EFFECTIVE AID REQUIRES A LOCALLY OWNED DEVELOPMENT VISION

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Foreign aid has long played a significant role in Pakistan's economy. Total aid has averaged around 1.2 percent of GNI over the past three decades, with the economic significance of aid inflows magnified by ongoing current account pressures and large external financing needs. Today, with increasing exposure to climate shocks and weakening economic performance, it seems that Pakistan will continue to rely on substantial foreign aid inflows to meet its development and balance of payments requirements.

With aid likely to play a continued significant role in Pakistan's economy, the associated opportunities and risks should be carefully considered. International experience and literature are clear that aid can have both positive and negative economic impacts. Outcomes will ultimately be determined by whether Pakistan's political leadership can harness the power of aid behind a home-grown and credible strategy for overdue economic and institutional reforms.

POSITIVE AND NEGATIVE IMPACTS OF AID

The potential positive impacts of aid are intuitive and well-established. International financing, especially when provided on concessional terms, can help countries meet investment needs, expanding the productive capacity of the economy. International aid projects can provide a conduit for the transfer of best practices and innovative ideas from overseas and provide channels to build the skills and knowledge of government officials and staff through training and exposure to other experts. Aid inflows can provide resources to help manage the impacts of natural disasters and restore macroeconomic stability following external shocks or during periods of economic adjustment.

However, the potential negative impacts of aid are also serious and well-known. Large aid inflows can have similar 'Dutch disease' effects to resource windfalls, bidding up prices in non-tradable sectors and thereby driving currency appreciation and undermining competitiveness and exports (1). As has been noted in the Pakistan-specific literature, aid can have potentially deleterious political-economy impacts, with policymakers responding to the demands of aid agencies rather than citizens (2, 3). Geopolitical considerations can lead donors to support and thereby prolong the rule of regimes that adopt counter-developmental policies at the cost of their citizens. International donors can exhibit ideological rigidity and distort development policies, insisting on one-size-fits all approaches that do not adequately account for countries' differing development needs, contextual limits to the viability of standard development strategies, or the place of countries within broader international political-economic structures of domination and dependency (4, 5). Finally, aid agencies can arguably contribute to local capacity gaps, by driving a 'brain drain' of skilled staff out of government positions and crowding out local analysis and locally developed solutions (6).

The international literature is inconclusive when it comes to the aggregate economic development impacts of aid, reflecting the complexity of the transmission mechanisms involved (7). The simple (but unsatisfying) answer to the question of whether aid drives economic development is 'it depends', with most evidence pointing towards positive impacts on growth and poverty reduction only when country institutions and policies are appropriate and coherent (8).

IMPLICATIONS FOR PAKISTAN

What does all of this mean for Pakistan at the current juncture? Right now, few would argue that current policy and institutional settings are conducive to economic growth and development. Growth rates and productivity have been in long-term decline, poverty is estimated to have recently increased, while the economy remains subject to periodic macroeconomic instability (9). Economic policies are widely regarded to have undermined productivity through distorting the allocation of resources often to the benefit of incumbent powerful and wealthy interests (10).

In such contexts, aid inflows can still be useful in providing resources to deal with immediate human needs (for example, supporting reconstruction in the wake of the calamitous 2022 floods). Aid projects and conditionalities can also occasionally drive incremental improvements to institutions and policies against the grain of entrenched political constraints. Aid agencies can support the transfer of skills to government counterparts and provide fixes to localised technical problems. But under current policy and institutional settings aid – on its own – has little hope of driving a step-change in growth and development (11). Further, in the absence of a clearly articulated domestic development strategy – and amid severe policy-generated constraints to productivity – the potential negative impacts of aid in terms of policy coherence and Dutch-disease effects, will remain magnified.

WHAT IS TO BE DONE?

International experience clearly shows that countries achieve rapid economic development progress when powerful stakeholders can agree on and commit to a locally-owned reform and development strategy (12, 13). This kind of development commitment and vision is also required to ensure the effectiveness of international aid. In the context of current pressing economic challenges, Pakistan could break with the patterns of the past and adopt a home-grown reform strategy to address well-known constraints, including through long overdue reforms in fiscal management, international trade, energy, and the business environment. Departing from a history of accepting conditionalities in return for urgently needed external financing amidst ongoing crises, government could instead proactively articulate and take major steps in implementing a clear reform program. With the increased credibility and economic self-reliance that such a reform program would deliver, government could – from a position of strength – request donors to contribute to implementation, both through financing and technical assistance. Following the path of other rapidly developing countries, Pakistan could take a discerning approach to accessing international support, progressing only with reforms, projects, and approaches aligned with its overall vision (14).

International donors know full well that development can only be achieved when their programs are aligned with a country's own development plans. While development agencies face their own political and economic constraints and sometimes perverse incentives (15), the goal of successful economic development is ultimately shared. In the context of a government taking determined and credible reform steps towards a plausible economic development vision, international partners would be obliged to lend their support. This should mean providing timely financing to priority programs, coordinating between themselves to reduce duplication and transaction costs, creating space for local adaptation and variation taking account of context, and – above all – listening when government explains its development needs.

DEVELOPMENT PARTNERSHIP

There is broad consensus that Pakistan's development problems are largely political (9, 10). With the state captured to serve short-term elite interests aid can – at best – only provide resources to protect those most in need, and support incremental improvements in policies, institutions, and infrastructure. Under these conditions, donors should be aware of the potential negative economic impacts of aid and be open to criticism and dialogue, especially to inform mitigation of these risks. While international donors can and should support any step towards improved development progress, the decision is ultimately in the hands of Pakistan. It is only when Pakistan's policymakers adopt a coherent development vision and implement overdue reforms that the potential positive impacts of aid can be fully realised.

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