CHAPTER I
INTRODUCTION

1.1 THE PROBLEM AND ITS RELEVANCE

An issue of major importance in our times is the unequal growth rates that exist among the developed and developing countries. Many of the countries of Asia and Africa that we now classify as developing, gained their political independence after the Second World War. Since then, most of these countries have formulated and implemented policies designed to promote economic growth so that they may achieve a higher standard of living. During this period, international attention was also focused on the problems of growth as many developed countries were transferring large sums of money to developing countries as foreign aid.

In the past forty years, many policy prescriptions, such as land reform, creation of social overhead, provision of technical assistance and other similar measures to accelerate growth and reduce poverty have been undertaken. Though they all raised hope and much enthusiasm among the advocates of development, the results achieved were regarded by many only as modest.

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1 Countries may be grouped using many different criteria. A popular method of classification implicitly puts all countries on a continuum based on their degree of development. Thus, we may speak of developed and underdeveloped countries or to recognize continuing change, developed and developing countries. The degree of optimism that underlies 'developing countries' and the handy acronym LDC, for 'less developed countries' make these the two widely used terms.
In more recent years, we have seen a slackening of the vigour with which the development agenda is pursued by development policy makers and analysts. This is due mainly to two related distracting developments that took place in the eighties: the 'adjustment' and the 'debt' crises. The origin of these two crises may be traced to the oil shock of 1979-80 generated by the embargo imposed by the Organization of Petroleum Exporting Countries (OPEC). This embargo raised the price of gasoline, which triggered a set of macroeconomic policy decisions in the advanced industrialized countries of the West, including the United States. These decisions, in turn, created financial crises in many parts of heavily indebted Latin America, Africa and to a lesser degree of Asia. Developing countries with heavy debt were told to bring the excess of their imports over exports into line with the maximum inflow of capital they were willing and able to obtain, i.e., 'adjust'. Thus, the goal of development itself became 'adjustment'. A related third development was the dwindling resources available to major donor nations and the international lending institutions. This scarcity of funds was accentuated by the diversion to Europe of available direct investment funds, as this region began to receive increasing attention in the mid-eighties. There was also a general lowering of expectations both among practitioners of development and policy analysts (Developmentalists).²

² Developmentalists is a term that is used frequently in this study. The term includes a number of factors in the development arena: Policy makers, analysts, development economists, and anyone who practices international development in its broadest sense.
At about the same time, the development doctrines that consisted of theories about how public policies can promote economic development in the developing countries were themselves undergoing revision. These revisions always made new contributions to development literature. Among other things, the public policies also deal with the role of development assistance in shaping the environment for development. These revisions have important implications for the future of development practice because incorporated in them are lessons learned in the past in setting new goals and in formulating strategies for future growth.³

During a time of extensive revision of many accepted doctrines, several useful topics could be examined or reexamined to gain more insight into the process of growth and development. An important area that needs to be examined further is the contribution of public policy research to the study of policy formulation as it relates to economic growth and development. Public policy research offers unique theoretical perspectives that could be used to explain why, in the course of their development, a group of developing countries chose to adopt certain policies over some other policies. In fact, we do know a good deal about the effects of macroeconomic policy variables (such as taxation and government spending) on growth in output, but it is also true that very little is known about the often complex process of policy formulation itself.

³ Here the terms economic growth and economic development are used interchangeably, though there is a fundamental distinction between them. Economic growth refers to a rise in national or per capita income and product. Economic development implies more fundamental changes in the structure of the economy.
A better knowledge of how different countries react to economic disturbances created by the same external events (i.e., a steep rise in the price of their export or import goods) or the same internal event (such as domestic investment boom) in policy formulations and whether the differences in policy responses of different countries to these events have contributed to differences in growth rates would be a valuable addition to the existing literature on development for two reasons: First, it will provide information useful to policy-makers in formulating future policies, and second, it would help analysts understand more clearly the underlying contextual factors (explained in Chapter Two) that shaped the formation of macroeconomic policies and their implementation in developing countries. This is a critical area that requires careful study as many policymakers in developing countries are themselves becoming concerned with unequal growth in output and, therefore, incomes in their countries. In this context we propose to examine, within the framework of a comparative study, the factors — with particular emphasis on political and other noneconomic factors for six South Asian Countries — that determined the growth policies. We will investigate whether and how these factors have accounted for inter country and intra country growth differences for selected periods within a span of forty years (1950-1990). The selected countries are Bangladesh, India, Malaysia, Nepal, Pakistan and Sri Lanka referred to as the South Asian Countries (SAC).
This study is relevant to developmentalists for a number of reasons. First, there are very few cross-regional studies of South Asian Countries, though several relating to the Newly Industrialized Countries (NIC) of East Asia and some Latin American Countries exist.\textsuperscript{4} Comparative efforts similar to this study to analyse the domestic political and other noneconomic factors that underlie alternative paths to economic development are even more rare. A main reason for the rarity of comparative work that examines the role of noneconomic factors in the growth process is the dominance of two strands of theoretical thinking; the neoclassical and dependency perspectives which will be explained in some detail in Chapter Two. We will here simply note that economists have focused their attention on the effects of policy on development, but generally have not examined the determinants of policy choices; they treat for example, politics in particular as exogenous. Other social scientists, working in the general field of development on the other hand, have viewed external constraints as determinants of national policies; with similar neglect of domestic political forces and other noneconomic factors.

Second, during the last decade, a number of new realities have surfaced in the global development arena. To be effective, any development strategy needs to address

these new realities properly. For example, according to a World Bank Study, global trade and financial links in the near future are going to be affected by intra-Asian Trade and investment flows.\(^5\) It is, therefore, imperative that we gain more insight into the evolution of different aspects of economic growth in South Asian Countries, which form a significant part of Asia.

Third, the emergence of trade and financial blocs in many regions of the world may lead to protectionism in the advanced industrialized countries.\(^6\) In that event, even if there is an increase in trade and financial flows within blocs, it could ultimately lead to a decline in global ratios. Therefore, the specter of emerging regional groupings of countries to facilitate trade is something which development policymakers have to take note of. Since our study also discusses trade issues among member countries of South Asian Associations for Regional Cooperation (SAARC), it may be of potential value to policymakers not only in South Asia, but to the whole of Asia.

The fourth reason is the focusing of attention by international lending institutions on the domestic institutional problems of aid recipient countries. These institutions want to closely monitor the domestic institutional problems of aid recipient

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\(^6\) An excellent survey article on Regional Economic Integration may be found in “Crisis in Regional Economic Cooperation (Integration) among Developing Countries: A Survey”. Constantine V. Vaitsos in *Recent issues in World Development.* Ed. Paul Streeten and R. Jolly, pp. 279-329. (1981). Pergamon Press, UK.
countries so that they may set revised guidelines for these countries to follow in setting
stable macroeconomic policies. While analyzing the political and other noneconomic
factors we will also outline the institutional setting and the associated problems in each
country so that the analysis will be of relevance to policymakers.

Finally, viewing modern developments with a historical perspective as
background may be instructive for some analytical purposes. Recently efforts are
under way in the SACs, notably in India, Pakistan, and Bangladesh to liberalize their
markets so that their economies may be unshackled. Growth studies for different
periods of the past under different political organizations, and with different degrees of
state intervention may be helpful in viewing these new developments in a historical
perspective.

1.2 AN OVERVIEW OF DEVELOPMENT EFFORT SINCE 1950

An overview of development effort since 1950 may be necessary to understand
the shifting goals and strategies of development over the last four decades. This
understanding, in turn, is essential to identify and study some of the major
contemporary issues in the realm of economic growth in developing countries.

In the 1950's, "mainstream" development strategists were concerned with the
neo-Keynesian growth models of Roy Harrod and Evesey Domar. By "mainstream" it is meant here to refer to all those influential analysts in the Western World
whose views were typically shared by their counterparts in the South. (In general the Third World).
the rate of growth of GNP was set as the goal of development. As a strategy to
achieve this they were mainly preoccupied with industrialization and with lifting the
capital constraint on development. There was, however, pessimism regarding the
ability of developing countries to increase their earnings from exports fast enough to
keep pace with import requirements. In order to help these countries move along the
path of self sustaining growth, two measures were, therefore, given emphasis: a net
transfer of concessional capital (i.e., aid), and adoption of import substitution.

In the late 1960's two developments of some importance took place. The first
was the rediscovery of the values of market as an instrument of social control by many
theorists and policy analysts. Inspired by the models of U.S. and British economic
mobilization for the Second World War, theorists and policy analysts in the developed
countries were promoting the virtues of the free market. They even felt there was
indeed a necessity for governments in poor countries of Asia and Latin America to
undertake restructuring interventions in their economies. The idea that restructuring
interventions could be knit together by comprehensive planning also began to gain
some degree of acceptance among developmentalists. However, planning brought
along with it proliferating direct controls and growing bureaucracies to administer
them both of which were having a negative influence on growth. The second, was the

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9 A good treatment of 'Conventional Development Strategy' is given in Diwan, Romesh and
increased focus given to agriculture by policymakers. This resulted in enhancing the effectiveness of strategies for agriculture expansion. Commitment to aid also gathered strength simultaneously as some major donors assigned a higher priority to agricultural development.

At the beginning of the 1970's, the conventional wisdom has it that the emphasis again shifted from growth to equity, as the main objective of development.\textsuperscript{11} It was widely felt that poverty as an urgent issue was not receiving adequate attention. Therefore, the developmentalists were persuaded to pay more attention to solving intra-national distribution problems, in particular to low-end "absolute" poverty. There was also renewed concern with the problems of unemployment and underemployment, which in many poor countries were identified with poverty. Direct attacks on the latter, along with growth promotion were needed.

A related effort suggested was to meet the 'basic human needs.'\textsuperscript{12} However, most developmentalists felt basic needs had to be met mainly by raising productivity and, therefore, the earned incomes of the poor. Yet much of the issues surrounding basic-needs targeting were closely associated with an array of social-sector or human resources issues (health, nutrition, population, education) as well as a variety of integrated-rural-development ventures.

Anti-poverty cum basic needs was particularly a donor fashion. It was favoured by various multilateral agencies, and nearly every bilateral aid donor represented in the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) adopted this nomenclature. Several developing countries also went along with this version for a while. Anti-poverty cum basic needs approach was also adopted in a document titled Declaration of Principles and Program of Action by all the developed and developing country delegations to the World Employment Conference sponsored by the International Labor Office (ILO) in June 1976. Thus, by the mid 1970's, we had two versions of how to accelerate growth: that of the 1950's, and then that of the 1960's - followed by a heavy pro-equity shift in "mainstream" development policy. Many thought the time was appropriate for a tidy growth-cum-equity synthesis. From then on emphasis on goals began to shift and sometimes overlap. The basic needs-integrated rural development thrust fell apart as it gave too low a priority to agricultural output as well as to building human and institutional infrastructure for accelerated growth. Besides, developing countries began to resist intrusion by international aid grantors into what they perceived as internal distributional issues. The rather conciliatory tones of basic-needs dialoging were soon overtaken by the harsh approach of New International

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Economic order dialoguing (NIEO), wherein the developing countries of the ‘Group of 77’ (now consisting of 178 countries) demanded faster reductions in inter-country inequalities, while asserting sovereign prerogatives to deal with their own internal distributional issues as they saw fit.

Another development that needs to be mentioned, arose as a result of two oil shocks; the first in 1973-74 and the second in 1979-80. The first shock gave an added impetus for the NICs and some of the middle-income countries to press ahead with the export-oriented strategies they had adopted in the 1960’s. In continuing their productive expansions some of these countries made varying use of the temporarily cheap credit available to them. However, the production and income advances of all of them contributed to widening differentiation of development performances that characterized the 1970’s, and early 1980’s. With many low income countries (especially South Asia) not sharing these advances, it has become clear that future development strategies need to be country-region specific. The second oil shock, ushered in the era of ‘adjustment.’ Currently in the developing countries, this ‘adjustment’ priority, along with “innovative institutional” structure building remain central elements of mainstream development thinking.

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14 In 1974, the political unity of Third World Leaders as demonstrated in the debates of United Nation’s sessions culminated in the formulation of a coherent set of ‘Third World Demands’ for a New International Economic Order (NIEO). The demands for NIEO, as it became known, were accepted by a resolution of the UN Special Assembly in May 1974 and confirmed in the charter of Economic Rights and Duties of States (1974).
In regard to the broad development strategies currently in use, it is seen that all of them pursue the same three goals: (1) economic growth; (2) interpersonal equity, including, in particular, the reduction or elimination of poverty at the lower end of the income distribution scale, and (3) national self-reliance in the sense of being able to pay for needed imports by means of exports and/or access to commercial credit.

1.3 THE OBJECTIVES OF THE STUDY

The basic objective of this study is to broaden our understanding of economic growth among six South Asian Countries. Do growth rates in output differ across and within countries over time and if they do what are the reasons for such differences in output growth? The study will seek reasons for differences in growth rates by investigating the effects of various macroeconomic policies on growth of different countries during selected periods. It will also examine the policy-making process in those periods in these countries to assess the role played by political and other noneconomic variables in economic decision making. The purpose of this examination is to find out whether and how these variables have contributed to growth differences among and within the SACs during the periods selected for study.

Specifically, the objectives of the study are:

(i) to examine the growth rates of output of the six SACs for selected periods.
(ii) to identify the major policies employed to promote growth and the various circumstances that led policymakers to formulate such policies during those periods.

(iii) to investigate if and how various macroeconomic policy initiatives adopted during the selected periods have resulted in differing growth performances among and within the SACs.

Since our primary concern is to examine if there are differences in growth rates among the six SACs, and to ascertain whether policy changes have contributed to their growth differences, it is useful to adopt a comparative historical approach for this purpose. This method, it is hoped, will make it easy to examine the political process in these countries more closely, and expose clearly the mechanisms that link economic and political variables.

1.4 SCOPE AND LIMITATIONS

This study examines the macroeconomic policies pursued by six SAC to internal and external shocks to their economies in a comparative framework, and assess their success and failures in terms of growth so that lessons learned from such assessment can be of value to policymakers and analysts.

There are studies of macroeconomic policies that reviewed the experiences of two of the six countries included in this research with emphasis on how they managed
their external and internal shocks for different periods. These studies, in which the economic policy changes are analysed in the context of broader social and political circumstances, link macroeconomic policies to long-term growth. However, they do not provide explanations for different growth performance in terms of political and other noneconomic factors. Our study on the other hand has a much broader scope in that we analyse longer periods for these six countries than most others, and attempts to provide explanations in terms of political and other noneconomic factors, wherever they are appropriate.

This study is subjected, however, to a few limitations. For instance, the comparative historical approach used here raises an important methodological problem. We cannot meaningfully compare two countries of different sizes with different resource endowments and population. Also compounding the problem of comparability is the concern that some key historical questions, particularly those concerning the perceptions and ideas of economic decision makers may never be answered. It is true that when we deal with larger historical contexts, rigorous theory for micro decisions may be lost. However, if induction and comparative historical analysis have a role in social sciences, they must offer something to development theory.

15 J.M.D. Little, Richard N. Cooper, W. Max Corden, Sarath Rajapatirana, Boom, Crisis and Adjustment. The Macroeconomic Experience of Developing Countries (1993), Oxford University Press, London. This Volume includes the study of India and Sri Lanka besides sixteen other countries.
The subject matter selected is interspersed with value judgements: the importance of growth, the role of state in economic development, the failure or success of certain strategies are all subjects that involve value judgements. While analysing the policy outcomes in this study these judgements may have to some extent, affected our conclusions.

Also, this study has not dealt with the distributional (welfare) aspects of economic policies. Recent discussions of economic development certainly reflect widespread concern with growing income inequality in developing countries. Indeed, it is often argued that policies that promote economic growth also promoted income inequality. Though this argument is supported by only limited evidence, it is very persuasive. Nevertheless, policies designed to promote income inequality are not explicitly treated in this study.

There are also other factors that are not adequately reflected in GDP: two such factors are education and health. Improving educational standards and providing better health care are no doubt important objectives, but we do not deal with them directly. However, a high rate growth of GDP may facilitate the attainment of these social goals.

While we focus mainly on macro magnitudes such as changes in aggregate output, we are interested also in the movement of output at the disaggregated level. But such disaggregated data are not available in many instances and we could not,
therefore, carry out micro level analyses of certain policy initiatives. Nonetheless, we are able to assemble adequate information to permit a meaningful analysis of growth differentials in the SAC and to provide explanations for these differentials in terms of political and other noneconomic factors.

1.5 ORGANIZATION OF CHAPTERS

In Chapter Two we will first review the literature relevant to our study. Then an analytical framework to explain the differences in growth rates of output will be developed, followed by a discussion on the sources and limitations of data used in this study.

Chapter Three gives brief profiles of the SACs that we have included in this study and the structural changes that have taken place within them during the period of our analysis. This will be followed by a discussion of the nature and extent of growth differences that exist among and within these countries during the selected periods.

Chapter Four provides explanations for these differences at the aggregate level within a framework that emphasizes political and other noneconomic factors that went into economic decision making. Analysis will focus on the role of policy adopted by different countries in the region and examine whether and how policy differences affected important macroeconomic variables, such as deficits, investment, fiscal and trade balances, and thereby influenced aggregate growth rates of output. In the subsequent chapters, we take a sectoral look at the role of various macroeconomic policies in generating growth at the sectoral level for each country and the factors that
shaped such policies. Chapter Five examines the agricultural sector for each SAC while Chapter Six examines the industries sector. In Chapter Seven, the summaries of earlier chapters and the main conclusions are given.