

## Development Strategy for Pakistan

by

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Economic planning is of such recent origin in Pakistan that, up to now, it has necessarily been *ad hoc* in character. The problems of the present and immediate future have always appeared so pressing to the planners that, aside from hopeful compound-interest projections to the next generation and occasional evasive reference to the advantages of a "mixed" economy, there has been little in the way of a philosophy or long-run strategy of economic development that one could attribute to the planning authorities. This is not at all surprising when one recalls that the First Five Year Plan was not officially approved until more than one-third of the plan period had passed. The final version had to be in part a rationalization of what had already occurred. Even the Second Plan was ready only on the eve of the beginning of the plan period and the final revised version did not appear until 15 months later.

In contrast, at the midpoint of the second-plan period, there is already underway a considerable amount of preparation for the Third Plan and its general structure has been tentatively outlined. In addition, work on a long-range "Perspective Plan" has begun and a Perspective Planning Section has been established within the Planning Commission. And in the context of preparation of a Third Plan and a Perspective Plan, considerably more attention is being given to broad questions of development strategy.

The publication of Dr. Mahbubul Haq's work on planning strategy<sup>1</sup> is, therefore, very timely. The author's long experience as an economist with the Planning Commission lends weight to his evaluation of Pakistan's First and Second Plans, but it is his attempt to fit Pakistan's experience and prospects into the framework of a general growth model with a long-run perspective that should be of particular interest to students of Pakistan's development. Consequently, in this review I shall focus on the development strategy that I see emerging from his planning models and his critiques of first- and second-plan experience. The value of the book extends much beyond this, however. The chapters analyzing the First and Second Plans and blueprinting the Third are

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<sup>1</sup> M. Haq, *The Strategy of Economic Planning*. (Karachi: Oxford University Press, 1963).

indispensable reading for those who want to understand the critical issues facing Pakistan at this juncture in its development effort as is the chapter on regional development. Moreover, the wealth of data—particularly in the extensive appendices—makes this a very valuable reference for all who are doing research in this field.

### THE STRATEGY

The first element in Dr. Haq's strategy is a bold approach to development planning: aiming at a more rapid rate of growth justifies itself in more rapidly rising consumption as well as more rapidly rising income. The bold approach is described as a "Russian" model in contrast with a "Rostow" model of timid development planning, though the author recognizes that the "Russian" model has little in common with Soviet experience. The "non-Russian" character of the model is most evident in the prominent role given to foreign aid. While the total amount of foreign aid is the same in the timid and bold approaches, the latter strategy calls for more aid earlier. Illustrating with figures for Pakistan, the author comes up with quite a massive concentration of aid in the first half of a thirty-year development schedule. This means, of course, that, instead of consumption rising more slowly at first in order to rise faster later (the relation to which we are accustomed in models of this sort), consumption rises more rapidly right from the beginning in the "Russian" model. This dependence on massive early aid suggests that the model should perhaps be labelled 'Taiwanese' or 'Israeli' rather than "Russian", however.

But dependence on foreign aid comes to an early end with a steady rapid rise in the domestic saving rate. This is to be achieved by concentrating income increases in the capitalistic sector—typified best by large-scale manufacturing—where the saving propensity is assumed to be the highest, by curbing government consumption, and by increasing the yield of the tax system. His specific tax proposals are not worked out in detail, but they deserve serious consideration as a general approach to tax reform.

The emphasis on saving out of profits leads the author also to urge economizing on infrastructure investment in favour of investments with quicker returns. Elsewhere, he puts the argument against building infrastructure in advance of current needs in terms of reducing the capital-output ratio, but it is the same argument.

Dr. Haq recognizes that the problem of regional growth is a critical one for Pakistan and he spells out the regional disparity issue in very dramatic terms. Moreover, his estimate of the saving transfer from East to West presents a startling picture of a poorer and more populous region supporting a richer and

less populous one. The dilemma he sees is that too sharp a shift in development allocations to the East Wing may halt the momentum of growth that has built up in the West Wing. Hence, he opts for the attainment not of per-capita income parity, but of parity in rates of growth.

The need for more rationality in economic decision-making, according to Dr. Haq, calls for the use of shadow prices for capital, labour and foreign exchange in development planning. While he suggests some very crude approaches to the calculation of actual shadow prices for Pakistan, he seems to be primarily interested in convincing the reader of the soundness of the principle. In any case, if the shadow prices could be translated into market inducements *via* taxes, subsidies, *etc.*, the next step in achieving greater economic rationality would be greater reliance on the market instead of on direct controls. He sees what he considers to be an excessive amount of direct administrative intervention in the economy by government as stemming from *i*) a tradition of bureaucratic custodianship, *ii*) a distrust and misunderstanding of market forces, and *iii*) an unwillingness to recognize that consumption must be sacrificed for growth. The consequence is a serious dilution of the importance of development criteria in economic decisions. In addition, he emphasizes that the need for economizing on administrative resources reinforces the argument for more reliance on the market.

His preference for the market over direct controls, together with his emphasis on the growth of the capitalistic sector to increase saving, suggests a leaning toward a private-oriented rather than a public-oriented development process. Indeed, throughout most of the book there seems to be a concern lest government should waste resources through inefficiency and divert resources away from capital formation through premature considerations of equity. In the final chapter, blueprinting the Third Plan, however, the author comes out for a "socialist" framework—which turns out to be an old-fashioned, pre-Soviet kind of socialism meaning essentially social welfare and distributive justice. This is so inconsistent with the strategy reflected elsewhere in the book that I suspect that Mahbubul Haq, the political planner, has here taken over from Mahbubul Haq, the economic strategist.

#### CRITIQUE OF THE STRATEGY

No one can quarrel with the author's call for a bolder approach to development planning in Pakistan. As best we can estimate it, per-capita income has remained virtually constant during the First and Second Plans. While it is possible that shortcomings in the data mask some real improvement, any corrections we might allow for this possibility would still mean only very

modest gains. Moreover, it appears very likely that per-capita income in East Pakistan has fallen.

Another test of the adequacy of the development effort is its effect on employment of labour. According to Dr. Haq's calculations, unemployment, including redundant labour in agriculture, has risen from about 15 per cent of the labour force in 1950 to 18 per cent in 1955 and 22 per cent in 1960. Investment has fallen far short of providing productive employment for the growth in the labour force, to say nothing of absorbing the previously existing backlog of unemployed.

The bolder strategy, it will be recalled, calls for a massive, early concentration of foreign aid—say, in the next five or ten years in Pakistan. The argument implies that absorptive capacity is elastic and that total saving committed to Pakistan development (both foreign and domestic) would be significantly greater as a result. If these assumptions hold, one cannot deny the result: that earlier gains, because of exponential growth, have a permanent advantage over later gains.

Unfortunately, however, Dr. Haq does not take up explicitly the question of the validity of the assumptions. His expressed preference for directly productive investment over investment in infrastructure leads one to wonder if he is not excessively optimistic about the elasticity of absorptive capacity. Moreover, his treatment of foreign and domestic saving as essentially substitutes in his long-term growth model (gross domestic saving for each plan period is calculated by deducting assumed external assistance from gross investment, where the latter is derived from assumed income targets and capital-output ratios) suggests that total saving would not be higher. Nor does he make the growth target itself dependent on the availability of foreign assistance. Rather, the argument is put that the bold growth-target is the only meaningful one and that the alternative to foreign aid is imposing far greater sacrifices on the present generation of Pakistanis *via* some kind of totalitarianism<sup>2</sup>. It is then in the interest of both parties that the present generation of the aid-giving countries should bear the sacrifice of consumption rather than the present generation of Pakistanis. I should add that I think that this is a fair argument.

The question whether foreign assistance and domestic saving are substitutes or might better be thought of as complements deserves further comment, however. The argument that imposing a sacrifice of consumption on the present

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<sup>2</sup> I may be ascribing too much rigidity to the strategy. Planners can exhibit some very fancy footwork in defence against any attempt to pin them down to an explicit strategy. See F. C. Shorter, "Planning Procedures in Pakistan", *Pakistan Development Review*, Autumn 1961.

generation requires totalitarian methods applies, I think, to a degree of sacrifice beyond anything that has ever been contemplated in Pakistan. Of course, if it were deemed absolutely necessary to invest 25 per cent of national income in the Third Plan, then any additional foreign assistance that would be forthcoming should properly be thought of as contributing, *via* substitution of foreign for domestic saving, to the lessening of the need for measures of repression or compulsion. But if we are in the lower range of sacrifice, if we are thinking of raising the rate of investment from 10 to 15 per cent (with the domestic saving component currently at about six per cent), then I suggest that foreign saving should more properly be thought of as complementary to domestic saving.

Let me put the argument in the following way. Suppose we start by planning for the full mobilization of the nation's real resources for economic development. Owing to rigidities, immobilities, discontinuities in production functions, *etc.*, some resources will be fully mobilized while others are still in ample supply. Foreign assistance should then be thought of as supplying from the world market those critically scarce resources whose domestic supply cannot be easily augmented in the short run, but whose availability is essential to the mobilization of other resources whose domestic supply is ample. If foreign-aid programmes could be implemented in this fashion, foreign aid would contribute to increasing domestic saving by permitting greater employment and output. This obviously requires a shift in emphasis in aid programmes away from specific projects toward general commodity aid, the desirability of which Dr. Haq also stresses.

Such a change in the character of aid programmes would not be justified, however, without a basic change in Pakistan's development strategy. This means putting the question of full mobilization of Pakistan's resources (including saving) first, with foreign assistance as a complement, rather than taking foreign assistance and an income target as given with domestic saving and employment as residuals.

The planners would undoubtedly claim that nothing is taken as a residual, that in the trial-and-error process of formulating a plan adjustments are made in all of the key variables. The question remains, however, which variables bear the brunt of the adjustments. I think that it is fair to say that in Pakistan the mobilization of domestic resources has never had first priority. And it is certainly true that the greatest failures in the development effort so far have been the inability to raise domestic saving or employ the growing labour force.

The above argument points to what I think is a serious weakness that runs throughout Dr. Haq's book. While he stresses the saving potential in the highly

unequal distribution of income and wealth, he has little to say about the potential for saving in the extensive unemployment and underemployment of labour. This neglect is in part responsible, I think, for his preference for "quick pay-off" investments on the ground that they contribute more to saving. Earlier profits can be saved and reinvested earlier, but they can also be consumed earlier. Slower-yielding investments offer less opportunity for consumption, having a large built-in element of forced saving. Hence if their internal rates of return are equal, the quicker-yielding investment is actually inferior in terms of saving potential to the slower-yielding one<sup>3</sup>.

Consider, for example, two investment programmes of equal size, one paying off in one year and the other yielding nothing until ten years have passed. (In both cases, it is assumed that the pay-off is in a supply of consumption goods.) If their internal rates of return were equal, the former would achieve the same income growth as the latter only if gross profits were 100 per cent reinvested each year for the full ten years.

Both investment programmes would generate the same demand for consumption, given the marginal propensity to consume. The quick pay-off programme would, however, generate a supply of consumption goods each year. Hundred per cent saving would require that the whole supply be exported or be matched by a reduction in imports (I rule out accumulating stocks, since these could not be expected to earn the internal rate of return). The second programme, of course, produces no current supply of goods (during the ten years) to match the demand it generates, with the obvious danger that inflation would dilute saving *via* reduced exports and increased imports. But to the extent that there are underutilized resources elsewhere in the economy, other supplies may be elastic and increased output would result. If, in the end, consumption were the same in the two cases, the slower-yielding investment programme would have generated more saving by inducing more output.

Moreover, even if there were no elastic supplies elsewhere in the economy, the chances are that the slower-yielding programme would force more saving than the other through induced government policies. Both would require the same kinds of curbs on consumption to achieve a given saving target for the whole period—one in order to increase exports or reduce imports, the other in order to prevent a fall in exports or a rise in imports. The important difference is, however, that in the first case (quick-yielding programme) the government has to act to curb consumption by deflationary measures in the face of an

<sup>3</sup> The author might conceivably have in mind the case where the absolute level of profit is the same, the only difference being the period over which it is realized. This implies different rates of return, however, and the choice between them should be described in those terms.

adequate supply of domestically produced consumption goods. In contrast, the second case finds the government facing the twin challenges of inflation and a balance-of-payments problem. In both cases, the same policies are required; but in the second, the challenge to the government is far more clear and forceful.

The preceding argument suggests that, in general, the allocation of income between consumption and saving can be affected by what is produced, though we are more accustomed to thinking of the use of income as determining the pattern of production. Let me put this in a more formal way. A given investment programme (I) implies a certain growth of income ( $\Delta Y$ ), if the aggregate incremental output-capital ratio ( $k$ ) is also given:

$$\Delta Y = kI \dots \dots \dots (1)$$

Additional saving ( $\Delta S$ ) out of this increase of income depends on the marginal saving rate(s).

$$\Delta S = s \Delta Y \dots \dots \dots (2)$$

Assuming for the moment a closed economy, any increase in investment ( $\Delta I$ ) depends on an increase in capacity in the capital-goods sector, which in turn depends on the investment allocation there ( $I_i$ ) and the incremental output-capital ratio for the sector ( $i$ ).

$$\Delta I = iI_i \dots \dots \dots (3)$$

Let the actual proportion of total investment allocated to the capital-goods sector be shown thus:

$$I_i = aI \dots \dots \dots (4)$$

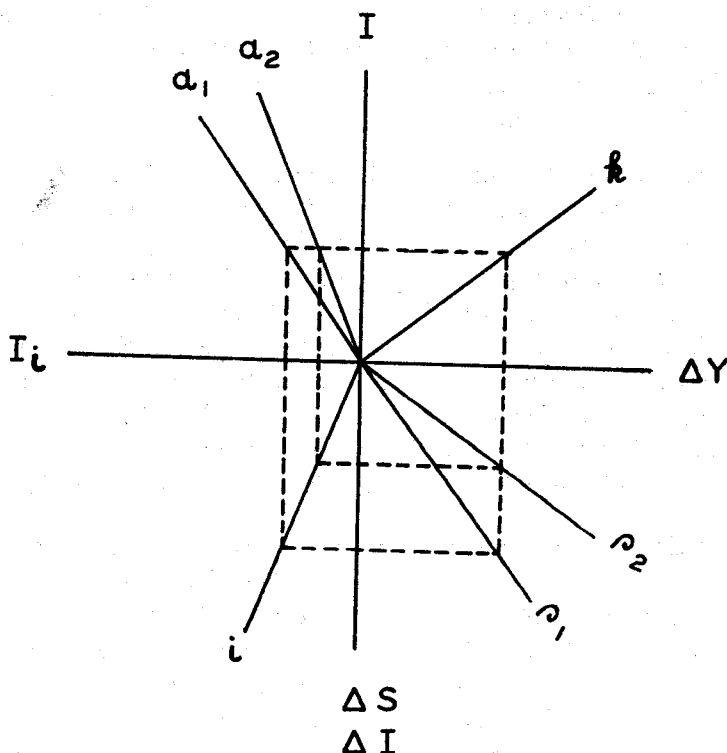
Finally, we have the condition that additional investment equal additional saving:

$$\Delta I = \Delta S \dots \dots \dots (5)$$

Given  $I$ ,  $k$ , and  $i$ , these five equations determine  $\Delta Y$ ,  $\Delta S$ ,  $\Delta I$ , and  $I_i$  if either 'a' or 's' is also given. If both are given the system is overdetermined. In other words, given an investment programme and the incremental output-capital coefficients<sup>4</sup>, a particular marginal saving rate requires a particular investment allocation, and vice-versa.

This can also be seen graphically in Figure I. Starting at a point on the  $I$  axis (given investment programme),  $\Delta Y$  is determined by  $k$ . Then moving back counterclockwise,  $\Delta I$  is determined by  $a_1$  (given) and  $i$ . This requires the slope of  $s$  to follow  $s_1$ . Alternatively, we could move clockwise from  $I$ , with  $s_2$  as given, to determine  $\Delta S$  which, together with  $i$ , specified  $a_2$  as the required investment allocation.

<sup>4</sup> The aggregate coefficient ( $k$ ) will obviously depend on the ratio  $I_i / I$ , but this does not affect my argument in any way.

**FIGURE I**

Though the requirement for compatibility between  $s$  and  $a$  is clear, the model says nothing about how it is to be achieved. It is ordinarily assumed, I think, that  $a$  is determined by  $s$  through market forces. The allocation of investment responds to the pattern of final demand. Marxists often assume the reverse causation, however, and a true "Soviet model" would probably have saving forced by a shortage of consumer goods resulting from an investment allocation favouring the capital-goods sector.

In any case, the model helps to illuminate two points. First, investment allocation must be planned so as to be consistent with the planned marginal saving rate. I have not been able to find any explicit recognition of this point in the Pakistan planning literature. Second, it is possible to raise the marginal saving rate by allocating more investment to the capital-goods sector if resources are not fully employed or if the government responds positively to the challenge of inflation and declining foreign-exchange reserves.



The model must, of course, be generalized by abandoning the assumption of a closed economy. Then, production for export and import substitution are means of acquiring capital goods alternative to capital-goods production. While this greatly increases the possibilities for diverting goods and resources *via* the market mechanism away from production for additional consumption, there still remains the basic requirement of allocating sufficient investment to export expansion, import substitution and capital-goods production to match the planned marginal saving rate.

This emphasis on forcing saving through a pattern of output that is biased against consumption helps, I think, in understanding an important aspect of the regional problem. In the East Wing, the ratio of gross saving to gross product has been 8 or 9 per cent, while in the West it has been only 3 or 4 per cent. I doubt that anyone would argue that this is due to the greater "thriftiness" of East Pakistanis. Rather, it seems clear that a high rate of saving is forced there and, while we need to know more about the mechanism by which this occurs, I suggest that the export orientation of production has much to do with it. Similarly, in the West Wing the consumption-goods orientation of investment allocation may help to explain the low saving-rate there<sup>5</sup>.

While Dr. Haq expresses some concern that the solution to the regional problem should not disturb the momentum of development in West Pakistan, he adds that the West Wing's high investment rate is "precariously based on external assistance". Real, self-sustaining momentum would, of course, require a saving rate much above the present one in that province. A shift in investment allocation away from the West Wing could conceivably help in forcing more attention there to exports and saving. The real danger, it seems to me, is that the greater investment expenditure in East Pakistan will reduce its saving rate—that the higher incomes will result entirely in higher consumption. To forestall this possibility, it is important to plan the West Wing's industrialization with a sufficient bias toward production of capital goods and export goods, as well as to provide for tighter fiscal controls on consumption.

I would like finally to conclude this review by setting the argument that has been developed above at some length against Dr. Haq's criticism of the first-plan investment allocation, since his view in this context seems to me to exemplify very well his strategic position. This will also give me an opportunity to make a brief reference to the question of reliance on market forces.

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<sup>5</sup> For fuller discussion of this point, see, A.R. Khan, "Import Substitution, Export Expansion, and Consumption Liberalization: A Preliminary Report"; and J.H. Power, "Industrialization in Pakistan: A case of frustrated take-off?" both in *Pakistan Development Review*, Summer 1963.

Dr. Haq feels that not enough income was generated in the capitalistic sector owing to insufficient allocation of foreign exchange to private investors. This, together with a failure to compensate for the resulting shortfall in private saving by means of increased taxes, explains the failure of the saving rate to rise. This view may be correct, but it leaves out the very important question of what kinds of industries private enterprises would have invested in if they had had access to foreign exchange. Unless a sufficient proportion of the investment had gone into capital-goods production or export expansion, it is not at all certain that this would have had the favourable effect on saving that Dr. Haq assumes. The increased production of consumption goods can augment saving *via* import replacement, but it need not. It is not easy to induce a government to tax consumption when it is emphasizing the growth of consumption-goods industries. And yet, this is what would have been required to insure that the additional production replaced imports rather than adding to consumption.

Moreover, the market incentives were weighted strongly against investment in capital-goods production or export expansion. Owing to the system of import licensing and duties, the market offered far greater profits in the production of finished consumer goods than in the production of capital goods and goods for export<sup>6</sup>. It might be argued that investment allocations are controlled by the planners, not by the market. But it is difficult to imagine that in Pakistan private investors can be induced to shift their investments from high-profit to low-profit industries. The market alone may not be relied upon to allocate investment, but market inducements cannot be too far out of line with the planner's allocation.

In sum, Dr. Haq's strategy of relying heavily on the build-up of the capitalistic sector for generating the saving required by self-sustaining growth suffers from three disadvantages. First, it leads to a neglect of infrastructure investment on the mistaken notion that the latter does not generate as much saving. Second, it fails to emphasize the saving potential in unemployed resources. Third, it risks the attempt to raise saving by allocating investment in the wrong pattern. These three deficiencies can be corrected, however; and, in a broader framework of growth strategy, the role of the capitalistic sector in generating saving can complement the various other devices for extracting saving from an unwilling economy.

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<sup>6</sup> See, S.N.H. Naqvi, "The Balance-of-Payments problem and Resource Allocation in Pakistan: A Linear Programming Approach", in this issue of *Development Review*.