

Market or Government: Lessons from a Comparative Analysis of the Experience of Pakistan and India*

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In the 1980s a remarkable consensus developed that all economies, including the Less Developed Countries (LDC), will achieve both more rapid growth and alleviation of poverty with greater reliance on a market oriented strategy and minimal government direct control and ownership in the economy. The disputes that remain have to do with marginal issues: how fast to move from dirigiste to private enterprise systems and the extent to which there is a residual role for government in dealing with market imperfections. There remain a few unregenerate interventionists, especially in South Asia, but they are definitely a beleaguered minority. Even more remarkable is that the consensus is not only with respect to the economic efficiency of the market, but is nearly as great on its effectiveness in reducing poverty.

A powerful tool for analyzing whether greater reliance on markets indeed is successful in raising the rate of growth and reducing the extent of poverty is to compare the experience of similar countries with different strategies in that respect. A comparison of the experience of India with that of Pakistan and Bangladesh during the last 40 years can be particularly fruitful because:

- (i) Except for some deregulation beginning in the late 1970s, India's strategy was consistently based on extensive government intervention in the economy. Pakistan (and Bangladesh),¹ in contrast, had two periods of substantial deregulation and of greater reliance on the market;

*The Pakistan Society of Development Economists is grateful to the Friedrich Ebert Stiftung, Germany for providing the funds for the delivery of this Distinguished Lecture.

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Author's Note: Work on this paper was started with support from the Agency for International Development (AID). Dr Eshya Mujahid's Research on Agriculture was supported by the Ford Foundation. Some of the issues in this paper are seen to have considerable ideological component. It is therefore important to stress that no one else bears any responsibility for any of the ideas expressed.

¹The terminology to use is inevitably awkward. Bangladesh, of course, was part of Pakistan as the Province of East Pakistan, until 1971, when it became an independent country. To refer to 3 countries before 1971 is as incorrect as to refer to 2 countries after that date. Whenever data are separately identified the reference will be to Bangladesh, even though the correct nomenclature would be to East Pakistan in the earlier period. In the text references to "Pakistan" invariably include East Pakistan and Bangladesh, even where the latter are not specifically mentioned. This makes for smoother flow of narration and easier tabular presentation at some cost in terminological accuracy.

- (ii) The two countries were one for more than a century and share a heritage of similar institutions, economies, peoples and even statistical systems;
- (iii) The effects of differences in development strategies can therefore be seen more readily than in comparisons between countries which have little in common; and
- (iv) Moreover, one can compare the periods of a more market oriented strategy in Pakistan with the more interventionist or dirigiste strategy in the same country, as well as in India. The most useful period for such comparisons is from Independence in 1947 to 1969-70, when Pakistan's economy and society was quite similar to northern India's.

The analysis in this paper concentrates on that period, but also includes the 1970s and most of the 80s. It therefore extends to Bangladesh and includes data, where possible, for East Pakistan, the area which became independent Bangladesh in 1971.

I. GROWTH RATES IN MARKET ORIENTED AND DIRIGISTE PERIODS²

The facts are completely consistent: during the periods of a more dirigiste strategy Pakistan and Bangladesh had an economic growth rate comparable to or below that of India; during the two periods of more market oriented strategy their growth rates typically doubled and were higher than India's (Tables 1 and 2). During market oriented periods growth was higher in both industry and agriculture. Particular periods might be explainable by exogenous factors, most notably the adjustment which Pakistan and Bangladesh had to make to their break-up, but the discrepancy is too great and consistent to be explained away by such factors. Moreover exogenous factors worked the other way as well. For instance, during the deregulation phase of the 1960s Pakistan's economy was set back by a war, increased defense expenditures following it and a series of very bad harvests.

²The terms used here are "dirigiste" and "market oriented", although neither term is ideal for distinguishing the two systems. The principal differences in the 3 countries were the extent to which:

1. Government allocated foreign exchange via import licenses or adopted an exchange rate which made it possible for allocation to be largely market determined;
2. Agricultural output prices were fixed and output was subject to compulsory purchase by government;
3. Prices of other goods were controlled by government, resulting in formal or informal rationing;
4. Large scale industrial firms were owned and managed by government;
5. Investment decisions were determined by government or left to private firms; and
6. The economy was open to international trade and foreign investment or isolated from it.

Table 1

*Growth Rates in the Gross Domestic Product of India and Pakistan
1949 to 1970*
(Compound Annual Rates in Percent)

	1949-50 — 1959-60				1959-60 — 1969-70			
	India	Pakistan	(E. Pak)	(1.0)	India	Pakistan*	(E. Pak)	(3.3)
Agriculture	6.7	1.3	(1.7)	(1.0)	1.7	3.5	(4.7)	(3.3)
Manufacturing (Excludes Small)	6.7	20.5	(23.2)	(15.5)	6.9	12.4	(13.2)	(10.2)
Other	4.1	3.2	(3.8)	(2.3)	5.1	6.9	(7.4)	(6.0)
Total Product	3.8	2.6	(3.5)	(1.7)	3.8	5.8	(6.9)	(4.7)
Population	1.9	2.3	(2.3)	(2.3)	2.2	2.6	(2.7)	(2.6)
Product per Capita	1.8	0.3	(1.2)	(-0.6)	1.6	3.1	(4.2)	(2.1)

Sources: Sources are generally official publications. However, substantial adjustments were required to develop comparable series for the two countries and different periods. Agriculture data are trend growth rates. Details in Statistical Appendix available from author.

Note: Figures in parentheses are for the present Pakistan and Bangladesh, then West and East Pakistan respectively. They are especially subject to error.

Table 2

*Growth Rates in the Gross Domestic Product of India, Pakistan, Bangladesh
1970 to 1987*
(Compound Annual Rates in Percent)

	1969-70 — 1976-77			1977-78 — 1986-87		
	India	Pakistan	Bangla- desh	India	Pakistan*	Bangla- desh*
Agriculture	2.0	2.6	1.1	0.7	3.8	2.5
Manufacturing	4.1	4.9	12.5	6.7	9.3	3.5
Other	4.5	6.2	2.4	5.4	7.4	6.1
Total Product	3.8	4.7	2.0	3.9	6.7	4.0
Population	1.9	2.3	2.9	2.2	2.6	2.4
Product per Capita	1.8	2.4	-0.9*	1.6	3.1	1.5

Sources: From World Bank, "World Tables", 1989. Data for different countries are comparable to the maximum extent possible. However these data are not fully comparable with Table 1. Table 1 is at market prices, Table 2 at factor costs. For Table 1 growth of value added in agriculture is derived from a regression on time and for manufacturing excludes small scale industry, which is included in "Other". For Table 2 agriculture is the average of annual rates and manufacturing includes small scale. For comparisons over time none of these differences should matter much.

*More market oriented strategy.

The average percent rates of growth were as follows:

Pakistan, Bangladesh-market: 5.6;	All 3 countries dirigiste:	3.4;
Pakistan, Bangladesh-market: 5.6;	India-dirigiste, same time:	3.85;

Per capita:

Pakistan, Bangladesh-market: 2.7;	All 3 countries dirigiste:	1.1;
Pakistan, Bangladesh-market: 2.7;	Pakistan, Bangladesh-dirigiste:	0.5;

There is obviously a dramatic difference between a per capita growth rate in income of about 1 percent during the dirigiste period in all 3 countries and a nearly 3 percent growth rate in the more market oriented periods. Even more dramatic is the comparison for Pakistan and Bangladesh alone, since India was more successful with a dirigiste strategy: Bangladesh had declining per capita incomes during the dirigiste period, a nearly 2 percent rate of growth during market oriented ones; Pakistan in the 1960s grew more than 3 times as rapidly in the market oriented 1960s as in the dirigiste 1950s and almost twice as rapidly as in the dirigiste early 1970s.³ Performance in the more market oriented late 1970s/early 1980s was less impressive, in part because the move to a market was far less pronounced.⁴

A. Causal Factors in the Rapid Growth with a Market Oriented Strategy

There clearly is a strong correlation between market orientation and higher growth, but conclusions about causality are more questionable unless one can show the specific causal linkages. There are several such links.

³It could, and has, been argued that the early 1970s under the government of Mr. Z. A. Bhutto was actually more market oriented than the 1960s. It is true that in the 1960s there was a big gap between the market and shadow foreign exchange rates and interest rates and that in the early 1970s the new government finally devalued the currency, which had remained fixed for 15 years, and raised the nominal interest rates. As far as the exchange rate is concerned, however, the nominal devaluation was countered by: (i) termination of a massive subsidy for non-traditional exports (see section on Exports) and (ii) by accelerating inflation. In the 5 years from devaluation in 71-72 to 76-77 consumer prices more than doubled, while in the 9 years of the 1960s they increased only by one third. The increase in nominal interest rates did not compensate for accelerating inflation, so that real interest rates remained negative. The weighted average deposit rate went from 3 percent to 5 percent and the advance rate from about 8 percent in 1971 to 11 percent in 1976, but inflation averaged over 14 percent during the same period (inflation rates from Pakistan 1982; interest rates and exchange rates from World Bank 1979 except for 1971 interest rates from Pakistan 1981). So the nominal increase in exchange and interest rates does not reflect greater reliance on market forces. At the same time this was a period of massive nationalization in industry and foreign trade and of reimposition of controls over agriculture and domestic trade. It was a period of increased dirigism.

⁴Note that Pakistan's performance in the early 1970s is overstated. The most rapid growth occurred in "Other", essentially trade and services. Part of that was statistical artifact: government rapidly expanded the share of the military and the civil service. This showed up as rapid growth in GDP even though these expenditures may be quite unproductive in improving welfare.

1. *The Effect of More Aid*

Since the late 1950s Pakistan (and Bangladesh) have received far greater amounts of foreign aid than India.⁵ (Tables 3 and 4). Since most of the aid came from the Market Economies and was related to economic performance, it increased during the periods of market oriented strategy. In the 1960s, the first market oriented period in Pakistan, aid increased to India as well, but reached over 10 percent of GDP in Pakistan, less than half that in India. In the second, the late 70s to the late

Table 3

Investment, Defense, Savings and Aid, 1949-50 – 1969-70
(In Percent of GDP at Adjusted Current Prices)

	1949-50		1954-55		1959-60		1964-65		1969-70	
	India	Pak	India	Pak	India	Pak	India	Pak	India	Pak
Defense	1.5	4.0	2.0	3.8	1.9	3.6	3.7	3.1	3.2	4.2
Investment (Gross)	11.7	5.3	13.3	10.1	16.4	13.5	18.1	22.0	13.8	15.5
Total Non-consumption	13.2	9.3	15.3	13.9	18.3	17.1	21.7	25.1	17.0	19.7
Import Surplus*	-0.5	-2.5	-0.2	-0.6	-2.0	-4.1	-4.5	-10.6	-0.9	-5.5
"Savings" (3 - 4)	12.7	6.8	15.1	13.3	16.3	13.0	17.2	14.5	16.1	14.1
Savings (2 - 4)	11.2	2.8	13.1	9.5	14.4	9.6	13.5	11.4	12.9	9.9

Source: Calculated by the author. Details available in a Statistical Appendix available from the author.

Notes: Because of the large share of foreign exchange in all the variables in Table 3, the exchange rate used was not the official one, but one more nearly reflective of the opportunity cost of foreign exchange. Details in Appendix.

The data have a considerable margin of error. This may have been increased by using shadow foreign exchange rates in some cases in order to provide comparable foreign exchange rates for both countries [see Papanek, (1983) for the error introduced in failing to make this adjustment]. The whole import surplus was calculated at the shadow or accounting rates. Defense and investment were adjusted upward to take account of their import component. The absolute percentage numbers above therefore are subject to considerable error, but should be roughly comparable for the two countries.

*In nearly all years the import surplus was almost wholly financed by aid. Foreign private investment made a minor contribution. In 1949-50 Pakistan financed its import surplus by drawing down Sterling balances. India drew on its Sterling balances in the 1955 - 58 period.

⁵The import surplus, or the Balance on Current Account, for all three countries has been overwhelmingly financed by grants and concessional loans since the early 1950s. Foreign private investment and commercial borrowing have been negligible until the 1980s, when some commercial borrowing occurred.

Table 4
Investment, Savings and Aid, 1969-70 – 1986-87
 (In Percent of GDP at Current Prices)

	1969-70 — 1976-77			1977-78 — 1986-87		
	India	Pakistan	Bangla- desh	India	Pakistan	Bangla- desh
Defense	2.9	6.2	0.9	2.8	6.0	1.4
Investment (Gross)	20.0	15.6	8.6	24.3	17.4	13.1
Total Non-consump- tion (1 + 2)	22.9	21.8	9.5	27.1	23.4	14.5
Import Surplus*	0.3	7.4	5.7	2.5	10.7	11.4
“Savings” (3 – 4)	22.6	14.4	3.8	24.6	12.7	3.1
Savings (2 – 4)	19.7	8.2	2.9	21.8	6.7	1.7

Sources: From World Bank, “World Tables”, 1989 except for defense. That is from other World Bank documents, drawing on country budgets. Data for different countries are quite comparable.

Notes: These data are not fully comparable with Table 3, since Table 4 does not adjust the foreign exchange component for the overvaluation of the currency. This does not matter much however, since overvaluation was small for all countries after 1971. Even in 1969-70 (in Table 3) no adjustment was made either since by then the overvaluation was relatively small and reasonably comparable among the countries (see Appendix).

*The import surplus was primarily financed by foreign aid in all periods. In the final period there was a small quantity of commercial borrowing.

80s the import surplus for both Pakistan and Bangladesh was around 11 percent, with India one quarter of that (Tables 3 and 4).

But aid explains little of Pakistan’s higher growth rate. In large part the additional aid permitted Pakistan to have a rate of investment almost equal to India’s, despite a much lower rate of savings, and to have defense expenditures double those of India as a percent of income. The difference in aid levels does not explain the principal reason for different growth rates: with roughly the same rate of investment in the first market oriented period why did Pakistan have a 50 percent higher growth rate; and in the second market oriented period, when investment in Pakistan was 30 percent below India’s, why did Pakistan have a growth rate 70 percent higher, while Bangladesh with investment barely more than half India’s had the same growth rate?

Some averages again provide compelling evidence:⁶

	Domestic Savings	Foreign Savings	Total (Investment)	Defense
Market oriented-Pakistan, Bangladesh:	7.4	9.6	17.0	3.7
Dirigiste India, same period	16.1	2.6	18.7	3.2
Dirigiste-3 countries	11.6	2.6	14.2	3.0

The reasons for higher growth per unit of investment lay in a series of inter-connected policy decisions, most indeed involving deregulation and greater market orientation.

2. Using Idle Capacity

All three countries for almost all of their post-Independence history have had idle capacity in industry and in a variety of trade and service activities. Output can be increased dramatically and quickly by putting this capacity to work. The principal constraint causing idle industrial capacity has been the lack of foreign exchange for imported inputs. A secondary reason, applicable for some industries, was inadequate demand. For some important labour intensive industries the principal reason for idle capacity was lack of demand (e.g., jute goods, cotton textiles). The domestic market had been served at prevailing prices and excessive costs at prevailing exchange rates prevented exports. Lack of domestic demand was also the constraint on much of trade and services. When output and income in industry was increased, by releasing its foreign exchange constraint, the increased demand therefore also increased output of trade and services. For the economy as a whole foreign exchange also was a constraint as increased income generated demand for imported consumer and capital goods.

The supply of foreign exchange available to the economy increased during the market-oriented period because, first, of the already mentioned increase in foreign aid and, second, due to policies which increased export earnings. The latter, discussed below, released both the foreign exchange constraint on inputs and the limits on demand of the domestic market.

3. Expansion of Exports

The growth of Pakistan's exports in the 1950s (Table 5) appears rapid

⁶All are given as percent of GDP at adjusted current prices and are taken from Tables 3 and 4. "Foreign savings" is the Balance on Current Account and is overwhelmingly aid.

because statistical coverage improved and the base was extremely small. Exports were less than 5 percent of GDP in 1949-50 while they were more than 6 percent for India which, as the far larger economy, would normally have a smaller traded sector. Actually India followed somewhat more effective policies during much of the 1950s, but Pakistan's exports grew more rapidly, for both statistical and structural reasons.

At the beginning of the 1960s both countries maintained their official exchange rate but effectively devalued for non-traditional exports by providing them with a variety of indirect subsidies. But Pakistan's Export Bonus Voucher system was more effective in terms of the extent of devaluation, the automaticity of benefits and their stability. With the sharp decline in aid to both countries after the 1965 war, both moved to expand export earnings further. India devalued the currency in 1966 by nearly 60 percent, Pakistan did not have any official devaluation, yet the latter had an export growth rate more than double India's.

Contrary to some analysts, this outcome did not prove the failure of exchange rate policy to increase exports, because:

Table 5
Export Earnings, 1949-50 to 1969-70
(Annual Compound Rates of Growth — Percentages)

	1949-50 to 1959-60		1959-60 to 1964-65		1964-65 to 1969-70	
	India	Pakistan	India	Pakistan	India	Pakistan
Primary						
Products	3.7	0	4.0	5.0	-2.0	-2.3
Manufactures	0.1	<i>Infinite</i> ¹	6.4	8.7	6.5	16.5
Total Commodities	2.0	3.6	5.0	6.2	2.2	5.6
Invisibles	5.3	11.5	0.5	12.9	4.1	5.3
Total Earnings	2.6	4.5	4.1	7.4	2.5	5.5

¹Started from zero.

Notes: The Pakistan rate is overstated in the 1950s, partly reflecting improved statistical coverage. In 1969-70 political disturbances damaged real exports and caused export earnings to be underreported, as exporters moved capital out of the country. Therefore the growth rate between 1959-60 and 1969-70 is almost certainly understated and affected by political factors.

- (i) Pakistan's exchange rate for exports under its Bonus Voucher scheme was Rs 8.5 or more⁷ to the dollar as a result of that scheme alone. In addition Pakistan continued a gamut of indirect subsidies. After devaluation India's rate was only Rs 7.5 and most indirect subsidies were abolished;
- (ii) Moreover, India's industrialists generally bought their traded inputs at Rs 7.5 to the dollar, while Pakistan's obtained some of their inputs at Rs 4.75 to the dollar. The latter therefore had a much higher effective subsidy;
- (iii) Indian devaluation occurred only in 1966, Pakistan's in 1959. Lags therefore were more serious for India in the 1960s, especially since India's exports were more heavily concentrated in capital goods where the need to build reputation and service facilities makes for long lead times; and
- (iv) Finally, the Export Bonus Voucher scheme in Pakistan also permitted the ready import of crucial inputs for export production, albeit at a Rupee price substantially above that implicit in the official exchange rate plus tariffs.⁸ Indian exporters still had to get their inputs and spare parts through the cumbersome import licensing procedure, which involved delays, uncertainties, the cost of bribes and sometimes sheer inability to obtain needed imports.

In addition to these differences in policies, which especially affected manufactured exports, both countries also suffered from bad weather which reduced agricultural exports in the mid-60s. For India, the resulting slower growth of total exports was seen as evidence of the failure of devaluation. No such conclusions were drawn for Pakistan whose devaluation was larger, but more hidden.

As a result of more favourable prices and profits in the 1960s exports grew about twice as rapidly in Pakistan. The difference was especially great for non-traditional exports: manufactured goods and invisibles. During 1964 to 1970, despite a much higher base than earlier, Pakistan's growth rate was more than double India's. (See Table 5.)

The 1970s reinforce the evidence that exports respond to broad changes in policy, among which the exchange rate is an important component. Pakistan carried out a massive devaluation in 1972, which cut the value of its currency by more

⁷The premium for the bonus vouchers increased continuously from their introduction to their demise, so generally the rate was above 8.5.

⁸No import licenses were required if Export Bonus Vouchers equal in value to the imports were bought in the open market, where the premium began at 65 percent.

than half. India devalued only in 1974 and then by less than 10 percent. Yet India's total and manufactured exports grew at more than twice the rate of Pakistan's from 1969-70 to 1976-77 (Table 6).

The reasons are quite clear. As a result of more stable prices than in other countries India's real effective exchange rate declined by 20 percent over the same period [Nayyar (1988), citing Joshi (1984)]. Comparable calculations do not exist for Pakistan, but the devaluation was offset by:

- (i) The abolition of the Export Bonus Voucher scheme, which had provided a very effective, largely automatic, and tailored subsidy to non-traditional exports. The effective devaluation was, as a result more like 30 percent than the nominal over 100 percent for most manufactures;
- (ii) The higher cost of imported inputs and debt servicing which followed inevitably from an uncompensated devaluation;

Table 6

Export Earnings, 1969-70 to 1986-87
(Annual Compound Rates of Growth — Percentages)

	(in US \$ at current Prices)					
	1969-70 to 1976-77			1977-78 to 1986-87		
	India	Pakistan	Bangla- desh	India	Pakistan	Bangla- desh
Primary						
Products (incl. Fuels)	15.3	6.8	8.1**	5.3	9.4	6.6
Manufactures	19.7	7.3	5.0**	8.4	14.0	8.3
Total Commodities	17.7	7.1	6.3	7.3	12.2	7.7
Invisibles	29.9	12.6	-2.4	10.0	11.1	10.2
Total Exports	20.8	8.6	0.3(6.6)*	7.8	11.6	9.3
Remittances	49.4	13.3	Infinite+	6.4	7.3	22.1

Source: Calculated from Ministry of Finance, *Economic Survey* of the three countries for various years as the principal source.

**1971-72 - 1976-77;

*1970-71 - 1976-77; figure in parenthesis for 1971-72 - 1976-77.

+Zero until 73-74.

- (iii) Rapid inflation of domestic costs, and particularly of wages, which rose between 50 percent and 100 percent in three years [Adams and Iqbal (1983)];
- (iv) The imposition of export duties on major primary goods and the two principal manufactured exports (yarn, grey cloth);
- (v) Uncertainty about the foreign exchange regime, which discouraged investment in export production and market penetration (*Ibid*); and
- (vi) Even greater uncertainty and reduction in incentives resulting from widespread nationalization in the early 1970s and the threat of further nationalization for several years thereafter which encouraged decapitalization in the textile industry and reduced efficiency in nationalized industries.

As a result the real effective exchange rate for a number of major exports was almost certainly lower than before the devaluation [see Adams and Iqbal (1983) for cotton yarn and cloth], even before the effects of the general deterioration in the economy are taken into account. So there were good reasons why, despite an ostensibly more massive devaluation Pakistan's exports grew more slowly than India's.⁹

For Bangladesh the devaluation from 1971 to 1977 was by 246 percent, yet exports stagnated. Again there were several reasons. The major devaluation occurred only in 1976 and exports indeed jumped 8.4 percent next year. Rapid inflation negated much of the effect of devaluation. The chaos in the economy from 1970 to 1974 sharply reduced exports initially and then kept them below their pre-Independence level until 1976. Finally there was a considerable deterioration in Bangladesh's terms of trade.¹⁰

During the late 70s to mid-80s the picture was again reversed. The new military governments in both Pakistan and Bangladesh again relied more heavily on the market. All three countries devalued by about 100 percent. But Pakistan and Bangladesh did far more in deregulating imported inputs and provided incentives

⁹The recession in the developed countries after the 1972 oil price increase did make it more difficult to export and particularly affected the price of primary products, after an initial run up, as pointed out by Dr Ashfaq Khan in his comments on the paper. But the conclusions in this paper are not due to differences in composition of exports. In the early 1970s India achieved a higher growth of primary, manufactured and invisible exports; in the next period Pakistan achieved the higher rate in all 3 categories.

¹⁰Bangladesh's exports dropped sharply, even in current dollars, from 1970 to 1971 and then rose from that year to 1977 to nearly where they had been in 1970. The measured trend therefore depends on the base year used. As the result of destruction, followed by great uncertainty and flawed policy, the growth rate of exports over the whole 70s was relatively low, despite the fact that it involved recovery and that the currency was devalued to less than a third of its original value from 1971 to 1977.

for export (e.g. Bangladeshi garment exporters benefited from a large, hidden subsidy). There was a dramatic reversal with respect to growth in exports: the growth rate for Pakistan and Bangladesh combined was about 50 percent higher than in India, while it had been less than half as rapid during the earlier, dirigiste, period.

The *conclusions* are clear cut. During market oriented periods exports grew substantially more rapidly in Pakistan and Bangladesh than during the dirigiste periods in the same countries or than in India in the same period. However, when the former were in their dirigiste periods, Indian exports grew more rapidly. The average annual growth rates for exports of goods and services were as follows:¹¹

Pakistan, Bangladesh-dirigiste	: 4.5%;	India same periods	: 11.7%;
Pakistan, Bangladesh-market	: 8.5%;	India same periods	: 4.8%;

The major reasons were as follows:

- (i) *Export prices were more favourable* in the more market oriented period. A full or partial devaluation (i.e. a dual, more favourable rate for non-traditional exports) was usually an important element in this. But obviously a devaluation in the nominal exchange rate was neither necessary nor sufficient for a rapid increase in exports. It could be rendered ineffective by the simultaneous abandonment of important indirect subsidies or by rapid internal price increases. Conversely in the absence of nominal devaluation a major hidden subsidy (like Pakistan's Export Bonus Voucher system) could, at least for a while, have the same effect. Indeed, when prices of imported inputs rose with those of exports, in a traditional devaluation, that was less effective than dual price schemes under which input prices changed little;
- (ii) The favourable *export prices were assured* for some period of time, were readily available to actual and potential exporters and involved substantial benefits for non-traditional exporters. There seemed to be a threshold effect. Effective subsidies of 20–30 percent had limited effects for some potential exporters, but at 65 percent the risk, uncertainty and cost of breaking into the export market seemed worthwhile taking. Subsidies that depended on the vagaries of the bureaucratic machine and came with only a delay were not very effective;
- (iii) The *availability* to exporters of *imported inputs* made a great deal of

¹¹The more dirigiste periods for Pakistan and Bangladesh in all these summaries are the 1950s and 1969-70 – 1976-77; the more market oriented periods are 1977-78 – 1986-87. The same periods have been used for the comparison with India.

difference for manufactured exports. In a highly controlled system where exporters were at the mercy of an uncertain import licensing system for crucial inputs they could not assure the timely delivery or quality of output that their competitors could because these competitors had ready access to the cheapest and most reliable sources for quality inputs in the world market. This was a handicap for Indian garment exporters, with limited access to needed cloth, Indian machine tool exporters with limited access to high quality drill bits or other vital parts. On the other hand the ability to import gem stones was crucial to the rapid growth of the Indian gem and jewellery industry; and

(iv) *Freedom from some controls* was a factor in export growth, especially freedom from:

- Limits on foreign private investment (the garment industry in Bangladesh initially depended heavily on Korean investors and their market access);
- Limits on investment, which delayed investment needed to meet world market standards; and
- Complex and time consuming processes to obtain the foreign exchange to travel abroad to establish needed input and marketing contacts, or to hire foreign technicians if needed.

Clearly export earning also were affected by exogenous variables: the weather, the world price for particular goods and the effect of political events. But the consistency with which exports grew more rapidly in the market oriented period supports the argument that policy variables were dominant.

The greater potential and actual exports during these periods released the foreign exchange (imported input) constraint on the economy, as well as the constraint due to the limited domestic market for some goods.

4. *Incentives to Use More Inputs in Agriculture*

It is clear that the major cause of differences in overall growth was the higher growth rate of Indian agriculture during the 1950s and of Pakistan's and Bangladesh's in the 1960s and 1977 to 1987. Another summary provides striking evidence:

Pakistan, Bangladesh-dirigiste	: 1.6%;	India same periods	: 2.4%;
Pakistan, Bangladesh-market	: 3.6%;	India same periods	: 1.2%.

When all followed dirigiste strategies Indian growth was 50 percent higher. When Pakistan and Bangladesh followed more market oriented strategies their agricultural growth rate was 200 percent higher than India's.

Causal factors can more clearly be identified by comparing the two Bengals and the two Punjabs. Prior to 1947 each of these pairs was usually a single Province. With climate, soil and other exogenous factors virtually identical the correlation coefficient for annual fluctuations in Gross Value Product (GVP) and GVP per hectare ranged from .92 to .97 [Papanek *et al.* (1986)]. The effects of policy differences are therefore little contaminated by the effect of weather or other exogenous variables. For these two pairs the difference in output during different policy periods was a growth rate in GVP of about 8 percentage points (Table 7), a massive difference due to policy. During periods of greater government control over outputs and inputs in both (all three) countries the Indian Provinces had significantly higher growth in output while the Pakistan (Bangladesh) Provinces grew much more rapidly when they relied more on the market.

Several factors explain the differences all from Papanek, *et al.* (1986) and from Mujahid (1983):

- (i) *Prices were more favourable.* Input-output price ratios were consistently more favourable in the non-Indian, than in the Indian, regions. The internal terms of trade for agriculture, that is the purchasing power of agricultural products in terms of industrial consumer goods, was more favourable only until the 1970s. Both ratios were especially favourable outside India in the policy periods when the Pakistani Punjab and Bangladesh followed a market oriented strategy, and achieved a higher rate of growth. Favourable price ratios might be expected to encourage greater input use and greater management and labour effort and therefore lead to greater output.
- (ii) *Prices were stabilized and guaranteed.* Since farmers are risk averse, because they dread above all losing their land, price stability affected the willingness to invest and to buy inputs. During the dirigiste periods in Pakistan and Bangladesh, and throughout much of the period in India areas producing a surplus of foodgrains were allowed to sell only to the government procurement organization at a price predetermined by government. Major export crops were also in government hands. The fixed prices tended to be low to protect the urban consumers and the competitive position of the government export agency. This produced great uncertainty about cultivators real income. A bad harvest combined with fixed prices would make for low incomes. Cultivators were therefore reluctant to invest in much fertilizer or other purchased inputs.

Table 7

*Growth Rates in Agricultural Outputs during Different Policy Regimes
A Comparison of Indian and Pakistan Punjabs and of the Two Bengals*

A. Punjabs										
(Average Annual Rates of Change in Percent)										
	1950-51- 1960-61		1961-62- 1966-67		1967-68- 1970-71		1971-72- 1976-77		1977-78- 1980-81	
	Pakistan	India	Pakistan*	India	Pakistan	India	Pakistan	India	Pakistan*	India
GVP	0.7	7.1	4.9	0.1	5.5	12.2	3.8	3.5	3.6	1.3
GVP/ha	0.1	4.6	2.3	-0.4	3.9	9.4	2.6	2.0	1.8	0.7
Area	0.5	2.5	2.6	0.5	1.6	2.9	1.2	1.5	1.2	0.6

B. Bengals										
(Average Annual Rates of Change in Percent)										
	1952-53- 1960-61		1961-62- 1966-67		1967-68- 1970-71		1971-72- 1974-75		1975-76- 1980-81	
	Pakistan	India	Pakistan*	India	Pakistan	India	Pakistan	India	Pakistan	India
GVP	2.1	3.3	0.8	-1.1	3.5	7.0	-1.6	0.95	4.2	-1.2
GVP/ha	1.8	2.3	-0.1	-1.9	1.4	4.6	-0.5	-0.7	2.7	-0.3
Area	0.4	1.0	0.9	0.7	2.1	2.5	-1.1	1.6	1.6	-1.0

C. Differences in Output Growth										
(Percentage Point Differences: Pakistan/Bangladesh Minus India)										
	1950s		Early 60s		Late 60s		Early 70s		Late 70s	
	Punj	Beng	Punj	Beng	Punj	Beng	Punj	Beng	Punj	Beng
GVP	-6.4	-1.2	+4.8	+2.0	-6.8	-3.5	+0.3	-2.5	+2.3	+5.5
GVP/ha	-4.5	-0.5	+2.7	+1.8	-5.5	-3.2	+0.6	+0.1	+1.1	+2.5
Area	-2.5	-0.7	+2.1	+0.2	-1.3	-0.3	-0.3	-2.7	+1.2	+2.5

Average Annual Rates of Growth in GVP		
	Punjabs	Bengals
1950s; Late 60's; Early 70's (Dirigiste)	-4.8	-2.0
Early 60s; Late 70s (Market)	3.6	5.95
Difference between Market Oriented and Dirigiste	8.4	7.95

Source: Calculated from parts A and B above.

GVP = Gross Value Product; GVP/ha = GVP per hectare.

The uncertainty produced by compulsory procurement at fixed prices also provided an incentive in both surplus and deficit areas to grow subsistence foodgrains, even if a cash crop made more economic sense.

An element of changed policy in 1959 was to eliminate compulsory procurement at government-fixed prices. Instead prices were market-determined and generally more favourable. Government guaranteed a minimum price for the two major grain crops. It became attractive, for cultivators who could do so efficiently, to produce wheat and rice for cash sale and to increase the use of inputs on all crops, sure of at least the guaranteed minimum price.

- (iii) *Competitive distribution of inputs was more effective.* In the early 1960s the Pakistan government also permitted the private sinking of tubewells and the private distribution of fertilizer. It made imports freely available at a modest premium, which facilitated the procurement of relatively minor but crucial tubewell parts and equipment not produced in the country. India continued to limit fertilizer distribution to government and cooperatives and prohibited private tubewells in areas served, or potentially served, by government irrigation. Imports were strictly controlled for most of the 60s.

India eased some of these restrictions in the late 1960s. Conversely in the early 1970s Pakistan and Bangladesh re-introduced some of them and, in addition, nationalized some agricultural processing and distribution facilities (e.g.: Pakistan nationalized cotton gins, rice and wheat mills and Bangladesh the jute trade). The growth in the proportion of land served by wells reflects the far more favourable incentive system in Pakistani/Bangladeshi Punjab/Bengal during the early 60s, when tubewell intensity grew more than 3 times as fast on the non-Indian side (Table 8).

Table 8

Tubewell Intensity during Different Policy Regimes
A Comparison of Indian and Pakistan Punjabs and of the Two Bengals.
 (Percentage Increase in the Proportion of Areas Covered by Tubewells)

	Punjabs		Bengals	
	Pakistan	India	Bengal- desh	India
1956-57 to 1967-68	100%*	29%	2,500%*	-11%
1967-68 to 1974-75	28%	94%	600%	12%

Source: Calculated from Papanek *et al.* (1986).

*Somewhat more market oriented period. Data are not available for the exact time periods used in other tables. Therefore these approximations for the appropriate periods have been used.

Government enterprises charged with distributing agricultural inputs or processing outputs simply were not very efficient. They had all the usual problems of public enterprises in providing appropriate incentives and autonomy to its managers. But in the case of agri-business these were compounded by the fact that most were small, scattered enterprises, in unattractive locations. Moreover they needed to react quickly and flexibly to changes in weather and world commodity prices. Such flexibility is especially difficult for public firms.

The result during dirigiste periods was inefficiency in distribution, as fertilizer depots were closed at hours convenient to cultivators, wells were sunk in the wrong places or were not repaired in a timely fashion and managers were picked more for political loyalty than technical competence. Worse, when processing facilities were nationalized, some managers, unwilling to work for a salary in a rural area, sold stocks and used the proceeds for their own purposes. Cultivators found some of these small units had gone out of operation.

It is not surprising that tubewell sinking and fertilizer distribution accelerated when private traders and investors were also allowed to compete. The Indian Punjab in the 1950s had nearly 50 percent greater tubewell intensity than Pakistan's. In the 60s the share of the area covered by tubewells increased by 80 percent on the Pakistan side compared to less than 30 percent on the Indian. With greater control, fewer incentives and great political risk, wells increased less than 30 percent on the Pakistan side from 1968 to 1975, almost 100 percent on the Indian (Table 8). The Bangal figures are greatly affected by the fact that the Indian side had 200 times the intensity across the frontier in 1956-7, so the effect of policy changes is less clear cut. In the 1960s, when policy in Bangladesh was more favourable wells increased 25 fold, while they declined in Indian Bengal. Subsequently the Bangladesh increase was still 6 fold despite less favourable policy, partly because aid funds were readily available, while on the Indian side wells increased only slightly.

- (iv) *Investment was more profitable.* The data on tubewell sinking have already been mentioned. Tubewells could be classed as investment, rather than being discussed under inputs. Obviously the greater availability of cheaper imported parts and the higher, more stable prices for output made private investment in wells, and later in tractors, more attractive.
- (v) *Shift to higher value crops.* With fewer government-imposed distortions in crop prices it was likely that cropping patterns would adjust

more effectively to relative crop values and input prices during the more market oriented periods. The effect of crop shifts can be considerable, accounting for 1/3 to 1/2 of the increase in value for some crops and areas at some times.

- (vi) *More efficient use of inputs.* Fertilizer was not only more readily available during market-oriented periods, when it was distributed by private storekeepers as well as cooperatives and government agents, it was also more likely to be available at the time needed. Fertilizer applied at the right time is far more effective than if it is even a week or two late.

Similarly water from wells, mostly privately owned, can be applied in a more timely fashion on individual holdings than water from large, government operated canals.

There is some evidence for these qualitative effects of timely availability in regression analysis, but it is difficult to distinguish them from the quantitative effects of the additional inputs used.

In sum, more favourable and more stable prices were the indispensable base which made increased input use, including increased investment in water control, profitable. More efficient distribution and easier access to inputs, especially to tubewell water and fertilizer, then speeded the adoption of modern technology, including high yielding seed varieties during the market oriented periods. Fertilizer, tubewells and improved seeds all produce results in 4 months to a year. So there were quick output results from changed price and input policies. Undoubtedly there were also long term effects from greater investment during the more profitable market oriented periods.

5. *Capacity Utilization and More Efficient Investment in Industry*

The higher industrial growth rate during the market oriented periods was due to both short and long term policy effects. In the short term two factors, already discussed, made most of the difference. There was an immediate boost in industrial output due to:

- (i) The greater availability of crucial imported inputs for industry with the relaxation of the foreign exchange constraint, as both foreign aid and exports increased (see above); and
- (ii) The relaxation of the demand constraint for many industries as exports became possible and profitable as a result of a more favourable effective exchange rate and better access to imported inputs, including spare parts, under a more relaxed foreign trade regime.

In addition, with the deregulation and greater market orientation, owners and investors were less concerned about political risk, more willing to invest in rehabilitation, working capital and small improvements, all of which had short term effects.

In the longer term there again were again several factors which made for higher growth in the market oriented periods:

- (i) The pattern of investment was a more efficient one, more attuned to the relative scarcity of different factors in market oriented Pakistan in the 1960s. Indian industry became increasingly capital intensive (Table 9), using more capital and less labour than was desirable for social efficiency, because:
- India had raised the cost of labour more than had Pakistan, by making it very difficult and costly for a large firm to fire any workers and by extending the coverage of the minimum wage;
 - And had lowered the cost of capital by providing it free as equity to the large group of public enterprises and at below market interest rates through the nationalized banks to many private firms;
 - For managers of public firms maximum profit was not the principal goal. Avoiding trouble was more important and was easier with fewer workers; and
 - Capital intensity in India was also increased by the widespread consensus on the importance of capital intensive "heavy industry", mainly steel production and steel processing (e.g., machine tools) and the equally widespread belief that it was very difficult to expand export earnings, due to secularly declining terms of trade.

Table 9

Capital Intensity in Indian Manufacturing Industry

Fixed Capital per Worker (1959-60)	Number of Sectors	Weighted Average Growth in Fixed Capital 1959-79
2.5	14	7.7
2.5 - 3.0	12	10.9
5.0	12	12.9

Source: Lucas and Papanek (1988).

Import substituting industrialization therefore had to be pushed. It was increasingly capital intensive, because the labour intensive textile, shoes and processed foods industries had been developed much earlier.

- (ii) Pakistan had not established its labour intensive import substituting industry at the time of Independence, India had. So history gave Pakistan more scope for investing in industries appropriate for a labour abundant country; and
- (iii) In pursuit of goals other than efficiency or growth India introduced a number of policies which caused economic losses, especially over the longer term:
 - To protect a large number of existing jobs in handloom weaving, the modern, power loom sector was restricted. This greatly weakened India's ability to compete in the world market since handloom cloth does not meet some quality standards and greatly slowed the expansion of the textile and garment industry; and
 - Under pressure from regional constituencies India pursued a more effective policy of dispersing investments among the States. For many industries this had costs in smaller, less well sited, and therefore less efficient, factories. Unable to compete in the world market as a result, India had slower growth in these industries.

Virtually all of these longer term problems existed in Pakistan as well, but generally were less severe there. There was substantial investment in capital intensive industry in Pakistan as well, for some of the same reasons. Such industry was generally as inappropriate in labour abundant Pakistan as in labour abundant India.¹²

But one of the major factors for capital intensity in both countries, a capital intensive public enterprise sector, was far smaller in Pakistan. In 1965-66 public sector enterprises held 30 percent of assets in Indian industry. The comparable figure for Pakistan in 1959 was only 12 percent and it probably did not change much by 1965-66. The importance of heavy industry and export pessimism also had their advocates in Pakistan, but never became firm government policy, as they did in the second Indian Plan. As a result, Pakistan delayed substantial investment in steel and machine tool production to the 1970s and experimented earlier than India with

¹²Indeed some of the industries were even more inappropriate in Pakistan. For instance, the steel industry in Pakistan was based on imported, not domestic, iron ore and coking coal.

a successful programme to expand exports of manufactures. The dominant and most rapidly growing industries in Pakistan tended to be labour intensive cotton and jute textiles in the 1960s (see Table 9A for Pakistan data on growth rates in different industries and industrial employment). Finally, in the 1970s Pakistan substantially increased the price of capital to industry and narrowed the gap between its market and shadow prices.

Table 9A

*Employment and Capital Intensity in Pakistan's Industry***A. The Cost of Capital**

	a. At Shadow Prices	b. At Market Prices (10 Year Tax Holiday)	c. a/b
1959-60	59.1	16.2	3.6
1969-70	110.5	37.4	2.95

B. Employment in Manufacturing

	1960-61	1963-64	1969-70	1974-75	1986-87
1. Million Man-years	2.7		3.7		
2. Employment		2.2	2.8	2.8	4.1

C. Value Added in Industry – Share of increase by major industry groups

	1959-60 to 1969-70	1969-70 to 1976-77	1976-77 to 1984-85
Textiles	30%	17%	14%
Food	16%	27%	16%
Indust. Chemicals	0%	5%	11%
Iron and Steel	2%	5%	13%

Sources: [Guisinger and Kazi (1978); Stern and Falcon (1970); Government of Pakistan (1990, 1989).]

Notes: In C. the pattern of growth in 1976-77 to 1984-85 reflected in substantial part the long gestation period of some investments started under the previous government (during 1971 to 1974) notably a large steel mill and chemical plants.

In the early 1970s policies in Pakistan in all these respects were reversed. There was massive investment in so-called "heavy" industry, particularly a large steel mill and industrial chemicals. Some of the impact of these industries was felt only after the change in government in the late 70s or early 80s as these investments had a long gestation period. During the early 1970s investment in the textile industry came to a virtual halt under the threat of nationalization, so this labour intensive industry did not create many productive jobs. The public sector was greatly expanded with widespread nationalization. With the change in government in the mid-70s textiles again expanded more rapidly and garments began to be a major export industry in the late 1980s (see Table 9A for some evidence).

In short, as a result of both short and long run factors Pakistan consistently had the higher growth rate in manufacturing. The discrepancy was especially great in the early years when Pakistan, starting from nearly zero naturally had a higher percentage point growth rate. But it was policies that resulted in a more labour intensive and efficient pattern that permitted Pakistan to have an industrial growth rate nearly 50 percent above India's even 30 years later (1977-78 to 1986-87) when Pakistan's industrial base was comparable.¹³

B. The Role of Government Intervention in Efficiency and Growth

The story so far has been one of government intervention being counterproductive, of instances when a reduction of the government's role, an increased reliance on market forces, increases efficiency and growth. That is because in all three countries government intervention generally worsened distortions.

1. Government as an Agent of Greater Distortions

The reason throughout for the efficiency of the market in India, Pakistan and Bangladesh was that government intervention generally did not counter market imperfections and distortions, but worsened them.

For instance, exporting is inherently more difficult than producing for the domestic market, because the exporter: (i) lacks the automatic cost advantage of low transport costs; (ii) needs to service unknown markets, whose taste and other preferences it is costly to learn; (iii) has to overcome well established prejudices about presumed low quality of South Asian producers; and (iv) faces greater risk of

¹³Growth in East Pakistan, as well as in the West was higher than in India in the 50s and 60s. For the post-Independence period no comparison is made, because the data for Bangladesh (i) start from a very small base, so growth rates are not very meaningful for the initial period; (ii) industries were especially disrupted by the war and civil war and the recovery period therefore shows unusually high growth rates; (iii) because of great annual variance in output, some of it due to strikes and civil disturbances, the choice of initial and terminal years substantially affects the conclusions.

non-payment, pilferage and rejection on spurious grounds. At a minimum government should provide the same kind of infant industry protection to non-traditional exports it provides for new domestic producers. Indeed, the argument can be made that infant industry protection should be greater for exporters because of these additional costs of exporting.

Instead of compensating exporters, government policy discriminated against them. A study of Bangladesh showed that the highest Effective Rates of Protection on average went to activities which had the least comparative advantage [Islam (1980); Papanek and Schydrowsky (1980)], while activities which actually lost the country foreign exchange by operating enjoyed considerable protection. Similar evidence can be mustered for the other two countries.

Abundant labour was made expensive, scarce capital and foreign exchange were made cheap by a series of policies, many with highly laudable stated objectives.

When government worsens distortions, then deregulation, reducing the role of government can increase efficiency and growth. The history of India, Pakistan and Bangladesh over the last 30 years suggests that many government interventions indeed worsened distortions. This was not accidental, nor was it due to ignorance. Rather it had to do with the fact that much of government intervention was in response to political pressures and designed to provide visible, clear and major benefits to a politically powerful groups, especially permit and license recipients. But these were the very interventions which resulted in major economic distortions. On the other hand interventions which compensate for existing market imperfections tend to have little political support because their benefits are difficult to identify, diffuse and to accrue in small amounts to large parts of the economy. Naturally intervention usually takes the forms that have political support.

While government intervention can in theory be structured to be wholly benign, in fact it was primarily counterproductive in terms of economic efficiency, though not necessarily political objectives in the recent history of South Asia.¹⁴

2. *Government as a Crucial Actor in Development*

But in the enthusiasm for "the magic of the market place" the positive contribution of government to economic development is sometimes forgotten. In South Asia, as elsewhere, that contribution involved, as economists might expect, dealing with market imperfections.

(a) *Compensating for externalities and threshold effects with respect to non-*

¹⁴And other countries as well [see Papanek (1986)].

traditional exports was important in Pakistan. Exports in Pakistan began their rapid rise when the export Bonus Voucher scheme introduced a massive subsidy, quite comparable to the subsidy implicit in the typical exchange rate, import licensing and tariff regime in the early stages of import substituting industrialization. The implicit subsidy was sufficient to induce industrialists to learn how to produce for a demanding international market, to establish marketing channels and to look beyond the familiar domestic market for their customers.

- (b) *In the early stages of industrial development massive infant industry protection compensated for the great risk of industrial investment.* For the traditional traders who were to become industrialists [Papanek (1967)] the perceived risks of investing in fixed capital, rather than quickly moving commodities, were even greater than the real risks. The latter were large enough, given political uncertainty and the lack of an industrial tradition. The massive subsidy implicit in a rigorous import control system, which assured profits in some industries in the 50–100 percent range, induced the shift into industry. Once made, the perceived risk shrank to more realistic dimensions and the real risk also diminished as entrepreneurs became familiar with industry and more convinced that Pakistan would survive as an independent country.

It took powerful incentives, which only government could provide, to launch rapid industrial development in a country with little tradition and experience with modern industry. Powerful economic incentives overcome obstacles, sometimes considered insurmountable in the short run, created by the near absence of experienced industrialists, willing entrepreneurs and skilled personnel.

In all three countries, as almost universally in the world, some infants were protected who should not have been and some were protected long after they had reached senility. But during the liberalization periods in Pakistan and Bangladesh these distortions were sharply reduced. In the light of these steps and the likelihood that industry would have developed very slowly in its early stages, given the obstacles, without substantial protection, the original protective episodes represented a positive intervention.

- (c) *Reducing the risk of crop price fluctuations* by guaranteed minimum prices speeded the adoption of modern seed varieties and investment in fertilizer and water control which that required. In the absence of such guarantees there was asymmetry in risk perception. Cultivators with limited landholding faced the risk, if prices of their cash crop dropped, of forever losing their land. That was a risk that many would not have

been prepared to bear, even if the likely benefits of investing in modern inputs was substantial.

- (d) *Subsidies for modern inputs* for agriculture also reduced the risk of adopting them and were vital in overcoming the initial hesitation to adopt what cultivators considered untried and high risk technology. Once the benefits were clearly established to the farmer's satisfaction the subsidy could be reduced (although naturally it was in the farmer's interest to keep them as long as possible).

All of these examples shared 3 characteristics:

- (i) *Government used the price mechanism to intervene* in the economy, not the far cruder and more distorting instrument of quantity controls;
- (ii) *The risk to the individual was greater*, or was perceived to be greater, or both, than the risk for society as a whole and government intervened to reduce the risk to the individual; and
- (iii) *There were substantial positive externalities* from the actions which government intervention was designed to encourage. That is, inducing traders to become industrialists, industrialists to become exporters, or farmers to adopt modern inputs benefited others as a result of the learning which took place and the more efficient markets which developed.

These characteristics are those which even traditional neoclassical economics recognizes as justifying government intervention.

- (e) *Government construction of the infrastructure and development of the institutional framework* is another category of interventions that is also well established in theory. These usually also involve substantial externalities and risk plus many decreasing cost activities (natural monopolies).

The importance of an effective government role in this respect can be seen clearly from the study of *agricultural output* growth in the two Punjabs [see Papanek, *et al.* (1986)]. The importance of the market in explaining the higher rate of growth in Pakistan and Bangladesh in the early 60s and late 70s has been stressed earlier. But, as also noted, the government's role remained important in guiding the process and in performing a series of vital functions. It stabilized and guaranteed the prices of the most important products and subsidized the price of crucial inputs. It also carried out research, provided extension services, and invest-

ed heavily in agriculture. The surface or canal irrigation system was developed and managed by government and so were the wells designed to lower the water table to combat salinity and waterlogging.

India made the larger and more effective effort in developing both the institutional and the physical infrastructure for agriculture. It invested more in developing new seed varieties and creating an extension service that brought these to the farmers. The differences with respect to the institutional effort are difficult to quantify. One simple and undoubtedly quiet inaccurate index of institutional development is given by loans extended by the cooperative system. In the Indian Punjab the Cooperatives disbursed about double the loans of those on the Pakistan side in the early 50s. By the late 70s their credit was over 20 times that on the Pakistan side, a quite remarkable increase in the difference.

Another quantitative measure of institutional development is the proportion of children in *primary school*. Even in 1960 India had about twice the proportion of children in primary school as Pakistan, with Bangladesh almost exactly in between. But for girls the discrepancy was 3 to 1, while for Bangladesh it was 2 to 1. By 1981 Pakistan had caught up quiet a bit, with the Indian proportion 50 percent above that of Pakistan, and Bangladesh only about 10 percent ahead. For girls the gap had shrunk to twofold, with Bangladesh again almost exactly equidistant. While school enrollments can readily be measured, the impact on the rate of growth of agricultural output can only be guessed at.

India actively developed the *extension service*, a community development machinery and, somewhat later the Intensive Agricultural Development Programme. In terms of coverage and importance one might guess that Pakistan followed about 10 years later in most of these fields. The structure for *agricultural research* was better developed in India as well, according to all those who have compared the two countries.

The differences in physical infrastructure can be measured more readily. Throughout much of the 1960s and 1970s *electrification* in India covered 10 times the proportion of villages electrified on the other side of the border.¹⁵ By the late 70s the Indian Punjab had electrified all its villages, while even in the early 80s Pakistan reached less than one quarter. With electricity available it was no longer necessary to use a separate diesel engine for each well or pump. This reduced costs and, even more important, eliminated the major problem of managing, maintaining and repairing a diesel engine. This development was beneficial for equity, discussed below, as well as efficiency. It also facilitated the spread of machinery to process agricultural products, making it easier to shift to higher value cash crops and keeping a higher proportion of agriculture-generated income in the rural area.

¹⁵The discussion in this section is drawn from Papanek, *et al.* (1986).

It also helped with the development of local industry to provide employment and income in the agricultural offseason. But the main effect was via lower-cost wells and pumps.

Expansion of the *road network* also served a multiplicity of purposes. But the main effect was in lowering the cost of inputs and raising the cost of outputs to the cultivator. The change in cost was significant in some cases (Thomas), where roads allowed a shift from human or bicycle to bullock cart or pickup truck transport. Roads increased the speed with which fertilizer, pumps and wells spread. On the output side they made possible the growing of high value perishable cash crops, especially fruits and vegetables, as well as a more general shift from lower value subsistence to higher value cash crops. Finally they greatly eased access and therefore helped the spread of various services, especially extension and credit. The two Punjabs started with almost identical mileage, but by 1980 the Indian side had four times the mileage on the Pakistan side. In the Bengals the rate of growth was higher on the Bangladesh side. From having more than 2 times the mileage in 1950, Indian Bengal was only 50 percent ahead in 1970. But since the area of Bangladesh is far larger that still represents a considerable discrepancy.

The more rapid development of the physical and institutional infrastructure in India was one factor in the higher growth rate over the whole 30 year period of the Indian Punjab and may help explain why the growth rate in Indian Bengal lagged only modestly behind that in Bangladesh, despite the more favourable policy environment in the latter for about one third of the period under review. In the years when both Punjabs were under dirigiste regimes or under more market oriented ones the growth rate on the Indian side was quite regularly higher. Some of that is almost certainly due to the better physical and institutional infrastructure created by government.

C. Efficiency and Growth: A Summing UP

While some aspects of government intervention were clearly beneficial, and the Indian government was far ahead of Pakistan's (and Bangladesh's) in the extent and effectiveness of positive government intervention, the striking difference among the countries is the greater efficiency with which resources were used during the two periods when Pakistan and Bangladesh relied more heavily on market forces. There were also differences in investment rates among countries and time periods, but these are not systematic and do not allow for clear conclusions.

In the extensive literature on the subject the argument has been made that the propensity to save is higher in the public than in the private sector and that therefore a more interventionist or dirigiste government is likely to have a higher savings and investment rate. The converse argument has also been made on *a priori* grounds; the private sector saves more than profligate governments. The data in

Table 10 do not support either position. Investment (and savings, see Tables 3 and 4) was clearly higher in dirigiste India than in more market-oriented Pakistan/Bangladesh. But when the latter were in their more dirigiste phase their

Table 10
Incremental Capital-output Ratios
(at Constant Prices)

	1950s		1960s		1969-70-1976-77		1977-78-1986-87	
	Invest.	ICOR	Invest	ICOR	Invest	ICOR	Invest	ICOR
India	11.8%	3.0	16.8%	4.1	20.0%	5.3	24.3%	6.2
Pakistan	9.5%	3.5	19.1%*	2.6*	15.5%	3.3	17.4%*	2.6%*
Bangladesh	9.5%	3.5	10.3%*	2.5*	8.6%	4.3	13.1%*	3.3*

Averages for investment and Incremental Capital/Output Ratio

More Market Oriented

(Pakistan and Bangladesh

60s and 1977-78 - 1986-87

Investment : 15%

ICOR : 2.8

More Dirigiste +

(India - All Periods

Pakistan/Bangladesh

1969-70 - 1976-77)

Investment : 17%

ICOR : 4.7

India - More Dirigiste

(All Periods)

Investment : 20.4%

ICOR : 5.2

Pakistan and Bangladesh -

More Dirigiste Periods

Investment : 12.1%

ICOR : 3.8

Sources: For 1950s and 1960s from Niazi, generally using World Bank "World Tables"; for 1970s from Tables 2 and 4.

Notes: "Invest" = investment as percent of GDP.

"ICOR" = the Incremental Capital/Output Ratio; the rate of investment divided by the rate of growth.

*Periods when more market oriented governments in office.

+Excludes 1950s when comparable data not available.

savings and investment were lower yet. The only unequivocal conclusion is that India had higher savings and investment than the other two most of the time. One can speculate that political uncertainty and instability in Pakistan and Bangladesh was a major factor in lower savings and that a much bigger corporate sector in India was another, but to identify all the factors in different savings and investment rates is beyond the scope of this paper (for a recent analysis covering all three countries [see Kazmi (1990)]).

The striking difference between the dirigiste and market oriented periods is not in investment but in the Incremental Capital Output Ratio (ICOR). Depending on the basis of comparison, the more market oriented strategy resulted in each unit of investment yielding one third more output at a minimum to twice as much output at a maximum than the more dirigiste strategy (Table 10). To put it differently, a 20 percent rate of investment could produce as little as a 4 percent growth rate under a dirigiste strategy or as much as a 7 percent growth rate with a market oriented strategy. If a 2.5 percent rate of growth in population is taken into account, then the difference is between a very slow 1.5 percent rate of growth in per capita income under dirigism as against a quite adequate 4.5 percent rate of growth under the market oriented regime. That is the difference between doubling per capita income in 50 years or 16 years, a striking and important advantage for the market oriented strategy (Table 11).

Table 11

Summary: Growth Rates of GDP under Market Oriented and Dirigiste Strategies
(Average Growth Rates in GDP for Two Periods Each)

	1949-50 – 1959-60 and 1969-70 – 1976-77 More Dirigiste			1959-60 – 1969-70 and 1977-78 – 1986-87 More Market Oriented		
	India	Pakistan	Bangla	India	Pakistan	Bangla
Agriculture	2.4	2.2	1.1	1.2	4.3	2.9
Manufacturing	5.4	14.5	14.0	6.8	11.3	6.9
Other	4.3	5.0	2.4	5.3	7.4	6.1
Total Product	3.8	3.7	1.9	3.9	6.8	4.4
Population	1.9	2.3	2.6	2.2	2.65	2.5
Product per Capita	1.8	1.8	-.8	1.6	3.65	1.8

Sources: Table 1 and 2.

In actual fact the differences were not as great, because the more favourable ICOR was partly offset by a lower rate of investment in Pakistan and Bangladesh. But still, the growth of per capita GDP is about twice as high in the market oriented as in the dirigiste periods.

II. EQUITY AND POVERTY UNDER DIRIGISTE AND MARKET ORIENTED STRATEGIES

In appraising the development strategies of these countries one needs to look at their impact on equity, as well as on growth and efficiency. Two aspects of equity were paramount: regional and class (or group) income distribution. Given the size, heterogeneity and obstacles to mobility of both countries, the regional distribution of economic costs and benefits was bound to be an important issue. That issue will not be addressed here. With a low average per capita income, and its slow rate of growth, the nature of the classes or groups which bore the costs and received the benefits of development was likely to be another matter of considerable concern. Of particular salience would be the extent to which the poorest groups saw their absolute incomes rise over time.

1. Income Distribution as an Issue

Much of the analysis of Pakistan's experience during the 1960s implicitly or explicitly advanced the following arguments:

- (a) More rapid growth in the 1960s was accompanied by a deterioration in equity. This was a major factor – in some arguments *the* major factor – in the political upheavals of 1968 to 1971 and the eventual break-up of the country;
- (b) The most crucial aspect of equity in some analyses was income distribution by class, and specifically the deterioration in the position of the lower income groups and the concentration of income and wealth in the hands of "the 22 families; and
- (c) The deterioration of equity was an inherent and inevitable result of the development strategy followed by Pakistan.

In India the concern with equity has been more widespread and of longer standing than in Pakistan, in the pronouncements of the political leadership, in professional writings and in policy. Moreover, while in Pakistan the argument for major improvements in equity usually assumed that a basic change in strategy was necessary, in India it was generally expected that more vigorous pursuit of some ongoing policies would be adequate: more far-reaching land reform, nationalization

and social welfare measures.

There seems to have been less difference in the factual situation of the two countries in the 1960s than there was in the perception of the situation by analysts (and politicians). Both countries showed a high degree of concentration of income, wealth and power in the industrial sector. This was quite inevitable given their level of development, the structure of economic growth in the colonial period, and the importance of private enterprise. The unreliable estimates that exist are that in the 1960s the seven largest family houses in Pakistan controlled 20 percent of assets in the corporate industrial sector and the six largest family houses in India controlled 20 percent of that country's assets in the corporate industrial sector.¹⁶

However, the differences between the two countries are greater than these figures would suggest. Government enterprises controlled roughly one-third of the total assets of India's industry and nine out of the ten largest companies by asset size were government firms. These companies dominated many of the capital goods industries where large units are the rule. In addition, in the 1960s the Indian government exercised more control over its industrialists and Indian industrialists exercised less control over the government than was true in Pakistan. As a result, the few dominant business families had less influence on investment, price and other decisions in India than in Pakistan. Differences did exist between the two countries in industrial concentration, but they were almost certainly less than the differences that were widely believed to exist.

On class income distribution, the poor overall data that are available lead to the conclusion that income distribution was more egalitarian in Pakistan than in India. During the market oriented 1960s Pakistan's income distribution became more equal, while in dirigiste India it became less so (see Table 12). Bangladesh, then East Pakistan, was still more egalitarian and became remarkably more egalitarian over the 1960s.

On the face of it these results are precisely the opposite of the conclusions of most analysts in the 1970s. They believed that Pakistan's income distribution would become less equal as the result of the development strategy it followed, and that East Pakistan suffered particularly, while India's would become more equal as a result of a deliberate egalitarian and populist approach, designed to help the poor.

The data for the 1970s are very spotty, but if they show anything it is that dirigiste Pakistan and Bangladesh had substantial increase in inequality. Despite a shift to a more market oriented economy and more rapid growth, income distribution in Pakistan continued to become less equal until the mid-1980s and then substantially improved. It is not clear what caused the initial deterioration and subse-

¹⁶[Papanek (1967) and Grossman (n.d.)]

Table 12

Income Distribution and Poverty, 1960-1984

	India			Pakistan		Bangladesh	
	Share 40%	Poverty	Gini	Share 40 %	Gini	Gini- Rural	Share 40 %
1960	13.6%	44%	.47	-	-	.38	16.0%
1963-65	17.2	47%	.42	19.2	.35	.33	17.9%
1966-68	13.1	57%	.38	19.3	.34	.31	19.6%
1969-70	-	51%	-	20.6	.32	.27	-
1970-71	-	48%	-	21.1	.315	-	-
1971-74	-	41%	-	20.4	.33	.44	18.2%
1974-76	17%	46%	.48	-	-	-	17.1%
1979	-	-	-	-	.375	-	-
1983-85	-	34%	-	-	.43	-	17.3%*
1985-86	-	-	-	-	.355	-	-
1986-87	-	-	-	-	.35	-	-
1987-88	-	-	-	-	.35	-	-

Sources: Papanek *et al.* (1986) for most data through 1974 - 76 and for India and Bangladesh for 1983-84; Acharya and Papanek (1989) for Indian proportion below poverty line; Pakistan for 1979 - 1987-88 calculated by Dr Nadeem Burney of the Pakistan Institute of Development Economics - informal communication.

Notes: "Share 40%" = the share of the poorest 40% in National Income.

"Poverty" = percent below the poverty line.

"Gini" = Gini coefficient.

*1981-82.

quent improvement during the more market oriented government in the 1980s. Particularly striking is that the Gini coefficient for 1984-85 shows a sharp increase in inequality compared to both 1979 and 1985-86. Whether this is real, and if so what caused it, or statistical artifact requires further investigation.

But these rather poor overall figures simply do not support the contention that Pakistan's income distribution was less egalitarian than India's or that it has become less egalitarian during the period of rapid growth in the 1960s. Rather they support the notion that the more rapid growth in Pakistan was good for the poor.

The single data point for the early 70s shows a less egalitarian income distribution as growth slowed in both Pakistan and Bangladesh. Indeed in the latter there was an unprecedented short term deterioration in income distribution during the serious setback to the economy in the early 70s. It appears that when the economy deteriorates the poor suffer disproportionately.

The series for India itself also shows a tendency for poverty to increase and income distribution to worsen when growth is slow and vice versa for rapid growth [Acharya and Papanek (1989)].

2. Workers' Real Wage, Income Distribution and Growth

Some further evidence on income distribution and on the effect of growth on the lower income groups is provided by data on real wages. Again these are not terribly reliable and are especially sketchy for Pakistan. But as Table 13 shows there is a high degree of correlation between higher rates of GDP growth and rapidly rising real wages. During the time periods when per capita income rose more rapidly real wages also increased at a more rapid rate. In every time period in all 3 countries when per capita income growth exceeded 2 percent, real wages rose by more than 1 percent per annum. Conversely, when per capita income rose by 1 percent or less, in 6 out of 8 time periods, real wages declined (see summary of Table 13). The consistency of the association is high.

Within India itself, higher growth in GDP was associated with more rapidly rising agricultural wages [Acharya and Papanek (1989)]. Slow GDP growth was accompanied by stagnant or declining real wages. While individual time periods can be explained away, the overall pattern is quite consistent over time, consistent with the income distribution data and with the notion that rapid growth benefits the poor at least proportionately. Rapid growth may, in fact, benefit them disproportionately, while slow growth hurts the poor disproportionately.

3. Factors Making for a Correlation between Rapid Growth and Improvement for the Poor

The principal reason for the effectiveness of what has pejoratively been called "trickle down" among the three countries was that the market oriented strategy created demand for unskilled labour. Rising demand raised real wages of unskilled workers, not just in industry but also in agriculture. Since the poor derive much of their income from selling their labour, rising wage rates and increased working hours a week, and weeks in the year, meant rising incomes. Apparently when growth is rapid and labour intensive then unskilled workers, the largest group of the poor, benefit at least proportionately.

Several factors made for the labour intensity of growth:

- (i) More rapid growth in agricultural output during the market oriented periods involved double and triple cropping where there had been one crop before, especially in Bangladesh [Papanek *et al.* (1986)]. That

Table 13

Changes in National Income and in Real Wages, 1950s to 1980s

	India	Pakistan	Bangladesh
1950s (generally late 50s)			
Wages	-1.0	2.6	-0.6
Per Capita GDP	1.3	0.0	0.0
Early 1960s			
Wages	2.0	3.9	6.1
Per Capita GDP	1.9	4.4	2.1
Late 1960s or Late 60s			
Early 70s			
Wages	0.1	2.5	-2.7
Per Capita GDP	1.5	3.8	0.9
Early 1970s			
Wages	-3.8	6.6	-19.0
Per Capita GDP	0.2	1.1	-2.9
Late 1970s			
Wages	9.3	1.1	6.9
Per Capita GDP	3.9	3.5	1.9
Late 1970s Early 80s			
Wages	-5.2	-	-
Per Capita GDP	-1.1	-	-
1980s			
Wages	5.3	-	0.4
Per Capita GDP	3.2	-	1.0
1950s - 1980s			
Wages	1.2	3.9	-1.1
Per Capita GDP	1.7	2.5	0.7

SUMMARY:

Per Cap. Income Growth	Changes in Real Wages		
	Decline	0 - 1%	More than 1%
1% or less (incl. Negative)	6	1	1
More than 1% to 2%	1	1	4
More than 2%	0	0	7

Source: Papanek (1989).

Notes: Wages are for agriculture, except for Pakistan (construction/industry).

- meant a near doubling or tripling of labour inputs and may have been the largest single source of additional labour demand;
- (ii) Similarly, the increased use of agricultural inputs required more workers;
 - (iii) In the early stages of development in Pakistan and Bangladesh import substituting industrialization could involve labour intensive industries. The textile industry, the backbone of Pakistan/Bangladesh industrialization has fairly high labour requirements compared to other large scale, modern industries;
 - (iv) When import substitution had largely run its course and would, of necessity have become increasingly capital intensive, Pakistan began to move into the world market. Here again the lead was taken by textiles and miscellaneous simple manufactured goods, and by garments (especially in Bangladesh) in the 1980s. These are the industries in which the countries of South Asia have comparative advantage. If government does not unduly skew the rules to favour capital intensity, then comparative advantage in a labour abundant country almost inevitably will lead to the development of export oriented, labour intensive industry. These industries grew very rapidly after deregulation, first by employing idle capacity, then by a high level of new investment;
 - (v) A labour intensive public works programme was launched in the market oriented 1960s and provided employment in the agricultural offseason, supporting wages of the poorest at that time. Previously, in order to survive they had to take work at extremely low wages; and
 - (vi) With more rapid growth of both agriculture and industry, and a relaxed foreign exchange constraint, there was growing demand for trade and services. Large parts of these sectors are highly labour intensive, especially retail trade and personal services.

In short, in labour abundant countries a market oriented development inevitably was labour intensive. Labour intensive development in turn was both efficient and equitable. It alleviated poverty by increasing the earned income of unskilled labour, the source of most of their income for the great majority of the poor.

4. Some Benefits of Dirigism

The market oriented economies, and especially Pakistan, lagged in three respects behind the dirigiste periods in the same countries and behind India in dealing with poverty and equity.

- (a) They paid less attention to the provision of services targeted to the poor, and especially employment guarantee schemes used to develop the infrastructure at the same time. By the 1980s such programmes had become quite large in India and in at least some cases seem to have been rather effective;
- (b) They also were slower to expand the closely related education and health services. With the middle and upper income groups generally able to procure social services, the expansion of primary school and primary health care benefited the poor disproportionately (see below); and
- (c) Finally, the dirigiste governments tended to put greater curbs on the consumption of luxury goods, and especially on conspicuous consumption. This brought with it substantial political benefits, since it is disparities in consumption, not disparities in income, which mobilize political discontent. But austerity also has an effect in increasing savings. Competition in consumption lowers savings, other things equal, while competition in investment encourages it.

But despite these countervailing factors the effect of rapid, labour intensive growth was clearly overwhelming. It was during the market oriented periods that the poor benefited the most, despite the neglect of their special needs and concerns during that period.

5. The effect on Social Indicators

One of the most striking difference between India on the one hand and Pakistan/Bangladesh on the other is the far better performance of India in providing social services to its population (see Table 14). The rapid expansion of primary schools benefited primarily the poor. Despite a significantly lower per capita income India has infant mortality that is far lower than in Pakistan, while life expectancy is substantially higher. The gap has actually grown over the years.

There are several plausible explanations for this discrepancy:

First, the total resources available to the three countries differ. It is not completely unexpected that Bangladesh has higher infant mortality and lower life expectancy than the other two countries, given its low per capita income, inadequate caloric intake and limited supply of health workers.

Second, there are differences in social mores. Religion-based cultural norms limit the access of girls to schools and of women to health facilities in Pakistan/Bangladesh. As a result the gap in school attendance between India and Pakistan is especially great for girls.

Third, history had a role. At Independence the proportion of educated per-

Table 14

Social Indicators

	1960	1965	1970	1976	1985
A. School Enrollment (% of Relevant Age Cohort in School)					
Primary					
Total					
India	61	74	79	79	92
Pakistan	30	40	44	50	47
Bangladesh	47	49	50	53	60
Male					
India	80	89		94	107
Pakistan	46	59		68	61
Bangladesh	66	67		106	70
Female					
India	40	57		63	76
Pakistan	13	20		31	32
Bangladesh	26	31		60	50
Enrollment Ratio in Secondary Schools					
India	20	27	28	28	35
Pakistan	11	12	16	17	17
Bangladesh	8	13	15	23	18
B. Infant Mortality and Life Expectancy					
Infant Mortality					
India			139	128	88
Pakistan			142	132	114
Bangladesh			140	138	125
Life Expectancy at Birth					
India	43.0		47.5	51.1	56.2
Pakistan	44.0		46.1	47.7	51.2
Bangladesh	42.0		44.9	46.4	49.8

Sources: World Bank, *World Development Report 1979, 1980, 1988*.

World Bank, *World Tables*, 1976 and 1980.

sons was less at all levels in Pakistan than in India and so was the number of teachers, doctors and other professionals to provide social services.

Finally, policy plays a role, the priority and attention which government

gives to the provision of social facilities in general and of services for the poor in particular.

In comparing the three countries it is difficult, if not impossible to determine the relative importance of these factors. But the effect of policy can be isolated from the other factors to some degree by contrasting periods of dirigiste and populist policies with the more market oriented ones in Pakistan and Bangladesh. However, the periods when populist policies were followed are relatively brief. As a result their consequences are difficult to determine, since the effect of changed policies shows up in social indicators only with a lag.

Still one can see some speeding up in the provision of educational facilities in the early 1970s, during the more dirigiste, populist government than had been true in the previous half decade (Table 14). But lags are such, and statistics are so limited, that any effect on infant mortality or life expectancy cannot be traced.

6. Summing Up: Strategy and Poverty

In short, dirigiste governments did somewhat better in providing services that disproportionately benefit the poor. This, however did not seem to make up for lower growth in the earned income of the poor which resulted from slower growth in per capita income. Rapid growth during the more market oriented periods seems to have benefited the poor at least proportionately. The substantial gain in their real wages during the market oriented periods probably more than outweighed possible losses from slower growth in the provision of social services and from less attention to specific poverty alleviation programmes. Clearly it would have been best for the poor if rapid, labour intensive growth had been combined with rapid expansion of social services and targeted poverty alleviation programmes. The more important, however, was the achievement of rapid labour intensive growth. A greater reliance on the market was good for both growth and poverty alleviation in the three countries analyzed here.

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**Comments on
“Market or Government: Lessons from a Comparative
Analysis of the Experience of Pakistan and India”**

Since I am not an expert on the details of development in Pakistan or India, I shall only comment on the general themes of Gustav Papanek's paper. The main theme is that the development of Pakistan and India over the last 40 years is consistent with the finding of many other studies that growth rates are higher during periods when market-oriented policies are followed than when a government directed approach toward development is adopted.

This conclusion, which has been reached in study after study and is now generally accepted, is in my view, the most important finding of development economists over the last 40 years. It may seem evident now, but, as a co-author of one of the earliest texts in development economics, I can tell you it was not evident in the early 1950s. Indeed, at that time most believed that a policy of import substitution would produce the fastest growth rates for developing countries. And, of course, this approach did work well initially in most countries. The problem was that, after simple manufacturers such as textiles were established domestically, further growth was stymied by the lack of adequate domestic demand and insufficient human and physical capital resources. However, it was discovered that by eliminating the biases against exporting caused by import substitution policies developing countries could continue to grow at high rates by relying on the large demand for simple manufactures in the developed economies.

Given the wealth of data and experience supporting the efficacy of export-oriented growth based on relatively free markets in contrast to an import substitution approach involving extensive government participation in the production process, the most interesting question to raise now is why some countries have not adopted outward-looking policies and why others who have adopted these policies have abandoned them and returned to more government directed growth policies. It is this issue that I would like to talk about a bit.

To do so in a sensible manner, it seems to me it is necessary to adopt a political economy viewpoint. A political economy approach differs from an entirely economic approach in that policy is made an endogenous variable. In economics, we generally treat policy as an exogenous variable. We assume a particular policy is adopted, such as an increase in an import duty, and then ask what the economic

implications of this policy will be. But it has become increasingly apparent that if economists are going to be effective in promoting welfare-increasing economic policies, they must understand the political and economic forces that shape policies in the real world.

In utilizing this framework in investigating why some countries find it difficult to adopt and maintain outward-looking policies, the first and obvious point to make is that shifting from an import-substitution to an export-oriented policy generally entails high short-run social, political and economic costs. We know that unemployment generally increases in inefficient import-substituting industries after liberalization. Moreover, those employed in service and other non-traded goods sectors are likely to suffer a reduction in real income as subsidies and price controls on basic foodstuffs and fuels are removed. Since those in import substitution and non-traded goods sectors are often politically powerful – else they would not have obtained the policies that favour them in the first place – a government that liberalizes risks the political displeasure of this group. Still another factor making it difficult to shift to more market-oriented policies is the belief that the distribution of income will become more unequal with liberalization.

In considering how these adverse effects of liberalization can be overcome, a political economy framework looks at institutional, ideological and economic factors. On the institutional side, a key factor is the strength and efficiency of the government. As we know, a number of successful liberalization programmes have been carried out by non-democratic governments who could quite easily cope with the disruptions associated with economic liberalization. Taiwan and Korea are good examples. However, we also see liberalization taking place under democratic governments. Interestingly, this often occurs at the same time there is a shift toward a greater degree of democracy. What happens is that economic performance is so poor and inefficient under authoritarian governments that the people are willing to endure the hardships of adjustment in return for the promise of higher long-run growth. We have seen this recently in such Latin American countries as Chile and Brazil. Even better examples are the countries of Eastern Europe such as Poland and Czechoslovakia.

Ideology is another important factor influencing the ease with which liberalization policies can be carried out. This seems to be an important factor in explaining why India has never really tried a market-oriented approach toward development. Most intellectuals outside the government as well as most of the top officials within the government have a value system that puts great emphasis on the importance of making the distribution of income more equal and certainly not permitting it to become more unequal. They basically believe that the free-market system will undermine this goal and thus they oppose liberalization on these grounds. Stressing

politically the inequities associated with liberalization has proved to be very effective in gaining popular support for government directed development. It must also be recognized that many in the government or closely associated with it who oppose liberalization have much to lose in terms of power and economic status if liberalization occurs. But the costs in terms of lost growth have been enormous for India. However, as Papanek points out, the government's policies have had some benefits in terms of dealing with poverty and equity.

The last set of factors to consider in assessing the prospects for successful and sustained liberalization are economic ones. These range from the nature of world economic conditions when liberalization is attempted to the sequence of liberalization and the particular policy tools utilized. Quite obviously, if one happens to undertake liberalization when prices of exports are declining and world demand is falling due to recession, the likelihood of a successful liberalization effort is greatly reduced. As far as the sequence of liberalization is concerned, the recent World Bank country studies on this subject indicate that rapid liberalization is likely to be most successful. But strong governments are also needed for rapid liberalization. In addition, we have found that liberalization efforts must not simply focus on the international sector Exchange rate changes, reductions in import barriers, and appropriate macro and fiscal policies are necessary but attention must be given to microeconomic policies as well. In particular, efforts to stimulate agricultural as well as manufacturing production improve the chances of success.

I would hope we begin to see country studies framed in political economy terms that attempt to explain why some countries fail to liberalize or do so for only short periods. This is a rich research area and Pakistan would make an excellent country to study.

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Comments on
“Market or Government: Lessons from a Comparative
Analysis of the Experience of Pakistan and India”

In his very comprehensive paper, Professor Gustav Papanek has compared the performance of two regimes – market-oriented versus active government interventionist in terms of their respective contribution to raising agricultural and industrial production and expanding exports. By doing so he has taken us back to the early days of independent Pakistan, in particular to the period when he was associated with the Harvard Advisory Group and was involved in policy-making in the country.

This paper is very timely because the newly elected government is embarking on the policy of privatization, denationalization and deregulation. The analysis of this paper can serve as an empirical evidence of the performance of the two regimes mentioned earlier.

While I agree with Professor Papanek on the broad conclusions of the paper, my comments are basically directed towards specific issues. First, Professor Papanek has mentioned that principal constraints causing idle industrial capacity in Pakistan have been the shortages of foreign exchange for imported inputs and the lack of demand in the economy. While I tend to agree with him on the first constraint, I certainly do not agree with him on the second constraint. In a developing country like Pakistan, deficiency of demand has not generally been thought to be a major constraint to industrial development. [See Klein (1978).] What is more relevant is the supply constraint – supply of agricultural output, supply of raw materials, machinery and technology in the industrial sector, supply of skilled technicians and adequate capital equipment etc. [See Del Rio and Klein (1974).] Impressed with the misplaced philosophy, the demand management policies adapted from the developed countries were vigorously pursued in the early days of Pakistan with little importance given to supply-side economics. What is appropriate for a developing country like Pakistan is to strike a balance between the demand and supply-side policies.

Second, Professor Papanek has pointed out that despite massive devaluation by Pakistan in 1972 as compared with India, the latter's total as well as manufactured exports grew at more than twice the rate of Pakistan's total and manufac-

tured exports during 1969-70 to 1976-77. I differ with him regarding the reason given for such a remarkable performance of India's exports. It may be noted that India inherited a strong industrial base compared with Pakistan and relied relatively more on the exports of manufactured goods. On the other hand, Pakistan with a weak industrial base relied mostly on the exports of primary commodities. The year 1969-70 to 1976-77 experienced widespread recession in the industrialized countries. Consequently, the prices of primary commodities were depressed in the international market. Pakistan, being the exporter of primary commodities, suffered in terms of the loss of export earnings. Hence, total export growth was also not very impressive. India, on the other hand, relied on the exports of manufactured goods whose prices in the international market remained relatively stable. Hence, export performance in India was better than Pakistan.

Third, Professor Papanek has discussed about the 246 percent devaluation of the Bangladeshi currency and its impact on export performance. He has pointed out that despite massive devaluation, Bangladesh's exports stagnated during 1971-77. Once again, I would differ with the explanation given for the poor performance of exports of Bangladesh. It is well-known that Bangladesh is a primary commodity exporting country and was a victim of recession in the industrialized countries during 1971-77.

Fourth, Professor Papanek has mentioned that during the late 70s to mid-1980s, the government relied heavily on the market mechanism and with a 100 percent devaluation, the exports of Pakistan and Bangladesh grew by 50 percent (combined Pakistan and Bangladesh) than India. Again, I would tend to relate the performance of exports to the external factor. The industrial countries came out of recession by 1981-82 which led to an increase in economic activity in those countries, resulting in higher demand for our exports. As such, the export earnings of primary goods exporting countries increased considerably.

Fifth, Professor Papanek has singled out several factors which were responsible for higher growth in the market-oriented periods. In the case of Pakistan, he writes: "The pattern of investment was a more efficient one, more attuned to the relative scarcity of different factors in market-oriented Pakistan in the 1960s". He writes: "Pakistan had not established its labour-intensive import substituting industry at the time of independence. So history gave Pakistan more scope for investing in industries appropriate for a labour abundant country". It is well-known that Pakistan, during the 1960s had vigorously pursued an industrial policy that encouraged the use of highly capital-intensive technology. The overall employment fell in the manufacturing sector during the 60s - 13.4 percent of labour force was employed in the industrial sector in 1960-61 which declined to 12.9 percent at the end of the period. This clearly reflects the capital deepening bias in the

policies which influenced the pace, structure and labour absorptive capacity of the industrial sector.

Sixth, regarding government intervention, Professor Papanek argued that it was used ineptly in Pakistan while in India it was used effectively. Being a member of the Harvard Advisory Group involved actively in advising the Government of Pakistan during the 1960s, Professor Papanek himself is partly to be blamed for the ineffective use of government intervention.

Finally, while Professor Papanek limited his comparison of the two regimes to agriculture, industry and exports, he has omitted a very important area, that is, the financial sector. A comparison of the pre- and post-nationalization of the financial sector and its impact on growth would have made the paper even more useful. The present government has already made a beginning by denationalizing banks. Similar financial restructuring is also going on in India.

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