Comments on Professor Huda's Conference Address: "Planning Experience in Pakistan"

by

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INTRODUCTION

It is a privilege to have been invited to comment on Professor Huda's Conference Address. It is worth noting that five out of the eight gentlemen whose comments appear in this symposium have been students of Professor Huda himself, no small achievement by one of the most successful teachers of his generation in this country. Ironically enough, the institution where Professor Huda has spent his whole teaching career (and hopefully will return to) does not have any of these presumably distinguished economists in its current roll; nor, for that matter, are any of them, save a solitary exception, currently serving any university in the country. But let us get down to business.

1.2 In his characteristically lucid exposition of experience and problems in planning, Professor Huda has touched upon issues in a range too wide for a commentator to do justice to within the constraints of space allotted to him. I shall confine my comments to two of the issues only, *viz.*, *repayment of external debt*, and the *strategy of generating higher income in the (private) capitalist sector*. Other issues will be discussed, I hope, by other more competent colleagues in the panel.

2. REPAYMENT OF EXTERNAL BORROWING

2.1 Professor Huda has rightly expressed concern over the terms at which external loans are being offered to the country [3, paras 38-42]. *Tied loans*, in effect, constitute less loans in real terms than their nominal worth, and hence higher interest rates than what the contractual terms of loans actually lay down. Calculations elsewhere done by the present commentator [7 ; 8] indicate that even with a rate of interest as low as 3 per cent the country may end up with a disproportionate rise in its external liabilities compared to rise in its assets. The picture would be worse if adjustments were made for the fact of tied loans in the calculations. The question to which we address ourselves

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here is whether an agreement towards *tied repayment* [3, para 39] would provide significant relief.

2.2 In the absence of an agreement towards tied repayment the country, *when it is able otherwise* to service its external debts out of its own resources, may have to "worry" about creating an export surplus to pay off its debts in foreign exchange. The possibility of creating an export surplus depends on the possibilities of increasing exports, increasing the home production of importables, adopting less import-intensive techniques of production and reducing consumption imports. Full exploration of all these possibilities in the country is still awaited and there seems to be no *a priori* basis for pessimism in this respect. Even then an agreement towards tied repayment would be a relief inasmuch as the country will not have to "worry" about generating an export surplus to that extent. But the more fundamental question of ability to repay out of the country's own resources, in whatever form it may be, remains. This ability is measured simply by the excess of domestic savings over investment.

2.3 In other words, whether repayment is to be tied or not, there has to be *surplus saving* to enable the country to service its external debt. The country's Perspective Plan does not promise that this necessary surplus, which, according to the present commentator's estimate [8], will have to be in the order of 8,000 to 9,000 million rupees in 1985, will be in sight in the foreseeable future.

2.4 The same holds, essentially, for 'soft loans'. If repayment in local currency is supposed to serve as a means of transferring *real* resources to the creditors, the nation must be able and prepared to come up with the necessary amount of surplus savings in real terms. Or else, the currency thus surrendered will have to be *blocked* in some form or other, to be released when the nation can spare the equivalent amount of real resources.

2.5 The point in brief is that there are several ways of transferring real resources back to creditors (as suggested in [3, para 4]) if the real resources can be spared, and tied repayment is one of them whose advantage over the others is to be decided by more careful investigation; the more fundamental question of generating the necessary surplus savings in real terms remains. Preoccupations with the so-called "foreign-exchange constraint" often makes us forget that presence of the "savings constraint", so aptly identified by Professor Huda as the main bottleneck in developing countries, may continue to keep a country dependent on foreign assistance even after the "foreign-exchange constraint" is released (by, say, a policy of import substitution or agreements towards bilateral trades or agreement to pay for imports and/or debt services in local currency). A recent study by Professor Sengupta [10] shows how persistent the savings constraint may continue to be, particularly if the country desires to maintain a high growth rate of domestic output. The fundamental question to which planners should, therefore, address themselves, so

far as repayment of external debt within a reasonable period is concerned, is how to mobilise the necessary increase in real savings given the *real* terms of external loans.

2.6 The *critical boundary* to the (real) terms of external loans follows from the same considerations. Given the initial conditions, the technological possibilities, the country's (long-run) growth target, and the extent of domestic savings (out of its current and incremental incomes), society is prepared to contribute towards attainment of its growth target, the critical terms of external loans depend on how fast attainment of "self-sustaining growth" is desired. With the Planning Commission postulates about growth target and domestic savings the rate of interest on external loans has to be considerably *lower than 3 per cent* for "self-sustaining growth" to be attained by the end of the present Perspective Plan, while the terms of external loans are actually becoming higher. It is important for us to realise that this implies that failing to obtain external loans in easier real terms, either domestic savings efforts have to be intensified, or the growth target brought down, or the nation has to reconcile itself with a considerably longer period of transition to "self-sustaining" growth than envisaged in its Perspective Plan[1].

3. STRATEGY OF GENERATING HIGHER INCOME IN THE PRIVATE CAPITALIST SECTOR

3.1 One of the most searching questions raised by Professor Huda is the welfare implication of the plan strategy of generating higher income in the capitalist sector [3, para 47]. The strategy in question rests on the presumption that the capitalist sector saves a larger proportion of its income than the non-capitalist sector, so that aggregate savings ratio for any given income should be higher from the strategy in question than otherwise.

3.2 The necessity for high domestic savings arises, in an open economy, essentially from the high (imputed) cost (economic, psychological, political) of foreign capital. For, otherwise, foreign capital could be regarded as a substitute for domestic savings and should actually have been *preferred* to domestic savings if an increase in the latter indeed necessitates a socially undesirable distribution of incomes; the role of foreign aid to a less-developed country could then be regarded as one of *helping the country avoid perverse distribution measures* in an effort to raise and sustain its economic growth rate to a magnitude commensurate with aspirations of its society. To the best of the present commentator's knowledge, such role of foreign aid has not been voiced either by donors or by recipients: donors insist on high domestic savings performance by recipients regardless of the way higher savings is to be generated; recipients' response is typified by the plan strategy questioned by Professor Huda. Neither

[1]For illustration of the relationship between the growth rate and the period of dependence on foreign capital, *see* Sengupta [10, Table III].

donors nor recipients, therefore, visualize an indefinite continuation of foreign aid to serve the specific welfare purpose cited above. This means, in essence, that foreign aid is regarded as much too costly a means of financing distributive justice in less-developed countries.

3.3 But two questions remain. First, is the aggregate savings ratio indeed a rising function of the degree of skewness in income distribution? In my own Conference paper [6] I have suggested that we go back to James Duesenbury of 1952 [2] and re-examine the implications of income distribution for aggregate savings in the light of *interdependence of consumer behaviour*. In the present comment I want to suggest the existence of interdependence in another area that has been missed in the formal thinking of the country's planners and also in the general Western literature on aggregative development theory, namely, *interdependence between distribution and the product itself that is to be distributed.*

3.4 National output, and any part thereof, is the joint product of physical capital and labour. Simple-minded intuition suggests that, given the amount of physical capital, the amount of output depends not merely on the physical amount of labour or technical skill labour may possess, but also in an essential way on how much "devotion" labour puts into his work. The latter is essentially a question of incentives or *motivation*. So far as pecuniary motivation goes, — and conventional Western theory would have us believe that this is the more important of various incentives — it seems reasonable to suggest that labour's motivation to devote himself to his work is a rising function of his *relative share* in the output to which he contributes[2].

3.5 The idea is not new, and has already been recognized in the principle of *profit sharing* with labour practised by some "generous" entrepreneurs (in agriculture, *crop sharing* is widely practised). The implication of this interdependence for national product is that, given the nation's capital stock, national product would be higher when labour's relative share is higher[3]. It thus becomes conceivable that, even if labourers saved a smaller proportion of their income than capitalists, a higher relative share of labour might yield, as there

[2]For example, instead of the conventional form $Q = f(K,L)$, the production function may be postulated as $Q = f(K,L), w^{\gamma}$ where 'w' stands for relative share of labour in total output and γ the "elasticity of motivation". It can be readily seen that, under usual convexity assumptions, *a)* total *output* will be maximized by maximizing w, and *b)* *surplus over the wage bill* (Q-wQ) will be maximized when $w = \frac{\gamma}{1+\gamma}$
The latter represents total profit of the capitalist sector in a private capitalist system, and "state income" under state capitalism.

[3]In a private capitalist economy incentive of capitalists to employ their capital should also be taken into account; but when we are discussing relative merits of private and state capitalism, incentive to capitalist is no longer a necessity for getting maximum output out of the nation's capital stock.

would be more aggregate income to save from higher aggregate savings and consequently higher ratio of savings to capital stock and hence, given the volume of external finance, a higher rate of growth of the nation's capital stock in the sense of productive *capacity*. A combination of the interdependence between national product and labour's relative share with the one suggested in the "Duesenbury hypothesis" referred to above should make this possibility all the more greater.

3.6 Notwithstanding whether the above conjecture is borne out by relevant econometric enquiry, and to what extent, a second and in a sense the more fundamental question remains. In a system where private enterprise is the main engine of growth, the *character* of growth in the sense of the time-profile of the bundle of real goods produced, will be governed by what the market will vote for. The more skewed the income distribution is, the more will scarce national resources be used to produce luxuries and semi-luxuries rather than basic necessities for which there would only be a *need* but no *effective demand.* Valuation of the resulting bundle of goods and its growth in terms of *market* prices might yield fluttering figures, but a "shadow" valuation in terms of relative social priorities would for the same reason give a different picture. To the extent that such shadow valuation would reduce the measure of national product and growth thereof compared to conventional measures, the case of the argument for generating higher income in the (already high-income) capitalist sector—namely, that it is necessary to concentrate first on enlarging the "size of the cake" before thinking about distribution[4]—would appear to lose force.

3.7 This also is nothing new. Nor is this as such a *criticism* of private (capitalist) enterprise, whatever other merits or demerits there may be of such enterprise. This is merely to say that because of its *modus operandi* centering around the "animal spirit" of profit-making, private enterprise may be expected to deliver the desired social goods only "*provided the state intervenes so as to make the initial distribution of dollar votes ethically proper*"[5]. This *limitation* of private enterprise must be reckoned against whatever other reasons there may be to entrust the responsibility of growth to this nineteenth-century engine.

3.8 It is in the light of the above that one should examine the question raised by Professor Huda: "Is it [the plan strategy of generating higher income

[4]This case has been presented emphatically by Harry Johnson in [4].

[5]Paul A. Samuelson [9, p. 1410] (italics in the original) on the welfare role of the "Invisible Hand". Note Arrow's criticism of Samuelson's generation of economists for its failure to follow up this inevitable conclusion: "I suspect that the partial and limited nature of Samuelson's investigations owes a great deal to his profound sense that such investigation would lead to deep and paradoxical levels of thought and feeling, where the mind and the judgment chase their own tails...... But it seems to me that successively greater understanding can only come from the articulation of formal systems which incorporate more and more of our intuition and experience" [1, Pp. 736-737].

in the capitalist sector] more efficient than mobilising additional savings by government to set up more public sector projects that may lead to a more equitable distribution in the long run?" The answer rests logically on the *valuation of efficiency*, and here one should beware of mechanical calculations based on an index of national product and its growth that has originated primarily out of the needs of analysis of business cycles in certain advanced economies and not out of the needs of welfare planning. Events have shown that the world's "richest" nation can be the world's sickest. The paradox can be explained only by a valuation of nation's wealth that fails to account for loss of social health concomitant to economic growth that relies for its steam on social disequilibrium.

4. Professor Huda has done a valuable service to both economic planners and the economics profession by raising searching questions that deserve serious thought. This is in welcome contrast to the Planning Commission's customary complacency with which it asserts, for example, that the (1965-85) Perspective Plan will "*eliminate poverty* and ensure that at least the basic minimum necessities of life are available to *everyone*" [5, p 18] (italics added) by 1985. It will be an accomplishment beyond compliments if this can be done[6]. Let us keep fingers crossed.

[6]An accomplishment that even the United States, with its *per capita* income in the order of 10,000 rupees a year, is unable to claim. It is perhaps not just a coincidence that a major section of the U.S. community of private capitalists seem opposed to those presidential candidates who are advocating maximum welfare expenditure at home and minimum war expenditure abroad.

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