 1987, P-12.

growth which has created a vicious circle and Pakistan needs to go out of that circle. Otherwise it would be difficult for Pakistan in the future to combat this crisis, for which Pakistan will be a mere puppet at the hands of the donors compromising with its national interest and sovereignty.

4.8 SOCIAL IMPACT OF AID CONDITIONALITIES

Social impact of conditionalities are very much indirect in nature, since they arise out of economic conditions. Due to submission of Pakistan's economy before the donors, the local labour force went without employment, because foreign technology were capital intensive. Cut in subsidies and cut in prices of fertilisers as prescribed by IMF led to large scale shortfall in production. The domestic production suffered a lot. Under commodity assistance, Pakistan was forced to buy food commodities from foreign countries. This led to rise in prices and it triggered off poverty in a massive scale. Socialist welfare orientation of the Pakistani government was changed and capitalist outlook was promoted. Thus poverty and unemployment became the catching note in Pakistan. This led to a lot of social resentment among the poor. This problem could not be tackled effectively because poor people in search of work migrated to other Islamic countries. Thus outmigration posed a problem. Skilled manpower mobilisation became a problem. Due to rising debt crisis, the assistance were

declined, this forced the government to go for domestic resource mobilisation through taxes. Taxes were charged exorbitantly for which the population of Pakistan paid heavily. The lack of macro-economic policy change to tackle the economic crisis resulted in large scale social problems.

CHAPTER V

CONCLUSIONS

Principally, Pakistan gets assistance from three sources such as consortium sources, non-consortium sources and also IMF Trust Fund. Out of these three sources consortium aid was higher during the 50s and 60s. But due to change in strategic equations, most donors have shown disinclination in providing assistance. However, US has always been the highest donor only to counter Soviet influence in Asia. Over the years, due to the growing debt problem in Pakistan, multilateral agencies like IMF and World Bank have prescribed some reforms. These reforms have a negative impact on Pakistan's dependence on foreign assistance. The consortium sources have been marginalized due to non-cooperation among donors and simultaneous hesitation towards giving aid to Pakistan. Due to policy prescription by multilateral bodies Pakistani economy is taking recourse to certain reforms. They are internal mobilization of resources, cut in subsidies etc. With the intensive structural adjustment in the late 1990s, the debt/GDP ratio and the debt service ratio rose compared to the mid 1970s to late 1980s period. Concessional aid as a percentage of the total has fallen, the average interest rate is higher, the maturity period is lower and the grant element is lower. Similarly, the effectiveness of aid has declined by tying agreements calling for the purchase of

equipment and materials from donors at costs much more than cheaper alternatives of similar quality. All the above factors have made Pakistan to take recourse to reforms which have a direct bearing on Pakistani economy. Pakistan with a heavy burden of debt on it, is trying hard to tackle the problem of debt by depending more on the commercial loans attached with harsher terms. This has led to the problem of debt-service ratio. Accumulating debt has posed a threat to balance of payment problem. Thus it can be said that passive attitude of the donors as well as stern reform programmes of multilateral financial bodies have made Pakistan to opt for commercial borrowings with higher interest rates and lower maturity period.

At the start of cold war, both the super-powers started giving assistance to developing countries without any condition. As the years rolled on, the multilateral bodies played more important role in providing assistance to developing countries. Moreover, due to strategic and economic reasons the donors showed disinclination in providing aid. Pakistan as an example had heavy dependence on aid upto last part of 1970s. Thus it was felt, quite unreasonable in Pakistan to mobilise resources on its own. Mostly the expenditure was non-productive. It made the debt burden rising. Every time Pakistan was lucky enough to get US favour. That is why it never showed inclination towards repaying the debt. But when,

multilateral agencies took charge of providing assistance towards the early part of 1980s, they insisted on repaying debt. But Pakistan showed non-compliance to it. When the structural adjustment programme was started in 1988, Pakistan had to undergo a serious exercise by cutting heavily on expenditure job and subsidies. This resulted in a lot of socio-economic problem in Pakistan. Pakistan was forced to undergo reform in order to avail further loans. The nature of assistance was changed. Large scale structural adjustment programme prescribed to bring reforms in Pakistani economy. Pakistani government started mobilising its own resources. Thanks to Pakistani government's initiative, because it has opened its economy for foreign direct investment which has worked as a step to balance the effect of the reform package. However, Pakistan has made itself less dependent on foreign assistance. If this trend goes on in Pakistan, it will not be a problem for Pakistan to bear the brunt of reforms.

Due to over dependence on foreign resources, Pakistan has accumulated a lot of debt. It has made Pakistan to face the debt crisis, which became rampant in the 1990s. Due to unsympathetic attitude of donors, Pakistan is receiving assistance with a total absence of grant element. Pakistan is passing through a problematic phase due to this. There is no immediate permanent solution to the rising debt crisis. But Pakistan as per the policy

prescriptions of IMF and World Bank has undergone vast reforms. Though the conditionalities have made Pakistan to get assistance on harsher terms, it has not stopped its efforts to tackle the problem. The external debt problem which was on rise till mid 90s, has shown a declining trend due to Pakistani governments efforts. Import has been lowered, productive expenditures have been made, subsidies have been cut and foreign direct investment has been encouraged. Thus Pakistan has taken every step to balance the effect of harsh conditionalities on the economy. The effects of borrowing on harsher terms have been negated due to the efforts by Pakistani government. This is how Pakistan government has taken positive steps to manage the debt problem of the future.

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