CHAPTER IV

EXPLANATIONS OF GROWTH DIFFERENCES
AT THE AGGREGATE LEVEL

This chapter will examine the aggregate growth differences of the SACs in terms of differences in their macroeconomic policies during the periods selected for analysis. This examination will first identify the economic policy responses of these countries to their development problems in general and to the four specific episodes mentioned in Chapter Two. Then, it will focus on the contextual factors that shaped the content and direction of such policies. Since our analysis strongly presumes that these contextual factors were largely different among and within countries, the explanations of growth differences will be given in terms of those contextual factors.

In section 4.1 period-wise growth differences for all the six countries will be analyzed at the aggregate level. In section 4.2 growth rates across-country for the same and/or different periods will be analyzed. Section 4.3 deals with the analyses of growth differences associated with the four episodes mentioned in Chapter Two. In the final section 4.4 a comparative analyses of selected growth differences with emphasis on noneconomic factors among and within the SACs will be given.

4.1 ANALYSES OF PERIOD-WISE GROWTH RATES

Period-wise growth rates at the aggregate level will be analyzed in the following manner. First, we will briefly outline the relevant country’s economic policy-making context in the period in which we are interested in, followed by a
discussion of its major macroeconomic policies. Then we will attempt to relate the key policy variables to the rate of growth in output of that country.

Before we take up the period-wise analysis three introductory remarks are necessary:

(i) A complete explanation for the changes in aggregate growth rates will emerge only when we finish discussing the two lead sectoral growth rates (Agriculture and Industry) because for a given change in the aggregate growth rate sectoral rates among countries and for different periods could vary significantly.

(ii) The scope of the analysis at the aggregate level is somewhat limited for two main reasons. One, reasonably comparable data on many variables (for example, on subsidies or on defense spending) is not easily available for more than one country. For instance, while discussing fiscal policy we could examine several aspects of it: Like transfers to subsidies or allocation of resources between capital and current expenditures, for such allocations do impact on growth. However, analysis at such disaggregate level is not undertaken. Two, the three major macroeconomic policies, Fiscal, Monetary and Trade are used unevenly by the SACs to stabilize or promote growth. Some countries rarely use monetary policy in this context. Therefore, we will discuss it only where it is actively pursued by the policymakers to promote growth. With respect to trade policy, we are concerned only with its macroeconomic aspect and our discussion of it will focus on the instruments that are used in the pursuit of
external payment balance; especially on the two main instruments—trade intervention and exchange rate.

(iii) There are a number of supply-side factors, (such as an exceptional harvest due to good weather leading to an increase in agricultural output) that can also significantly alter the overall growth rates in output. Whenever deemed necessary, these factors, together with policy related measures, will also be explicitly mentioned so that our discussion will have a broader dimension.

With the preceding remarks as introduction we will now take up the examination of period-wise growth rates for each country. Decade is selected as the period for analysis. The aggregate growth rates pertaining to the six countries under study are presented in table 3-7 (in Chapter Three) and they will be examined period-wise in sections 4.1.1 through 4.1.6.

4.1.1 Bangladesh

For Bangladesh, we will examine the growth rates for the two periods. One for the years 1972/73 through 1979/80 (period III) and two, 1980/81 through 1989/90 (period IV). During the third period the average growth rate was 5.9 percent and it dropped to 3.8 percent in the fourth period (see rows four and six in table 3-7).

In Bangladesh two regimes covered the years 1972/73 to 1979/80: One of Sheik Mujib's and the other, General Zia's. Mujib headed the Awami League, a party that represented the interests of lower middle classes and the rural elite. Though the party professed a socialist ideology, Mujib was not able to consolidate power to offer
Bangladesh a coherent economic strategy based on it. Nonetheless, a nationalization program initiated by him placed nearly 25 percent of total industrial assets under public ownership. Zia, on the other hand, attempted denationalization and resorted to more market oriented policies. He wanted to cater to the needs of the rural areas and to achieve this goal mobilized the masses through local bureaucracies. Zia also assigned military only a second role in the national affairs. Together these measures gave his regime a degree of legitimacy among the people and he was able to succeed in his economic program of restructuring Bangladesh rural society which in turn increased production, particularly in the agricultural sector.

During the years 1972/73 to 1979/80, fiscal policy in Bangladesh was expansionary.\(^1\) Domestic revenues required to finance expanded public expenditures were not forthcoming because of the difficulty of mobilizing resources for financing development projects in an impoverished country. Public expenditures increased during this period due to two main reasons. First, there was a critical need to invest in new infrastructure and services. Second, as the size of the state owned enterprises (SOEs) increased there was also increasing transfers to this sector from budget revenues. The magnitudes of major macroeconomic variables that have altered the

\[^1\] Since the terms conservative, expansionary (liberal), and restrictive are used in several contexts to qualify fiscal, monetary, and trade policies, it is necessary to clarify them. If a policy is termed conservative, it is meant that the levers of that policy are not used to alter growth in output. Expansionary (liberal) means the policy levers are used actively to raise output; and restrictive implies they are used mainly to reduce inflation and not to alter output growth. Also, these observations are based on in depth analyses of each country's revenue and expenditure patterns, trends in money supply, exchange rates and other variables for the relevant period.
growth rate of output are given in table 4-1. The overall revenue shortfall and increased expenditures led to a budget deficit of 6.3 percent of the GDP for the third period. Gross Domestic Investment was 9.7 percent of the GDP while savings was only 2.6 percent. However, the domestic resource gap was financed out of foreign aid and therefore it did not negatively affect output growth during this period. Monetary policy played only a passive role in the government’s overall economic management.

In the external sector Bangladesh faced a serious debt service problem as a result of unfavorable balance of trade. The cost of food imports rose while export prices (mainly Jute prices) fell. Thus the terms of trade fell by 20 percent during 1978/79. However, gains in other primary export prices kept the average terms of trade a normal 10 percent for the entire period. Overall, developments in this sector did not negatively affect the growth rate of output as concessional aid was forthcoming in sufficient amounts. Therefore, it is safe to infer that the average growth rate of 5.9 percent for Bangladesh during the years 1972/73 to 1979/80 was mainly the result of a fiscal policy that generated sufficient aggregate demand (the Keynesian effect) to spur growth in output. The programs associated with this policy were largely financed out of external funds and therefore domestic economic distortions did not take place.

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Table 4-1
Growth Rates, Fiscal Deficits, Gross Domestic Investment and Savings of Bangladesh

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate Decadal (Average)</th>
<th>Fiscal Deficits (as a % of GDP)</th>
<th>Gross Domestic Investment (as a % of GDP)</th>
<th>Savings (as a % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970/71 - 1979/80</td>
<td>5.9</td>
<td>6.3</td>
<td>9.7</td>
<td>2.6</td>
</tr>
<tr>
<td>1980/81 - 1989/90</td>
<td>3.8</td>
<td>6.0</td>
<td>12.9</td>
<td>2.0</td>
</tr>
</tbody>
</table>


Lt. Ershad’s regime (1982-1990) covered most of the decade of the 1980’s.³

He was the first military officer to come to power in Bangladesh who was not involved in the struggle for independence, and lacked the charisma which Zia had. Therefore, despite a strong commitment to peaceful change from Zia’s civilian rule, Ershad was not able to achieve a proper balance between change and continuity of national values. Also, because of his various attempts to give military a political role in the country’s affairs, Ershad lost legitimacy for his regime. Under these circumstances he could not devise an effective strategy for economic growth and canvas support for it from political groups cutting across ideological boundaries.

During the years 1980/81 to 1989/90 also fiscal policy continued to be expansionary. Public expenditures increased during this period as more resources were allocated to loss-making public sector enterprises. On average, current expenditures including wages and salaries of government employees were higher than development

expenditures. In the meantime, revenues were lagging behind expenditures as trade-based taxes continued to account for a large proportion of total tax revenue, and they could not be increased without slowing down growth. The slower growth of tax revenues and the increased public expenditures contributed to a deficit of 6.0 percent of the GDP for this period. GDI was 12.9 percent and savings only 2.0 percent. The gap was partly financed out of aid funds and partly through borrowing. Even though the country had a higher gross investment rate during the years 1980/81 to 1989/90 than in the previous decade, its average growth rate in output during this period was lower than in the former period. This may be due largely to the type of investment made during 1980/81 to 1989/90 which involved sizable allocation of funds to SOEs. Another disturbing factor that slowed growth during this period was the way in which deficits were financed, that is through internal borrowing generating the crowding out effect.

Monetary policy during the years 1980/81 to 1989/90 was largely restrictive, with monetary expansion brought under control. Interest rate levels have been kept sufficiently high to encourage savings and thus to make investment funds available for the private sector. Nonetheless, demand for funds from the private sector was low for several reasons; the most important being the introduction of various regulatory measures and the expansion of the public sector. In the trade sector falling export prices (Jute prices declined 50 percent in 1986 and 20 percent in 1987) led to a
decrease in the terms of trade by 20 percent in 1986/87 alone. Though other export prices were fluctuating less than the Jute prices, on average, the terms of trade fell by 15 percent. For the years 1980/81 to 1989/90 this is a much sharper decline than in the previous period affecting the country's external balance. It could, therefore, be argued that the growth rate during 1980/81 to 1989/90 for Bangladesh was lower than in the previous decade, mainly because of its mounting external balance of payment problems and the increasing proportion of budgetary allocations made to SOEs.

4.1.2 India

India's growth rates will be examined for three periods: One for the years 1950/51 through 1959/60, (period I); two, 1960/61 through 1969/70 (period II); three, 1980/81 through 1989/90 (period IV). During period I average annual growth rate was 4.1 percent, for period II, 3.2 percent, and for period IV, 5.6 percent (see rows one, three, and six in table 3-7, Chapter 3). Since the difference in aggregate growth rates between the years 1960/61 to 1969/70 and 1970/71 to 1979/80 is only 0.1 percent point (which we consider to be small), we will simply compare the growth rates between 1960/61 to 1969/70 and 1980/81 to 1989/90, leaving out the years 1970/71 to 1979/80 (the third period) from the analyses here.

During the first period Indian economy policy-making was strongly influenced by Prime Minister Nehru's thinking. As a student in Britain, he had ample opportunities to come into contact with many socialist intellectuals of that country.
which made him a Fabian socialist, with Marxist sympathies. As a result, he developed a certain mistrust of business and had a genuine concern for the poor. Therefore, to attain the twin goals of economic development and social justice, Nehru preferred planning by state to free market solutions. This idea of planning found ready acceptance among the bureaucracy also who had a long tradition of efficient administration in pre-independent India. Bureaucracy naturally believed that it was their prerogative to administer the nation’s development tasks, and it distrusted the price mechanism. Briefly, this was the background in which planning by state came to be regarded in India as an acceptable strategy for economic development.

India’s fiscal policy during the first period was generally conservative. This approach to fiscal matters in the early years of independence may be attributed to two factors: First, in India, a democratic country, inflation could be unpopular among its people and elections needed to be won. Second, it may also have been due to the inherited character of the Indian bureaucracy and its long traditions of guardianship as well as the austerity of the country’s first generation of politicians. These two factors made fiscal prudence a necessary ingredient in the overall economic planning in India. During this period deficits were moderate, averaging 4.5 percent of the GDP. Therefore, the effects of fiscal policy on growth was only minimal. Besides, policymakers were mainly concerned with building infrastructure damaged by World War II and partitions in 1947. The Substantial investment necessary to rebuild and
modernize the economy was financed from a high rate of domestic savings and aid from international community. Gross Domestic Investment was 12.5 percent and Savings 11.6 percent (see table 4-2). These variables, therefore, appear to have acted to promote growth in output.

Table 4-2
Growth Rates, Fiscal Deficits, Gross Domestic Investment and Savings of India

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate Decadal (Average)</th>
<th>Fiscal Deficits (as a % of GDP)</th>
<th>Gross Domestic Investment (as a % of GDP)</th>
<th>Savings (as a % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950/51 - 1959/60</td>
<td>4.1</td>
<td>4.5</td>
<td>12.5</td>
<td>11.6</td>
</tr>
<tr>
<td>1960/61 - 1969/70</td>
<td>3.2</td>
<td>5.6</td>
<td>5.5</td>
<td>13.2</td>
</tr>
<tr>
<td>1980/81 - 1989/90</td>
<td>5.6</td>
<td>9.5</td>
<td>20.6</td>
<td>20.8</td>
</tr>
</tbody>
</table>


Monetary policy during the years 1950/51 to 1959/60 was restrictive, and therefore, inflation grew only at 1.5 percent on average during the entire period. Therefore, it did not slow growth. The country’s external payment requirements during the first half of the first period (1950/51 to 1959/60) were met satisfactorily out of sterling funds available to her after independence, and only during the remainder of the period it had to resort to various control measures to limit imports which became a permanent feature of its foreign trade regime. Trade policy, therefore, does not seem to have exerted any adverse effect on overall growth during the first period.

During the 1960’s after Lal Bahadur Shastri became Prime Minister (1964-66), there were significant shifts in the direction of national economic policies. Shastri had a rural background and did not share Nehru’s left-wing ideology. Public investment
was increasingly turned towards the agricultural sector and the power of the Planning Commission trimmed. An increasing role was given to private investment in the development of industry. Together the policy prescriptions represented a substantial departure from the course chartered during Nehru's leadership. However, Indira Gandhi on assuming power in 1966 saw the economy deteriorating. There was severe inflation caused in part by food shortage and partly due to a serious balance of payments crisis. The congress party's majority in parliament was slender and Mrs. Gandhi lacked the political support to take decisive actions to stem the deteriorating conditions. The government's response to the economic crisis dictated by purely practical considerations included three elements. One, a number of restrictive fiscal policy measures; two, devaluation of the rupee along with some import liberalization measures; three, a new agricultural strategy that encouraged the use of fertilizers and high yielding seeds. Second measure will be discussed when we refer to the trade policy. The third, a long-term measure will be discussed in the next chapter in which agricultural sector is examined.

Fiscal policy continued to be restrictive during the years 1960/61 to 1969/70, and it operated principally through restraint of capital expenditure which was politically easier to axe than current expenditure. Deficits averaged 5.6 percent of the GDP. Efforts to raise revenue were not successful, and as a result of the decline in aid
flows, public investment fell after 1966.\textsuperscript{5} Gross domestic investment was only 5.5 percent of the GDP, less than half of what it was during the preceding period. In the trade policy area, two important factors that had relevance to output growth must be noted. One was the continued reliance on controls as an instrument of balance of payment adjustments. During the years 1965/66 through 1969/70, the nominal exchange rate (NER) remained constant. But inflation continued to rise and therefore the real exchange rate (RER) began to appreciate leading to further tightening of controls. This reached a point where domestic industry was completely deprived of essential inputs reducing total output. Second was the nominal devaluation of the Indian rupee by 36.5 percent undertaken at the urgings of the international community in 1966. This measure did not prove successful as its favorable effects were swamped by other adverse effects like the reintroduction of tight import controls during the second half of the 1960's.

As shown in table 4-2, growth rate dropped during the years 1960/61 to 1969/70 to an average of 3.2 percent from 4.1 percent in the previous decade. This drop in aggregate growth rate cannot be attributed entirely to restrictive macroeconomic policies. Other factors were also equally important. India's war with China in 1962 and Pakistan in 1965 and two successive droughts in 1965 and 1966

have all jolted the economy leading to a slower rate of growth. Nonetheless, policy could have stimulated it. For instance, one of the factors that slowed growth during this period was the diminishing demand for industrial and consumer products. As noted earlier, Mrs. Gandhi's government did not try to stimulate demand, and its fiscal restrictions actually resulted in an overall reduction in demand away from productive operations. Besides, the wars with China and Pakistan also imposed a severe fiscal strain as defense expenditures more than doubled during the years 1960 through 1965. It rose as a proportion of GDP from 1.6 percent in 1960 to 3.2 percent in 1965. Increased defense spending and a cut off of aid from western countries made financing of capital expenditures difficult, which in turn, reduced growth.

The decade of the 1980's saw Mrs. Gandhi's return to power in 1980. She then initiated a partial liberalization scheme to open up the economy to spur growth. The main component of that scheme was the deregulation of the industrial licensing system. However, the pace of reform was slow during her premiership. When Rajive Gandhi became Prime Minister in 1984, he successfully expanded the liberalization measures adopted earlier under Mrs. Gandhi greatly improving the economic performance of the country.

There was relatively little fiscal restriction during the years 1980/81 to 1989/90. An erosion of fiscal discipline started in early 1971 with the failure of

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Congress Party to manage the growing demands and strength of various interest groups.\textsuperscript{7} This failure continued into the 1980's and it was in part due to Mrs. Gandhi's populist policies, and to her perceived authoritarian style of functioning. The deficit averaged 9.5 percent of the GDP during this period, and a large share of it was due to growing subsidies the government was handing out to various interest groups. As a result, current expenditures rose to 20.8 percent of the GDP. However, on balance fiscal policy has increased the output. Gross fixed investment averaged 20.6 percent of the GDP and most of it was financed by domestic savings and the rest by external borrowing. Public investment, mostly in infrastructure, also rose to 2.2 percent of the GDP during this period. In short, the expansionary policies in the first half of the 1980's, combined with a set of modest liberalization measures led to a faster growth in output. During the years 1980-84 there was reluctance to devalue the currency as Mrs. Gandhi was at the helms at that time. After 1985 the attitude towards nominal exchange rate management changed quite markedly towards flexibility, and this de-politicization of the exchange rate was a welcome sign that had a positive effect on growth in output.

In brief, India's rather modest output growth of 4.1 percent during the 1950's was the result of its policymakers deliberate attempts to build the country's infrastructure damaged by the war. For this, funds were available from the sterling deposits India had in Britain at that time. However, growth slowed in the 1960's as a

result of both policy and non-policy reasons. In the policy arena, India was following a restrictive fiscal policy due to fear of inflation and lack of development funds as a result of increased defense expenditures. Both these factors tended to lower growth. A non-policy variable, drought, also caused reduction in agricultural output during this period. On the other hand, in the 1980's growth rates began to rise as a result of the partial liberalization scheme initiated by Mrs. Gandhi and expanded under Rajive. Gradual depolitisisation of the exchange rate under the latter’s regime also helped raise growth in output.

4.1.3 Malaysia

For Malaysia we will examine the growth rates for two periods: One, for the years 1970/71 through 1979/80 (period III), and two, 1980/81 through 1989/90 (period IV). During the third period the average annual growth rate was 8.5 percent and in the fourth, 7.0 percent (see rows four and six in table 3-7, Chapter 3).

During the years 1970/71 to 1979/80 Malaysian economic policy-making had been significantly influenced by the multiracial underpinnings of its society. The National Front (NF), which was the ruling coalition, firmly believed in national unity through interracial harmony and economic development. This front represented the elites of Malaysia composed of a select body of federal and state level officials, the leaders of the parties affiliated with United Malaysian Nationalist Party (UMNP), and the chiefs of the tribal committees of Sarawak and Sabah. To realize its political objectives, the NF regime began implementing in 1970 a radically new approach
known as the New Economic Policy (NEP) to solve the country’s socioeconomic problems. As part of the implementation of Malaysia’s NEP, the government adopted an expansionary fiscal stance during the years 1970/71 to 1979/80. The impressive growth rate of 8.5 percent during these years was indeed due to the expansionary public expenditure policy the country adopted to accelerate growth, one of the major objectives of NEP. During the first half of the seventies, public development expenditure was equivalent of 11 percent of GDP, three percentage points higher than the preceding period, and it rose to 13 percent for the years 1970/71 to 1979/80. The composition of development expenditure has also undergone a significant change during this period. For instance, the share devoted to commerce and industry rose to 13.5 percent, raising total output. The major macroeconomic variables that seem to have accelerated growth in Malaysia during this period are given in table 4.3.

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate Decadal (Average)</th>
<th>Fiscal Deficits (as a % of GDP)</th>
<th>Gross Domestic Investment (as a % of GDP)</th>
<th>Savings (as a % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970/71 - 1979/80</td>
<td>8.5</td>
<td>None</td>
<td>26.0</td>
<td>30.0</td>
</tr>
<tr>
<td>1980/81 - 1989/90</td>
<td>7.0</td>
<td>10.0</td>
<td>22.0</td>
<td>33.0</td>
</tr>
</tbody>
</table>


Gross fixed investment averaged 26 percent of the GDP and most of it was financed out of domestic savings which averaged 30 percent of the GDP during this period.

During the years 1970/71 to 1979/80, monetary policy in Malaysia played only a secondary role in the management of its overall growth in output. In the trade policy area, the government generally followed a freemarket approach and this resulted in few balance of payment crises. During the 1970’s, the merchandise trade balance was positive in every year. The current account surpluses achieved in most of these years more than compensated for any deficits. This external balance played a crucial role in promoting growth in output during this period.

The concept of multiracial coalition rule as a gradualist vehicle for national integration through rapid economic development formalized and implemented in the early 1970’s remained in force in the 1980’s also. In 1981, Mahatir became Prime Minister and President of UMNP. He was trained as a medical doctor and was a commoner who had no connections with any of the Malay royal houses. He was decisive and businesslike, and was seen as giving impetus to Malaysia’s search for self-reliance. However, during most of the fourth period (1981-87) the Mahatir government was not able to address meaningfully the problems of sluggish growth of the economy. There were both short and long-term problems that needed immediate

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correction to promote growth. For example, in the short term, the public expenditure program that enabled the country to attain a high rate of growth during the third period encountered balance of payment difficulties due to rising international interest rates and worldwide recession. Long-term problems were also beginning to cause concern. One of the major concerns was the non-availability of skilled labor and its high costs. The country needed to make improvements in the skills of its workforce and modernize industry to justify high wages. Because the government was slow to undertake these urgently needed measures, it was falling behind other producers for the international market place.

In the fiscal area, two factors contributed to lower growth during the years 1980/81 to 1989/90. First, there was the marked slowdown in public expenditures. This was mainly due to the weak export performance of Malaysia as a result of slower world economic growth. Revenues also dropped as income from export duties on rubber, tin, and palm oil declined. The resource crunch that caused as a result of these developments led the government to revise downward the public sector development expenditures. The fiscal policy was, therefore, aimed at reducing the budget deficit which averaged 10 percent of the GDP. A second factor that led to slow growth was the volatility of fixed investment. The share of fixed investment in GDP was not very high for most of this period; it averaged 22 to 26 percent during the early 1980's, and then began to decline. Though savings, which was 33 percent of the GDP, financed
that investment, there were other factors that slowed the share of private investment. One major reason for the decline in private investment was the reduction in domestic demand by 11 percent from the previous decade.\(^{10}\) Private investment declined, and with it efficiency growth and technology upgrading.

During the years 1980/81 to 1989/90 monetary policymakers took steps to maintain a high level of domestic demand. To increase demand, the Central Bank embarked on an easy money policy by adopting various measures to inject liquidity into the financial system.\(^{11}\) Nonetheless, private sector borrowing has not increased sufficiently to give a major boost to overall production in this period. In the trade sector, the government continued to follow its earlier free market approach. In the early years of this period, the international recession brought record deficits to Malaysia’s balance of payments, causing severe strain to that account. For instance, the balance on current account registered a deficit equivalent to 13.3 percent of GDP in 1982. The burden of servicing the external debt more than doubled to 6 percent of the value of export earnings during the same year. Official borrowing from overseas also increased in 1983 by another 12 percent over those in 1982. Although the country’s debt service ratio was low compared to other developing countries, the government was clearly scrambling for funds during most of this period. This scarcity

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of funds substantially reduced expenditures on development projects slowing growth during this period.

4.1.4 Nepal

For Nepal we will examine the growth rates for two periods: One, for the years 1970/71 through 1979/80 (period III) and two, 1980/81 through 1989/90 (period IV). During the third period the average growth rate was 2.4 percent and in the fourth, 4.8 percent (see rows four and six in table 3-7, Chapter 3).

Nepal was ruled by a constitutional monarch during the years 1970/71 to 1979/80. What became the official economic policy was strongly conditioned by the views emanating from the palace, for the king remained the head of state in practice as well as in theory. He had very considerable influence on the direction and content of government policy and around him the traditional interest groups (the sacred elites, viz., the Brahmins, the military and the landed aristocracy) revolved. The palace secretariat became the nerve center of administration and political structure, even though its dominant policy and decision-making role was not clearly defined in law.

During the years 1970/71 to 1979/80 Nepal followed an expansionary fiscal policy. Nonetheless, deficits were kept moderate; they averaged only 5.2 percent of the GDP. Increased amount of foreign aid that was available to Nepal covered most of her deficits, eliminating the need for domestic borrowing. Yet, there were disturbing trends in the fiscal area. For instance, though revenue increased by an average annual rate of 13.5 percent, regular expenditures increased at a faster rate of 18.5 percent.
Also during Nepal’s fourth plan (1970-75) which fell within the years 1970/71 to 1979/80, the rate of increase in regular expenditures exceeded those in the development expenditures slowing growth considerably. The development expenditure was only 8.3 percent of the GDP during this entire period. All these developments had a moderating effect on the output growth. Domestic investment was only 11.2 percent and savings 8.4 percent of the GDP (see table 4-4). The resource gap was financed out of external aid funds. Nepal’s monetary and exchange rate policies during this period did not have any effect on output growth. In order to achieve a sustainable current payment balance in the external sector, the country relied more on foreign aid and less on its exports. Besides, Nepal’s external trade sector was very small compared to its domestic market.

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate Decadal (Average)</th>
<th>Fiscal Deficits (as a % of GDP)</th>
<th>Gross Domestic Investment (as a % of GDP)</th>
<th>Savings (as a % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970/71 - 1979/80</td>
<td>2.4</td>
<td>5.2</td>
<td>11.2</td>
<td>8.4</td>
</tr>
<tr>
<td>1980/81 - 1989/90</td>
<td>4.8</td>
<td>9.5</td>
<td>20.0</td>
<td>10.0</td>
</tr>
</tbody>
</table>


During the years 1980/81 to 1989/90, because of the deepening crisis of the national economy and the political response to this among the middle classes, the strategic core of Nepalese politics and policy-making has become open to other influences than the ones exerted by the traditional elites. As a result, the palace
secretariat has shown a willingness to consider a range of proposals for economic policies. Two new initiatives that emerged from this consideration are worth mentioning here: One was the emphasis given to the basic needs strategy in the sixth five year plan (1980-1985). The other was the enactment of the Decentralization Act in 1982 that entrusted to local panchayats the necessary responsibility and authority for district development plan, including its formulation, allocation of resources, supervision, management, and evaluation. These two factors have given development planning a new thrust during 1980/81 to 1989/90 accelerating growth.12

Nepal’s fiscal policy continued to be expansionary during the years 1980/81 to 1989/90. Deficits averaged 9.5 percent of the GDP which was higher than in the previous decade, in spite of renewed efforts to improve tax collections. The higher deficits were mainly due to the rapid growth of public expenditures and also in part to low tax collections. Reversing the earlier trend there was an increase in the proportion of development expenditures in total expenditures during this period. However, it was the quality of government expenditures rather than the rising level that had a positive impact on growth.13 Specifically, three factors were responsible for the improved quality of those expenditures. One was the shifting of emphasis away from long

maturing projects to quick yielding programs such as food production, small and medium scale industries, irrigation, power and drinking water.

The second factor concerns the improvements made in the budgeting and monitoring of development expenditures with the help of United Nations Development Program (UNDP) and the Asian Development Bank (ADB). Extensive technical assistance was provided by these agencies to help establish a sound portfolio of core projects selected on the basis of their economic efficiency, foreign aid content, nearness to completion and strategic importance to the overall development program.

A third factor was the improvement effected in the performance of public enterprises. Because of this only a smaller proportion of budgetary resources were transferred to them. The combined effect of these three factors was to considerably improve the quality of public expenditures which in turn led to increase in output. The gross domestic investment during this period was 20.0 percent of the GDP which was nearly double that of the preceding period. Though savings was only 10.0 percent, the gap was largely financed out of aid funds, leaving no distortions in the domestic economy.

In the early 1980’s, monetary authorities in Nepal took steps such as raising the reserve ratio and reducing the quantity of M to carefully control the net credit expansion so that inflation may be held in check.\(^\text{14}\) This measure also helped to

promote growth. A major initiative undertaken in the foreign trade regime was the devaluation of Nepalese rupee in 1985 by 15 percent in terms of other foreign currencies. This step, nonetheless, led only to a marginal increase in the volume of exports. On the other hand, several procedural and institutional reforms undertaken to liberalize the import regime greatly facilitated domestic production. The devaluation and liberalization measures together, however, greatly strengthened Nepal’s external position and as a result its current account deficit fell to 7 percent of the GDP. This tended to promote the growth in output during the fourth period.

4.1.5 Pakistan

Pakistan’s growth rate will be examined for four periods. One, for the years 1950/51 through 1959/60 (period I); two, 1960/61 through 1969/70 (period II); three, 1970/71 through 1979/80 (period III); and four, 1980/81 through 1989/90 (period IV). During the first period the average annual growth rate was 2.4 percent, the second, 7.2 percent, the third, 5.7 percent, and the fourth, 7.4 percent (see rows one, three, four and six in table 3-7, Chapter 3).

The economic conditions that existed in Pakistan immediately after independence in 1947 were not conducive to a higher rate of growth. Three important factors may be mentioned in this respect: First, in the early fifties the country had almost no industry. During the British rule the area was supplying agricultural

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products for processing to the territory that became India. Second, modern sources of energy were nonexistent and basic infrastructure facilities and other services, such as banking and government were undeveloped. Third, as a result of partition disputes arose between India and Pakistan which stopped the flow of goods between the two countries, disrupting the complimentary nature of their economies. The combined effect of all these factors was a slower growth in output in the early fifties.

For Pakistan, the years 1950/51 to 1959/60 was also a period of political instability. During this period the economic decision-making was largely confined to the civil service of Pakistan (CSP) whose responses to most economic matters were based on practical considerations. The CSP was an efficient institution with considerable administrative experience and prided on being the backbone of the nation. However, in the absence of firm political leadership to guide them, the bureaucracy could not embark on an ambitious program of economic growth in the fifties.16 This lack of political leadership and the consequent weak economic policies were also major factors that contributed to slow growth.

Pakistan’s fiscal policy during the years 1950/51 to 1959/60 was conservative. This was mainly due to the attitudes of the civil servants who were responsible for economic policy-making. They were trained to spend public funds frugally. The tax

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structure (tax collections as a ratio to GDP) was also low in Pakistan.\textsuperscript{17} This resulted in low revenues. Fiscal deficits were therefore held, on average, around 5 percent of the GDP during this period. Gross domestic investment was 11.7 percent and savings 9.1 percent of the GDP (see table 4-5). The gap was mostly financed out of aid funds. The main objective of monetary policy has always been the maintenance of monetary stability. The CSP followed a restrictive monetary policy during this period, because they believed that excessive growth of money supply could be inflationary and therefore, retard growth. During the early years of the first period, Pakistan had an over valued currency which discouraged exports of both manufactured goods and agricultural raw materials. To handle the balance of payment problems, the government imposed a variety of controls on imports, including direct licensing of capital goods which discouraged domestic production.

Table 4-5

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate Decadal (Average)</th>
<th>Fiscal Deficits (as a % of GDP)</th>
<th>Gross Domestic Investment (as a % of GDP)</th>
<th>Savings (as a % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950/51 - 1959/60</td>
<td>2.4</td>
<td>5.0</td>
<td>11.7</td>
<td>9.1</td>
</tr>
<tr>
<td>1960/61 - 1969/70</td>
<td>7.2</td>
<td>None</td>
<td>15.0</td>
<td>10.9</td>
</tr>
<tr>
<td>1970/71 - 1979/80</td>
<td>5.7</td>
<td>9.5</td>
<td>17.9</td>
<td>8.7</td>
</tr>
<tr>
<td>1980/81 - 1989/90</td>
<td>7.4</td>
<td>5.8</td>
<td>18.5</td>
<td>9.6</td>
</tr>
</tbody>
</table>


The 1960's was dominated by General Ayub Khan's regime. Under him the civil servants continued to make all major economic decisions. The councils Ayub

started under the basic democracy scheme were largely controlled by the bureaucrats. They laid major emphasis on the development of manufacturing output by implementing the policy of import substitution industrialization as the country lacked a credible manufacturing base. This initiative led to substantial increase in average growth rate during the second period, most of it coming from the manufacturing sector. Fiscal policy during this period continued to be conservative as the CSP was still in charge of policy-making. Government current expenditures were kept around 10 percent of the GDP, while current revenues were also around 10 percent. Gross Domestic Investment was 15 percent of the GDP and Savings 10.8 percent. The remainder was financed out of aid funds. Ayub followed a liberal trade policy in which a number of import controls were dismantled in the early 1960’s. This step towards liberalization contributed to higher growth in output.

The decade of the 1970’s may be characterized as the Bhutto period (1971-77) as he dominated most of it. When Bhutto assumed power, many believed that he would usher in a new era of sound development planning. However, he lacked any formal training in the field of development and downplayed the importance of economic analyses. Bhutto’s decisions were largely ad hoc and therefore they led to a slower rate of output growth during this period than in the previous period. For instance, in 1972 Bhutto nationalized 32 large manufacturing plants in 10 major industries. This reduced private investment in large scale manufacturing by nearly 50
percent between the years 1970/71 to 1972/73. By 1978 such investments were little more than one third (in constant prices) of what it was in 1975/76. At the same time, public industrial investment rose, surpassing private industrial investment during 1975/76. In brief, the drop in private sector investment and the expansion of public sector activities together exerted a negative impact on growth.

The Bhutto regime undertook another step that adversely affected the administrative efficiency of the country. He abolished the CSP, seriously weakening the administrative efficiency of Pakistan. Several government organizations were also restructured which made policy formation and implementation extremely difficult. These steps, along with reduced private sector investment, contributed to considerable slowing of economic growth during the years 1970/71 to 1979/80. Bhutto’s fiscal policy was expansionary, with a deficit averaging 9.5 percent for this period. Gross domestic investment was slightly higher than in the previous period at 17.9 percent of the GDP. Nonetheless, it did not lead to an increase in output as most of it was in the public sector, which was grossly inefficient. Savings was only less than half of the GDI, at 8.7 percent of the GDP. The gap was financed out of domestic borrowing which again was harmful to the economy as it reduced growth in output.

During Bhutto’s regime money supply grew faster than in any other regime due in large measure to budget deficits and commodity transactions by public corporations. The money supply increased by an average of over 20 percent a year between 1973
and 1980 raising inflation. This price increase was an additional factor that slowed output during the years 1970/71 to 1979/80. Bhutto also devalued the rupee by 57 percent in 1972 and abolished the multiple-exchange rate systems. These two measures could have stimulated exports. However, devaluation completely altered the cost and price structure for industry affecting the level and composition of industrial investment and the terms of trade between the industrial and agricultural sectors. For instance, devaluation helped agriculture, particularly large farms that had marketable surpluses, but adversely affected small farms. Therefore, the overall effect of Bhutto’s trade policy on exports was only marginal.

The 1980’s was dominated by the Zia regime (1977-89). Zia substantially reduced the government’s role in the economy and relied primarily on the private sector for faster growth. He initiated a series of measures to promote the private sector that included returning some of the nationalized businesses to its former owners, and effecting a number of price adjustments for important commodities and services to reduce subsidies. As a result, the private sector responded cautiously to the government’s overtures and investment incentives. Between the years 1977 and 1983, gross private fixed investment (in constant prices) increased 26 percent compared to 17 percent for government’s fixed investment. Private investment was also more widely distributed during this period, particularly to agriculture,

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transportation and services. These trends in investment continued during most of this period. To sum up, Zia’s regime was able to bring confidence to private investors and this in turn led to a high level of private investment in large-scale manufacturing. The increased private sector investment and denationalization initiatives that took place during Zia’s regime were positive factors and they have contributed to a higher level of growth during the years 1980/81 to 1989/90.

During Zia’s regime, fiscal policy turned conservative. This was necessary because tax collections continued to be a low ratio to GDP, though a number of new taxes were added and collections improved substantially, (collection increased by 70 percent from 1978/79 to 1981/82). Nonetheless, in 1982/83 total tax collections were still only 14 percent of the GDP. This Low tax structure required Zia’s government to curtail current expenditures as it made serious efforts to reduce the budget deficits.19 Deficits averaged 5.8 percent of the GDP during the years 1980/81 to 1989/90, which was lower than in the previous period (see table 4-5). Gross Domestic Investment was also higher at 18.5 percent. Savings averaged 9.6 percent. These variables acted to raise output during the years 1980/81 to 1989/90.

Monetary policy was largely restrictive during the years 1980/81 to 1989/90. Zia government’s efforts to restrain public borrowing, restore confidence in order to increase demand and time deposits by the private sector, promote savings schemes to

19 For an extensive analyses of efforts made by the Zia regime to reduce budget deficits during this period, see; Pakistan: A Country Study, pp. 139-142. (Op. cited).
avoid expansion of bank credit all have led to slower growth of the money supply. These steps in turn reduced the rate of inflation, and helped promote growth in output. Long-term loans were also readily available for development financing since mandatory allocations were made under the National Credit Plan. In the trade sector, the country faced acute balance of payment difficulties due to reduced foreign aid and a substantial increase in crude oil price. However, two developments eased the severity of this problem: First, the government imposed restrictions on the use of gasoline, which was very effective. Second, it got emergency help from Middle East Oil Exporters (Saudi Arabia and Kuwait) which avoided a serious crisis. Another major governmental initiative helped make the country's exports more competitive. In 1982, the government unlinked the Pakistani rupee from the U.S. dollar and tied it to a market basket of currencies important to Pakistan's trade. This delinking from the dollar resulted in a slow depreciation of the rupee in terms of dollars (which in June 1983 amounted to 25 percent) expanding exports and thus accelerating growth in output.

4.1.6 Sri Lanka

For Sri Lanka growth rates will be examined for three periods: One, for the years 1950/51 through 1959/60 (period I); two, 1960/61 through 1969/70 (period II); three, 1970/71 through 1979/80 (period III). During the first period, the average annual growth rate was 5.3 percent, the second period, 6.3 percent, and for the third period, 4.6 percent (see rows one, three, and four in table 3-7, Chapter 3). Since the
difference in aggregate growth rates between the years 1970/71 to 1979/80 and 1980/81 to 1989/90 is only 0.3 percentage points (which we consider small) the latter period is not included in this analyses.

At the time of independence, the basic outlines of Sri Lanka’s economy were simple. The economy exported tea, rubber and coconut products and in return imported more than half its basic food, almost all its investment goods, and a very large proportion of its intermediate and consumer goods. Living standards were relatively high since the revenues from substantial import and export taxes financed a ‘welfare’ state on the British model.

However, after the end of the Korean War when commodity prices began to fall, certain basic weaknesses of the export economy began to appear. There were three main reasons for this. First, after the Korean War boom, Sri Lanka’s international terms of trade began to decline continuously. The second reason was the rapid growth of population. In the late 1940’s and early 1950’s following the near-eradication of malaria and the general improvement in living conditions and health sciences, Sri Lanka’s population growth accelerated. The third reason was closely related to the second, there was strong and persistent demand for the expansion of public welfare facilities of various kinds. Different parties competed for access to the material resources distributed by the state, such as larger rice rations, expanded health services, wider subsidies for production inputs (e.g., fertilizer) placing an enormous
fiscal burden on the state. Any realistic analysis of the post-independence growth experience of Sri Lanka must be undertaken within the context of these developments.

During the years 1950/51 to 1959/60, Sri Lanka had two governments headed each by two major political parties: The United Nationalist Party (UNP) and the Sri Lankan Freedom Party (SLFP). It will be useful to know the basic differences between these two parties in their approaches to solving the fundamental economic problem facing Sri Lanka: How to facilitate a smooth transition from a colonial export economy to an economy that is self-sufficient in its basic needs. The UNP that was in power during the years 1950-56 followed a more "laissez-faire" approach, minimized restrictions on private economic activity, welcomed international links and generally favored agriculture rather than industry. By contrast, the government led by the Sri Lankan Freedom Party adopted a more statist economic policy.

Sri Lanka’s fiscal policy during the years 1950/51 to 1959/60 was expansionary. This was in large measure due to the food subsidies to which both the UNP and SLFP governments were strongly committed. For example, the subsidy for rice was kept at a higher level than in the previous decade, in part to appease the left wing politicians. By early 1952, expenditures on rice and flour subsidies exceeded expenditures on development projects.\(^{20}\) Also, the UNP was committed to large scale public sector investment in irrigation-cum-land development projects to create a prosperous and contended farming population. Revenues were, however, lagging

behind expenditures as the export income was steadily falling. No serious attempts were made to develop other revenue sources. As a result, deficits averaged 8.5 percent of the GDP for the entire period. They were financed mainly by borrowing from the Central Bank. Gross domestic investment was 14.0 percent of the GDP which was financed out of domestic savings (see table 4-6).

Table 4-6

Growth Rates, Fiscal Deficits, Gross Domestic Investment and Savings of Sri Lanka

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate Decadal (Average)</th>
<th>Fiscal Deficits (as a % of GDP)</th>
<th>Gross Domestic Investment (as a % of GDP)</th>
<th>Savings (as a % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950/51 - 1959/60</td>
<td>5.3</td>
<td>8.5</td>
<td>14.0</td>
<td>14.5</td>
</tr>
<tr>
<td>1960/61 - 1969/70</td>
<td>6.3</td>
<td>8.8</td>
<td>16.0</td>
<td>13.0</td>
</tr>
<tr>
<td>1970/71 - 1979/80</td>
<td>4.6</td>
<td>12.6</td>
<td>19.0</td>
<td>14.8</td>
</tr>
</tbody>
</table>


During the years 1950/51 to 1959/60, monetary policy had only a very limited impact on output growth in Sri Lanka. Most of the commercial banks were foreign owned and were engaged in financing the plantation and foreign trade sectors.

Therefore, the informal sector was the main source of finance for most economic activities, to the extent they utilized the capital market at all. In the trade policy area, the significant thing that happened was the falling external reserves. To tackle the problem of growing external deficit, the SLFP government introduced the policy of import-substitution industrialization which brought forth a number of controls to this sector, and they in turn had a negative impact on growth in output.

During the years 1960/61 to 1969/70 also, Sri Lanka had two governments: One of SLFP headed by Mrs. Bandaranaike (1960-65) and the other of UNP headed
by Senanayake (1965-70). When it assumed power in 1960, the SLFP government had to face a series of economic challenges. The major task that faced the government was to reduce the large budget deficit. It sought to reduce the deficit by proposing reductions in the national rice subsidy program. However, this proposal outraged the left and the trade unions who were supporting the government, and therefore, it later had to drop this. With revenues far short of expenditures, the government took another step to raise revenue. It nationalized all foreign owned oil companies operating in Sri Lanka and the Bank of Ceylon, the largest domestic commercial bank, and severely restricted the operations of foreign bank branches. These drastic reductions in the private sector activities moderated output growth during this period.21 On the other hand, the UNP government tried to develop a mixed economy with increased emphasis on the private sector. Between 1966 and 1970, private sector investment was double that of the public sector, thereby reversing the trend set in the previous administration.22 The generally pro-Western stand of the UNP government created a more favorable environment for Western aid to Sri Lanka. This pro-Western stand also strengthened confidence among foreign commercial banks and other lending institutions. The government, therefore, felt it could rely on greater external finance to overcome the country’s balance of payments difficulties.

22 Between 1966 and 1970 private sector investment on average was 8.9% of the GDP, while public sector investment was only 4.5%.
The SLFP government continued to follow a mildly expansionary fiscal policy during the years 1960/61 to 1969/70. Welfare expenditure dominated the current expenditures. Combined expenditures (current and capital) on social welfare (mostly health, education, and food subsidies) accounted for about 40 percent of total government expenditures between 1960 and 1970. Government revenues composed mainly of indirect taxes also increased but only at a slower rate. Therefore, the budget deficit rose slightly to 8.8 percent of the GDP during the second period. Gross domestic investment remained at 16 percent of the GDP while savings was only 13.0 percent. The remainder was financed out of domestic borrowing. The expansionary benefits of fiscal policy, viz, the increased aggregate demand, and the relatively easy availability of external funds to finance such expanded programs of the UNP regime in the latter part of this period promoted growth in Sri Lanka. With respect to the trade regime, the SLFP government was interested in pursuing a restrictive policy to solve the country's trade deficits. However, the UNP government wanted to liberalize it and the government, therefore, devalued the rupee by 20 percent against the pound (a net devaluation of 5.7 percent) in 1967 to stimulate export growth. After consultations with the World Bank, the government also introduced a package of trade liberalization measures to ease the external payment difficulties.23 The basic objective of these measures were to achieve substantial stimulus to exports and relax the rigidity

of the control measures on imports. The import liberalization measures alleviated critical shortages of inputs to import substituting industries and this raised output in the manufacturing sector.

During the years 1970/71 to 1979/80, Sri Lanka was governed by a United Front (UF) coalition. The SLFP was the dominant partner in a numerical sense, but much of the administration in terms of ideas and initiatives was made by the Marxist Coalition partners, the Lanka Samma Samaj Party (LSSP) and the Communist Party (CP). In general, the LSSP and CP gave higher priority than SLFP to equity issues, had a stronger commitment to public sector, and did not want to be dictated by the international lending agencies such as the World Bank and the International Monetary Fund (IMF).

Two developments of considerable significance to Sri Lanka took place during the 1970-77 period while the SLFP government was in power. First, was the armed though abortive, uprising in 1973 of Peoples Liberation Front (JVP), a Maoist group. This armed rebellion had far-reaching consequences on Sri Lankan economy and society. The government sought to mollify its supporters of the left while taking other steps to entrench its rule. The second development included a significant degree of land reform in 1972, and nationalization (with compensation) of foreign owned tea and rubber plantations in 1975. Because of the internal rebellion, the government had to increase its expenditures on defense leading to a large reduction in development
expenditures. Nationalization measures also had adverse consequences on the economy. Whereas, the UNP government that came to power in 1977 sought to implement a program of economic liberalization which was more wide-ranging in its overall effects on the economy than the partial liberalization it attempted during 1965-70. Nonetheless, these measures came rather too late to have any appreciable effect on output growth during this period.

Though the SLFP government adopted a restrictive fiscal policy during most of the 1970's, the budget deficit widened for two reasons: One deals with the expenditure side. Despite cuts in food subsidy, expenditures rose in absolute terms because of higher food prices. The second deals with the revenue side. Government revenues declined in real terms and as a proportion of GDP because of the reduced volume of trade. The combined effects of these two factors was a widening of the deficit which averaged 12.6 percent of the GDP during the third period. To hold down the huge deficits, the government took steps to restrain expenditures which was to be achieved through cuts in capital expenditures. Gross domestic investment was 19 percent while savings was only 13.0 percent of the GDP. The gap was financed mostly out of domestic borrowing. The reduction in Capital expenditures and increased domestic borrowing both acted to reduce growth in output. Monetary policy played only a secondary role in the government’s overall macroeconomic management during the years 1970/71 to 1979/80. In the trade sector, Sri Lanka
continued to suffer from external shocks in the form of oil price increases and substantial increases in the prices of main food items. Yet the central focus of the trade policy was import substitution, which did not bring any immediate gain to the economy. The UNP Government's attempt to encourage foreign private investment also did not succeed fully because of uncertainty created by the populist measures of the SLFP government, such as ceilings on income and land reforms. The cumulative effect of these policy measures was to slow growth during this period.

From the analyses of period-wise growth rates of the six SACs given above it is clear that policies do affect their growth rates and noneconomic factors often shape these country's policy responses to a given development task. For instance, in Bangladesh, Lt. Ershad's military regime did not enjoy legitimacy during its tenure in office during much of the 1980's. As a result he could not devise and implement an effective strategy for accelerated economic growth and canvas support for it from political groups having different ideological preferences. This, in turn, lowered Bangladesh's growth during the years 1980/81 to 1989/90. India's growth rate during the 1960's was smaller than its growth rate during the previous decade of the 1950's. This was in large measure due to the restrictive fiscal policy followed by Mrs. Gandhi's government during the later half of the sixties, largely because of the fear of inflation. However, other noneconomic factors like increased defense spending because of the wars with China and Pakistan during this period were also responsible.
for the government's pursuance of a restrictive fiscal policy as this reduced the resources available to it to conduct an expansionary fiscal policy. A higher growth rate was restored during the years 1980/81 to 1989/90 as a result of the partial liberalization measures and depolitized exchange rate adopted under Rajive Gandhi.

Malaysia's growth rate during the years 1970/71 to 1979/80 was higher than the subsequent period. This was mainly due to the expansionary fiscal policy this country adopted to accelerate growth during this period as a means of achieving racial equality in incomes, one of the major objectives of the New Economic Policy (NEP).

Nepalese politics and policy-making during the years 1980/81 to 1989/90 have become more open to other influences than the ones exerted by the traditional elites. As a result, the king has adopted several new initiatives such as the Decentralization Act of 1982 designed to promote growth and social justice. These initiatives in turn have resulted in doubling Nepal's growth rate during 1980/81 to 1989/90. Faced with the task of developing an overall economic development strategy for Pakistan during the 1950's, the country's civil service gave a rather undue emphasis in building up a strong manufacturing sector for her to the exclusion of all other important sectors. This led to a lower aggregate growth rate for Pakistan during the first decade compared to the other three decades. Sri Lanka's growth rate increase during the years 1960/61 to 1969/70 from the previous decade was primarily due to several policy initiatives the UNP government undertook to promote private sector activity.
Also, the generally pro-western strand of this government enabled it to attract foreign funds to finance a number of development projects that accelerated growth in output. The growth experience of the SACs, it is evident from the analyses so far, strongly affirm our basic proposition that noneconomic variables often shape policy responses and differences in policy responses explain differences in growth rates among and within the SACs.

4.2 ANALYSES OF GROWTH DIFFERENCES ACROSS COUNTRIES

In sections 4.2.1 through 4.2.3 we will examine the growth differences of five countries (Nepal is not included because its data for the years 1970/71 through 1979/80 is not reliable enough to compare with other countries) in terms of differences in their macroeconomic policies. The aggregate growth rates of the SACs for different periods are given in table 3-7 (see Chapter Three). From them we have selected for cross-country comparisons only those rates that are different by at least 3 percentage points. This will serve our purpose of inquiring into the role of macro policy differences in generating growth differences and establishing the relevance of non-policy variables in shaping such policy differences. The rates selected are: (7) Bangladesh’s 3.8 percent with Malaysia’s 7.0 percent; (8) Sri Lanka’s 6.3 percent with India’s 3.2 percent; (9) Pakistan’s 7.4 percent with Bangladesh’s 3.8 percent. For each country the analyses will focus on the major macroeconomic policy initiatives that may have altered the growth rates of output during the selected periods.
4.2.1 Bangladesh and Malaysian Growth Rates

The growth difference between Bangladesh and Malaysia will be explained in terms of policy initiatives undertaken by them in two areas: One, the allocation of government funds to its public sector enterprises and two, the manner in which they pursued their monetary policies. An important aspect of fiscal operations of Bangladesh that is relevant to its growth analysis was the significant amount of funds allocated to state owned enterprises (SOEs). This transfer of funds to loss making SOEs, mostly in public utilities, infrastructure and manufacturing amounted to nearly 13 percent of the GDP during the 1980’s. It had a negative impact on output growth as it reduced private investment activities in these areas. Though Lt. Ershad encouraged the private sector more than Zia, the allocation of funds to public sector enterprises continued to grow even under his regime. This happened mainly because much of the funds committed earlier in infrastructure and public utilities could not be stopped without completing the long-term projects undertaken in these sectors. The second factor that led to Bangladesh’s poor growth performance, compared to Malaysia, was the country’s pursuance of a restrictive monetary policy. Interest rates had been kept at higher levels by administrative fiat to encourage savings, but this resulted in less borrowing by the private sector. A related factor that reduced the availability of loanable funds was the low credit recovery rates by the nationalized banks. These factors made funds harder to get and impacted negatively on private investment, reducing growth in output.
While encouraging the growth of Non Financial Public Sector Enterprises (NFPSEs), Malaysia allocated only a much smaller amount, 7 percent of the GDP, compared to Bangladesh’s allocation to such enterprises (11 percent of its GDP),\textsuperscript{24} during the years 1980/81 to 1985/86. This promoted more private sector activities.\textsuperscript{25} Prime Minister Mahathir also called for cooperation between the public and private sectors and this in turn coalesced the privatization campaign which led to increases in private sector investment. Moreover, in contrast to Bangladesh, policymakers in Malaysia followed an easy money policy to help maintain a higher level of domestic demand. As noted earlier, the Central Bank adopted various measures to inject liquidity into the financial system which made it easier for the private sector to borrow funds. The two initiatives, the increased emphasis given to private sector investment and the active monetary policy designed to promote a higher level of aggregate demand together have contributed to a higher growth rate for Malaysia during the years 1980/81 to 1989/90. Stated briefly, Bangladesh allocated increasing amounts of funds to its SOEs and followed a restrictive monetary policy with high interest rates. Together, these two initiatives reduced the amount of funds that are available for private sector investment in Bangladesh sharply curtailing its output growth. On the other hand, Malaysia allocated only a much lesser amount to its NFPSEs and it followed an easy money policy that injected liquidity into its financial system. This

\textsuperscript{24} This figure has been computed from data in annual reports (various issues). Bangladesh Bureau of Statistics.

later step made available large amounts of funds at the disposal of the private sector, which in turn increased private investment accelerating output growth in Malaysia during 1980/81 to 1989/90.

4.2.2 Indian and Sri Lankan Growth Rates

The growth difference between India and Sri Lanka during the years 1960/61 to 1969/70 may be explained in terms of initiatives the two countries adopted in their fiscal and trade policies. India was following a rather restrictive fiscal policy during most of the 1960's mainly due to two main reasons: One, the policymakers feared inflation because of the short fall in production, especially in the agricultural sector, caused by severe droughts in 1965 and 1966. Two, there was a substantial decline in the aid flows after the war with Pakistan in 1965. These two factors compelled the government to adopt a restrictive fiscal policy especially since 1965. Its fiscal restrictions operated principally through restraint of expenditures, particularly capital expenditures which fell by a third in nominal terms from 1966/67 to 1970/71 (with a real decline of about 50 percent). This decline in public expenditures, in turn, moderated growth rate during the second period. In the trade policy area the most significant development that occurred during this period was the devaluation of the rupee in 1966. However, devaluation did not lead to an increase in exports and thus promoted growth. This was because in 1966/67 India was still heavily dependent on agriculture-based exports, and the severe droughts in 1965 and 1966 made it impossible for the country to raise the volume of exports in that category.
There were other reasons not related to economic policy initiatives that reduced the average growth rate in India during this period and they have been referred to in section 4.1.2.

In Sri Lanka, while the SLFP government under Mrs. Bandaranaike was in power in the early 1960's, it was a political necessity for her government to spend large sums of money on welfare schemes (mostly health, education, and food subsidies). This category accounted for about 40 percent of total government expenditures annually between 1960 and 1970. The increased spending on welfare schemes during this period had an expansionary effect on growth, and was beneficial in that sense. Though the SLFP government introduced several control measures to restrict Sri Lanka's imports, the UNP government in the latter half of the 1960's dismantled most of them. A major initiative taken by the UNP government in the trade sector was the devaluation of the rupee by 20 percent against the British pound in 1967. This measure adopted in the belief that it will stimulate exports, did not do so. However, the country was able to tap funds from external sources, both in terms of commercial borrowing and increased aid from international agencies as a result of the pro-western stance of its UNP government. This favorable environment in regard

26 There were several reasons why the 1967 devaluation did not lead to higher exports for Sri Lanka. We will mention only one. The traditional export industries continued to suffer from the anti-export bias inherent in the commercial policy. For example, since export industries continued to be a major source of government revenue the production of these crops carried a large tax burden. Also, efforts at crop diversification did not yield any positive benefits in terms of promoting growth.
to the availability of greater external assistance increased private investment leading to higher output growth in Sri Lanka.

In brief, the differences in growth rates between India and Sri Lanka may be explained as follows: India adopted a rather restrictive fiscal policy fearing inflation because of the sectoral short falls in production due to droughts and her devaluation did not lead to an increase in India’s exports. These two factors, together with the supply factors (see section 4.1.2), restrained India’s growth in output during this period. Whereas, Sri Lanka followed an expansionary fiscal policy which was rather a political necessity for that country as it involved food subsidies. Unlike India, this expansionary fiscal stance was made possible, in part, by the inflow of large amounts of concessionary funds to Sri Lanka because of the pro-western stance of its UNP government.27 The aggregate demand generated by the fiscal policy contributed to higher output growth for the country during this period.

4.2.3 Bangladesh and Pakistani Growth Rates

The differences in growth rates between Pakistan and Bangladesh will be explained in terms of differences in their policies towards each country’s public sector enterprises and its monetary policies during the years 1980/81 to 1989/90. The Zia regime of Pakistan in the 80’s adopted a number of measures to reduce the government’s role in the economy and to make its public sector enterprises more efficient. These measures included returning some of the nationalized firms to their

former owners and selling others. Also, private firms have been allowed to operate again in fields that were monopolies under the previous regime of Bhutto. These measures, in turn, reduced the size and improved the efficiency of the public sector enterprises making it possible for the government to allocate fewer resources to them. The funds released were in turn made available to build infrastructure and promote social services which had a positive impact on output growth. The Zia’s regime also undertook several initiatives in the monetary sector to restore the confidence of the private sector in the economy. For instance, measures were taken to reduce public borrowing by the government and to increase demand and time deposits by the private sector, and to develop savings schemes to avoid expansion of excessive bank credit. These measures had a pronounced influence in lowering inflation. Though money supply had been reduced, long-term loans were available for development financing since mandatory allocations were made under the credit plan. These initiatives undertaken in the monetary sector contributed to positive growth in output in Pakistan.

As mentioned in section 4.2.1, during the 1980’s the Ershad regime in Bangladesh was allocating higher proportions of government funds to public sector enterprises. This created a general shortage of funds for the government to allocate to other productive operations. Besides, Bangladesh was also following a restrictive monetary policy, keeping interest rates high to encourage savings. However, as noted
earlier, in the short term, this measure resulted in reduced private investment and slow growth of output. Together, the high proportion of funds allocated to SOEs and the limited availability of funds for private sector borrowing moderated output growth in Bangladesh.

The differences in growth rates between Bangladesh and Malaysia may thus be explained in terms of their policy differences in two areas: Each country's approach to its public sector enterprises and their respective monetary policies. Bangladesh, as explained above, was allocating a higher proportion of government funds to its SOEs. Also, the country kept its interest rate high to encourage savings which in the short run led to a paucity of investment funds. These two factors contributed to lower private investment and reduced growth in Bangladesh. On the other hand, Pakistan effected substantial improvements in the workings of its public sector enterprises, reducing the need for transferring of large amounts of funds from its domestic budget. Zia's regime, in contrast to Bangladesh, also took steps to make investment funds available to its private sector. This included the mandatory allocations to development finance made under the National Credit Plan. The cumulative effect of these policy initiatives was to raise the growth rate of output for Pakistan.

4.3 GROWTH DIFFERENCES ASSOCIATED WITH THE FOUR EPISODES

To explain the growth differences associated with the four episodes, we will first describe briefly the nature of the episode and the policy responses of each country to a particular episode. Then we will examine the growth differences across country
for a period immediately following that episode in terms of differences in their policy responses. Analyzing cross-country growth differences in this way may help us understand whether factors that were specific to decision-makers in each country and the relevant contextual factors in which they operated were in any way significant in explaining those differences.

4.3.1 Independence and its Aftermath

Independence in the late forties caused serious disruptions to the economies of India, Pakistan, and Sri Lanka. However, the type of problem it created for each country was different. For India, independence and the partition that preceded it resulted in the loss of a major external market (the area that became the newly created State of Pakistan). Pakistan lost almost all of its manufacturing capacity, whereas Sri Lanka lost an important source of external finance as the prices of its export commodities began to fall. How policymakers in the three countries reacted to these developments will help explain the differences in their growth performance.

To understand the policy responses of the three countries, we will briefly consider the policy-making context in them during the years 1950-55, beginning with India. \(^{28}\) In the Indian context, two factors that were important in promoting growth are worth noting. One, is the Indian bureaucracy which built state institutions early (for example, the Planning Commission) to purposefully plan and implement various

\(^{28}\) It must be pointed out that any precise dating of the beginning and end of these Episodes is somewhat arbitrary and is not uniform for all countries. However, there is no reason to believe they are significantly different for any one country.
development schemes. One of the major goals of these early development schemes was economic Self-Sufficiency, and this assumed great importance during this period as a result of the loss of major external markets to Pakistan. Besides, overall direction to the bureaucracy's effort was provided by a strong political leadership under Prime Minister Nehru. The second factor, was the conservative attitude of the bureaucracy that kept inflation under very low levels which in turn raised private consumption to very high levels, averaging 84.4 percent during this period.

Whereas Pakistan, even though it had an equally well-trained bureaucracy as India, lacked a sense of uniformed political direction as to what the country's economic goals ought to be. In the absence of strong political direction, the CSP based its responses to most economic matters on practical considerations and this prevented them from embarking on an ambitious program of comprehensive economic growth in the early 1950's. The CSP, instead, adopted a policy of import—substitution industrialization to build a strong domestic manufacturing base which the country was lacking at that time, and neglected completely the agricultural sector. This neglect of a major sector resulted in lower overall output. Also, Pakistan's development planning effort in the years 1950-55 faltered because of slow formation of policy-making bodies and planning organizations. For instance, Pakistan drew up her First Five Year Plan (1955-60) much later than India, and it was not even
approved until after a year of the Plan period was elapsed.\footnote{29} The lack of political direction to her development efforts and a rather weak institutional base led to slower growth in Pakistan during this period.

In the case of Sri Lanka, three strands of policy responses during the years 1950-55 must be noted: One is the essentially open market policy followed by the Sri Lankan government during this period. After independence, the country eliminated most regulations on imports and foreign exchange and encouraged the private sector in the domestic arena. Second, was the major emphasis the UNP government placed on agricultural development to make the country somewhat less dependent on food imports in view of the reduced availability of external funds after independence. The UNP leaders were strong proponents of reviving domestic food crop agriculture (based on irrigation schemes) in the sparsely populated dry zone and to achieve this goal, made large investments in the agriculture sector. Third, is the increased public expenditures associated with an expanded welfare program, which the government felt was a political necessity at that time.\footnote{30} (As part of the welfare programme, an extensive system of food subsidies was adopted during the early 1950’s. It is argued that in this way the government deprived the left of popular support.)

We will now examine the growth differences across country for the years 1955-60. In response to the critical loss of major portions of its territory (market) to Pakistan, India adopted economic Self-Sufficiency as one of her early development goals. This approach led the country to foster all the major sectors and it gave special attention to both agriculture and industry. This in turn made India’s growth rate even and higher than Pakistan’s during 1955-60. On the other hand, stressing the need to create a strong manufacturing base, which the country was lacking, the CSP adopted a policy of import-substitution industrialization. This policy, however, completely neglected the agricultural sector resulting in lower output for Pakistan during the same period.

Sri Lanka’s growth rate in output during the years 1955-60 was 4 percent, which was higher than both India’s and Pakistan’s. As noted earlier, it had essentially an open-market economy with a foreign trade regime free of all controls and restrictions. Whereas in Pakistan and to a lesser degree in India, the external trade, in particular, imports were subjected to a number of restrictions moderating growth in them. In the domestic arena, Sri Lanka encouraged the private sector while Pakistan and India created mixed economy structures in which public sector enterprises gained more importance. Since many of these enterprises were loss-making, overall output in these countries was lower than in Sri Lanka. Also, Sri Lankan government was less
inclined to restrict public expenditure during this period than the other two countries where it was kept at moderate levels by their fiscally conservative bureaucracies.

While examining growth differences among India, Pakistan, and Sri Lanka, two strands of policies may be distinguished as having contributed to those differences. One was Sri Lanka’s liberalized trade regime which was in sharp contrast to the Indian and Pakistani trade regimes that were restrictive. Two, the expansionary fiscal policy of Sri Lanka (as witnessed by the increased expenditures towards welfare programs and development projects like the irrigation schemes) which was in contrast to the conservative fiscal stance of the civil servants in Pakistan and India.

Between India and Pakistan, the aggregate growth difference was not very pronounced. India’s rate was 3 percent and Pakistan’s was 2.9 percent. Nonetheless, we may note two factors that will explain this difference as well. One is the attention India gave to all the sectors in order to achieve self-sufficiency in contrast to the more narrower approach of Pakistan to build up only the industries sector. The second was Pakistan’s weaker institutional base to carry out its development programs compared to India’s stronger base during this period.

In conclusion, we may attribute the post independent growth differences among India, Pakistan and Sri Lanka to differences in their policy responses to the task of building an overall development strategy for them. India, for instance, adopted economic self-sufficiency as one of her early development goals and sought to foster a
balanced growth giving adequate attention to all the major sectors. As a result she achieved a higher rate of growth than Pakistan’s. On the other hand, Pakistan adopted a rather narrow approach to its development effort and gave importance only to its manufacturing base thereby reducing overall growth. Sri Lanka’s growth rate was higher than the other two countries and she achieved this by following an open market policy in its external trade, and encouraging the private sector in the domestic arena.

4.3.2 First Oil Shock (1973-1974)

In this section we will examine the first oil shock (1973-74), the policy responses of the SACs to it, and the economic impact of crisis management of these countries on their growth rates of output. A similar treatment of the second oil shock is given in the following section 4.3.3. Since both episodes involved actual or potential balance of payments crisis, our analysis will concentrate mainly on the management of external sector equilibrium of these countries.

4.3.2.1 Bangladesh

The actual crisis was an enormous increase in the price of imported oil during 1973-74. Bangladesh was completing her reconstruction efforts after the Civil War in 1973 when the oil price rise adversely affected her balance of payments. The country’s terms of trade declined by 20 percent during this period. However, much of the short fall in the external reserve has been offset by foreign assistance.

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31 Nepal is not included for analysis in this section as reliable data relating to her external trade and other relevant parameters during 1973-74 are not available.
Bangladesh's fiscal policy was expansionary with foreign assistance enabling the country to keep up her domestic expenditure and maintain the external balance. Since consumption is an important source of growth, we may look into that segment to see whether it in any significant manner, contributed to growth in output. General government consumption increased by 87 percent (in current Takka) during 1973-74, whereas, private consumption increased by 73 percent for the same period. Gross domestic investment also increased by 34 percent. Inflation was moderate. These factors led to a moderate growth rate of 5.6 percent during 1974-77.

4.3.2.2 India

The balance of payments began to deteriorate in late 1973 as a consequence of the rise in the price of imported oil. The terms of trade worsened by 40 percent between 1972/73 and 1975/76 causing severe balance of payments difficulties. In India's case, there was also a domestically induced inflation caused mainly due to internal factors such as the severe droughts of 1972 and 1974. The political situation was extremely disturbing as unrest was mounting against food shortages and the perceived autocratic tendencies of Prime Minister Mrs. Gandhi.

India was slow to respond to the country's balance of payments problems. In the early stages, the shock was financed partly by external aid and loans. There was a substantial increase in grants and official loans, both bilateral and multilateral, though

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this is not the result of any specific government policy. Growing remittances from Indian workers abroad also eased the balance of payments pressures. The resource balance improved considerably because of three reasons: First, import controls were tightened in 1973/74. Second, measures were taken to reduce consumption of petroleum. Third, imports were restrained as a byproduct of the restrictive macroeconomic policies during the crisis. In this sense, government policy did play a critical part. Exports also rose as a result of some flexibility introduced into the exchange rate policy. From December 1971 to September 1975 the rupee was pegged to the pound sterling. This turned out to be a good move on India’s part as the sterling was weak during this period, and the rupee depreciated with it. As a result, India’s export grew even in 1974/75 when world trade was static and other non-oil developing country’s exports suffered. These explanations show why, in spite of suffering a large terms of trade shock, India’s current account deficit did not deteriorate to any significant extent, and to the extent it took place it was quickly corrected. This improvement in the balance of payment brought average growth to 5.3 percent during 1974-77.

4.3.2.3 Malaysia

In the years 1973-74 the terms of trade of Malaysia did not deteriorate, because the country was able to earn higher revenues by exporting her petroleum. However, the world recession of the early 1970’s did have an adverse effect on its economy, due to its openness, with more than half of the country’s income derived
from external sources. Although exports did not grow as rapidly as imports on average, mainly because of the increased importation of investment goods and materials, the former expanded from 45 percent to 62 percent of the GNP during 1973-74. In addition to petroleum, other items such as copper, palm oil, and manufactures led this expansion. In brief, the first oil shock did not result in a serious balance of payment crisis for Malaysia. The rate of inflation was also moderate, and its effects did not alter the underlying trends of the 1970’s towards increased investment, public consumption, and exports relative to private consumption. All these factors were conducive to a higher rate of output growth for Malaysia, and it averaged 5.8 percent during 1974-77.

4.3.2.4 Pakistan

The Bhutto regime was busy implementing its nationalization plans on a large scale during 1973-74 when the country experienced the first oil price increase. However, Pakistan’s terms of trade did not fall to any significant extent. This was mainly due to two reasons. One, the price of Pakistan’s main export item, raw cotton, rose very high during this period, increasing its export earnings. Second, the country was able to reduce substantially the quantity of gasoline it imported, thereby conserving valuable foreign exchange. These factors helped the country maintain a comfortable balance of payments position. Besides, workers’ remittances from abroad also contributed to close a vexing trade deficit in 1972-73.
Pakistan’s fiscal policy continued to be expansionary during this period and this increased the aggregate demand. This in turn led to higher levels of private consumption, though government’s consumption fell by 17 percent. Inflation tended to be higher than in previous years. These factors were responsible for the average growth rate of 6.7 percent during 1974-77.

4.3.2.5 Sri Lanka

At the time of the first oil shock, Sri Lanka was in dire straits economically. The country had an extremely rigid protectionist regime and a difficult balance of payments situation. The government also had an enormous fiscal problem (in the form of higher deficits). These circumstances limited the policy options available to the government when a combination of external and domestic shocks precipitated the oil crisis in 1973.\(^\text{34}\) Despite a 23 percent reduction in the volume of imports, the net import bill increased more than threefold.

To pursue a successful strategy to finance growing imports, the government ought to have made major changes in its domestic and foreign policies. However, in the 1970 election the SLFP adopted a radical political stand to assure their leftist constituencies and later followed a policy of nationalizing several foreign owned businesses. This alienated the western donor countries and multilateral lending institutions. Traditional commercial sources also became wary of lending to Sri

\(^{34}\) For a complete description of Sri Lanka’s efforts to manage the balance of payments problem during the first oil shock, see Macroeconomic Policies, Crises and Growth in Sri Lanka, 1969-90. Pgs. 65-70. (Op. cited).
Lanka, which did not enjoy the confidence of the IMF or World Bank. The government, therefore, opted to adjust by relying on direct controls, particularly import restrictions. Policymakers were also reluctant to undertake a nominal devaluation which may have spurred exports, because they thought direct controls had a more immediate impact on the level of imports and therefore wanted to restrict them. There was also a dramatic fall in investment, especially private investment, as the import policy favored public sector enterprises producing domestic intermediate goods. However, as most of the public sector enterprises were inefficient and therefore loss-making, this turned out to be a burden on the economy. These factors reduced the growth of output which averaged only 3.3 percent in Sri Lanka during 1974-77.

4.3.2.6 Explanations of Growth Differences

We will now summarize the explanations for the differences in output growth of the five countries during 1974-77 in terms of differences in their policy responses to the first oil shock. Bangladesh, India, and Malaysia had more or less similar growth rates. In the case of Bangladesh and India, the external assistance that was forthcoming largely closed the trade deficit. Malaysia relied on the revenue from exporting its petroleum products to ease her balance of payment difficulties. These are factors not related to any specific policy, but the result of special circumstances. However, Bangladesh's mildly expansionary fiscal policy must be specifically referred to, for it generated enough aggregate demand (as reflected in the general levels of
consumption and investment) to promote a growth rate comparable to Malaysia's. India experienced the most severe drop in its terms of trade compared to the other four countries, but was able, nonetheless, to register a growth rate similar to others because of her policy initiatives (see section 4.3.2.2). The most significant of these initiatives was the pegging of the rupee to pound sterling which raised India's exports even when the world trade as a whole was static. During this period, Malaysia's terms of trade on average was static, and it did not fall to any large extent for the reason mentioned in 4.3.2.3. Therefore, the country did not experience any deterioration in its balance of payments. At the same time, a mildly expansionary fiscal policy kept the aggregate demand at higher levels causing increased public consumption and investment leading to the highest average growth rate among the three countries.

During 1974-77, Pakistan recorded the highest growth rate, whereas, Sri Lanka the lowest. Pakistan's terms of trade did not fall and the country was able to rely on worker remittances from abroad to cushion the adverse impact of oil price increase on its balance of payments. However, policy played a role in enforcing conservation in the use of petroleum products. Pakistan's expansionary fiscal policy must also be credited with raising its private consumption which, in turn, led to the highest overall average growth for Pakistan among all the five countries at 6.7 percent. On the other hand, Sri Lanka had only limited policy options because of the difficult circumstances she was already in when the oil price increase broke out. The
government was politically constrained to initiate measures to gain the confidence of major western donor countries, and the bilateral lending institutions so that the country could receive external funds. Therefore, the government relied on direct controls to restrict imports and failed to devalue the Sri Lankan rupee which may have stimulated exports. These two strands of policy slowed Sri Lankan growth significantly during this period.

4.3.3 Second Oil Shock (1979-82)

In this section we will examine the policy responses of all the six countries to the second oil shock and see whether differences in their responses have contributed to differences in their growth rates.

4.3.3.1 Bangladesh

Bangladesh was hit hard by the second oil crisis. As a result, its terms of trade fell by 20 percent during 1979-82. The country’s export trade has always depended on traditional items such as jute and tea and their prices on the international market were falling continuously. For instance, raw jute and tea prices fell by 50 percent, and 53 percent respectively during 1978-83. The falling prices of export goods and increase in the price of imported oil created a severe balance of payment crisis. Volume of international assistance was also considerably smaller during this period than what the country received at the time of the first oil crisis. The drastic current account deficit and the reduced volume of external assistance imposed a severe resource crunch on the economy, leading policymakers to adopt a restrictive fiscal
policy during this period, slowing aggregate demand. Gross private consumption averaged only 16 percent and government consumption 13.6 percent (in current Takka) during 1979-82. This led to a considerably lower growth rate of 2.7 percent for Bangladesh during 1983-85.

4.3.3.2 India

For India, the 1979-82 crisis was caused by two hardships occurring simultaneously: One, a poor harvest and the other, an increase in the price of imported oil (import prices rose by about 50 percent between 1977/78 and 1980/81). These two events led to high inflation and a large current account deficit. Though the origin of the crisis was similar to that of 1973, the outcome was rather different. The current account deficit remained about 25 percent of exports until 1984/85, and public finances deteriorated significantly. To tackle the balance of payment problems and to contain inflation, India adopted tight fiscal and monetary policies. Nonetheless, sectoral recessions (mainly in agriculture and industry) were the main reasons for the smaller output growth for India. In marked contrast to the first oil shock, export volume stagnated mainly due to appreciation of the real exchange rate. A devaluation of the real exchange rate was necessary in view of the deteriorating terms of trade, and the need to increase competitiveness of non-oil exports. However, this option was not pursued as Mrs. Gandhi returned to power in 1980 and remained extremely wary of

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devaluation after the experience of 1966. These factors accounted for the rather low average growth of India at 3.9 percent during 1983-85.

4.3.3.3 Malaysia

Despite the resilience of the economy in the wake of the oil shock in 1973, the second round of major oil price increases in 1979 and the world recession of 1980-82 strained the Malaysian economy seriously. In 1981, its terms of trade dropped for the first time since 1972 and the combined current account deficits for 1981 and 1982 averaged 11.8 percent of the GNP. The government budget also went deeply into deficit reaching 23 percent of GNP in 1981 to make up for the anticipated lack of external demand. Fearing inflation similar to that experienced after the first oil crisis, the government prepared austere budgets for 1982 and 1983. Nonetheless, Malaysia also launched several initiatives during this period to improve her external reserves. For instance, in 1980 the government passed the Commodities Trading Act and set up the Kuala Lumpur Commodities Exchange Zone in an effort to gain some control over the prices of its export goods. Manufactured exports have also been boosted by the establishment of other free trade zones. The combined effect of all these factors mitigated the negative impact of world recession to a large extent and contributed to an impressive growth rate of 7.8 percent for Malaysia during 1983-85.

4.3.3.4 Nepal

In Nepal during 1979-82 there was a surge of public expenditures to accelerate the pace of development. This led to an increase in the overall budget deficit from 6.1 percent of GDP in 1980/81 to 12.3 percent of GDP in 1982/83. However, the higher budget deficit did not lead to higher current account deficit as Nepal was only importing smaller quantities of gasoline during this period. Yet another important factor was the devaluation of the Nepalese rupee by about 15 percent in rupee terms, and the several procedural and institutional reforms undertaken to liberalize its import regime. These factors, together with large quantities of external assistance, improved Nepal’s current account and her external reserves rose by 27 percent during 1981-85. Along with measures to improve her external position, Nepal also undertook several programs to strengthen her domestic economy. The major thrust of these programs was to improve macroeconomic and sectoral development policies and to increase the efficiency of its public sector investments and institutions. These programs in turn raised aggregate demand. As a result, during 1979-82 private consumption increased by 12.6 percent; government consumption 18 percent, and fixed investment 14.6 percent (all measured in current dollars). These markers clearly show that Nepal’s economy was not very seriously jolted by the second oil shock and it achieved an impressive growth rate of 7.8 percent during 1983-85.

4.3.3.5 Pakistan

Foreign trade has always been important to Pakistan's economy because of the need for a variety of imports in domestic production. When the country experienced the second oil price increase in 1979 its imports as a ratio of GNP averaged 19 percent. There were, however, several restrictions in place to discourage excessive imports to save scarce foreign exchange. Still the terms of trade fell by 30 percent during 1979-82. Two developments contributed to this. First, there was a sharp jump in the crude oil price and this increased Pakistan's oil bill by 200 percent between 1979 and 1981. Second, the increase in oil prices created a recession in many parts of the world that brought Pakistan's exports. This recession depressed the quantities purchased and the prices paid for them. The government took a major initiative to reverse this slide in the terms of trade by unlinking the Pakistani rupee from the U.S. dollar in 1982. The rupee was instead tied to a market basket of currencies important to Pakistan's trade which made its exports more competitive. This measure, along with the country's determined efforts to reduce the consumption of gasoline have improved her external payments position contributing to an average growth rate of 7 percent during 1983-85.

4.3.3.6 Sri Lanka

When Sri Lanka experienced the second oil shock, her economy was doing well. In 1977, both the trade and services accounts were showing moderate surpluses; the latter due to rising migrant worker remittances and receipts from tourism. However, the terms of trade started declining in late 1978 and in 1979 it fell by 28.3 percent. The cumulative decline between 1978 and 1982 was an unprecedented 62.3 percent, overall, and in this respect Sri Lanka was one of the worst hit developing countries by the second oil price increase. As a result, the country had to use its external reserves to finance its current account deficit. There were also higher levels of inflation during 1980 and 1981 and it rose to an all time high of 26 percent in 1981. In 1980, the policymakers adopted a combination of fiscal, monetary, and trade policy measures to correct the problems in the external sector. Nonetheless, there was no systematic attempt during this period to reduce imports through direct controls or through higher tariffs. Due to the availability of very substantial external finance in the form of foreign aid and private transfers (mainly remittances), the government managed to avoid a retreat to import barriers as a way out of balance of payments pressures. However, even during this episode Sri Lanka was unable to respond to the crisis by a rapid expansion of exports by not undertaking a necessary currency devaluation out of concern for renewed inflation. In brief, the main vehicle for Sri

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Lanka's growth was the increased public expenditure program that created strong aggregate demand pressures. This increased demand contributed to an average growth rate of 5.1 percent during 1983-85. (See section 4.3.4 below for a detailed discussion of expanded public expenditure program in Sri Lanka).

4.3.3.7 Explanations of Growth Differences

We will now summarize the explanations for growth differences during 1983-85 in terms of differences in their policy responses to the second oil shock. Bangladesh and India recorded the lowest growth rates among the six countries. Bangladesh was severely hit by the increase in oil price, and as a result, her current account deficit widened. Reduced international assistance also added to her difficulties. These two factors created a severe resource crunch for the country. As a consequence, the policymakers adopted a restrictive fiscal policy that drastically reduced Bangladesh's growth in output during 1983-85. Superimposed on the oil price increase, India had supply constraints (sectoral recessions) as well that drastically reduced her agricultural output during this period. Nonetheless, policy in action also acted to moderate growth. The most important policy failure occurred in not pursuing an active exchange rate that would have stimulated exports during the first half of the 1980's. A devaluation of the exchange rate was necessary for this, but was not pursued by Mrs. Ghandi's government for various reasons, including political.

In the aftermath of the second oil shock Malaysia, Nepal, and Pakistan all have recorded more or less similar growth rates. Malaysia resorted to several innovative
policies and programs to stimulate its exports in the face of the second oil shock and
the world recession of early 1980’s. They included the promotion of special export
promotion zones and the passage of Commodities Trading Act of 1980. These
measures stimulated her non-oil exports contributing to a higher rate of output
growth. Nepal’s major initiative in this context was to devalue the rupee by 15
percent and adopt several other measures intended to liberalize its import regime.
Both these measures contributed to significant improvement in the balance of
payments. Together with increased domestic spending, these measures led to an
impressive growth rate of 7.5 percent for Nepal. Pakistan instituted several steps to
conserve consumption of gasoline and it delinked the rupee from the U.S. dollar in
1982. The later measure stimulated export revenue which partly paid for the higher
import bill. Fiscal policy, while not expansionary, created sufficient aggregate demand
to produce an impressive output of 7 percent during 1983-85. The most significant
initiative Sri Lanka undertook in the context of the second oil price increase was in the
realm of public expenditures. The country received large amounts of external funds
(both as foreign aid and worker remittances from abroad) which enabled it to carry out
the expenditure program. This stimulated aggregate demand leading to a modest
growth rate of 5.1 percent during 1983-85.

It is also useful to compare the growth rates of SACs over the two shocks to
see whether policymakers were better prepared to handle the second shock. First, we
will compare the rates of Bangladesh, which dropped from 5.3 percent to 2.7 percent over time. During the first oil shock, Bangladesh had an expansionary fiscal policy and the external assistance available to it was sufficient to finance the public sector projects related to that policy. Also, much of the short fall in the external reserve was made up by foreign assistance. These factors contributed to a modest growth rate of 5.3 percent after the first shock. However, as a result of the reduced volume of external assistance and the growing balance of payments deficits, Bangladesh was facing a severe shortage of resources during the second shock. This forced the country to adopt a restrictive fiscal policy leading to a reduced growth rate of 2.7 percent during the years 1983-85. The two countries whose rates rose appreciably over the course of the two oil shocks were Malaysia and Sri Lanka. Their increase in output during the years 1983-85 can be attributed to the increased public expenditure programs they have undertaken at that time for various reasons (see section 4.3.4 below).

Summing up, we may conclude that the adoption of a restrictive fiscal policy by Bangladesh, necessitated by a reduction in the volume of external assistance, was the primary reason for slower growth of output during the second oil shock. International donors helping Bangladesh felt the country has overcome most of its economic difficulties following the civil war in 1970-71, and therefore, reduced their assistance. Malaysia and Sri Lanka, on the other hand, followed expansionary fiscal policies not necessarily to tackle the external payment problems, but to meet the
domestic political requirements imposed on their respective governments. In the case of Malaysia, the severity of the oil price increase was somewhat mitigated by the fact that it was an exporter of petroleum, a factor unique to this country. The above analyses show that experience gained by managing a previous oil price shock was not a guiding factor in deciding policies that were initiated during the second oil shock.

4.3.4 Public Sector Investment Boom (PSIB)

In this section we will examine the impact of expanded Public Sector Investment Boom (PISB) of Malaysia, Pakistan, and Sri Lanka on their domestic economies during 1983-85. In the other three countries we were not able to notice any clear pattern of increased investment as a counter cyclical measure and, therefore, they are not included in the analyses here. This Episode is different from the others discussed above, as its main cause, increased Public Sector Investment spending originated in the domestic arena, and not externally as in the other three Episodes.

As a counter cyclical measure, policymakers in Malaysia have undertaken a massive expansion of public development projects during 1983-85. The total investment into them amounted to nearly 23 percent of the GDP during this period. It was oriented mainly towards infrastructure, with transport, education and irrigation expenditures receiving approximately 85 percent of the total. Although the expenditures related to these projects were partially financed by a surplus in NFPE operations (attributable to profits generated by the Petroleum Nasional Berhard and its subsidiaries) the consolidated public sector deficit reached a high of 11.6 percent.
during this period. In order to reduce the large deficit that arose as a result of increased Public Expenditures, Malaysian policymakers initiated a process of fiscal adjustment based on the two following factors: First, there was an increase in the operating surplus of NFPES due to the expansion in petroleum production and exports. This acted to reduce the deficit. The second element of fiscal adjustment was in development expenditures. The sum of development spending accounted for by federal government expenditures in 1984 and 1985 had returned to the level of the 1970's, around 12 percent of GNP. This was accomplished by a one-third cut in nominal development expenditures, concentrated in defense, and commerce and industry\(^{40}\). These two factors contributed to reduce substantially the large deficit accumulated as a result of the expansion of public development projects. Although federal government expenditure was reduced after 1982, overall Public Sector Investment remained high through 1984, because NFPE investment continued to grow until then. Since there was no borrowing from the Central Bank to cover the deficits, inflation remained moderate, averaging 3 percent. From our discussion so far of the initiatives undertaken in the fiscal area, it is clear that to avoid recession, the Malaysian government kept up a higher level of demand through fiscal expansion. This contributed to significant activities in three areas: Public consumption as a share of GDP rose to 67 percent, private consumption 52 percent, and Gross Domestic

Investment 28 percent. These higher levels of consumption and investment activities led to a higher level of output growth in Malaysia during 1983-86.

During the same period, Pakistan also undertook an enormous increase in its public development expenditures. The government directed funds to certain priority areas such as energy and social sectors like education and health, as it felt these areas were neglected in the past. Also, to accelerate the development of the less developed areas, another government priority, substantial amounts have been allocated for special development programs for Baluchistan, the tribal areas of the North-West Frontier Province (NWFP) and lesser amounts to public services in Karachi. In the initial stages, financing of the Public Sector Development programme was made possible by assistance (including grants) from the multilateral institutions and substantial remittances from Pakistani workers abroad.\footnote{Remittances by citizens of Pakistan working abroad, mainly in Middle East, grew at an annual rate of 20% between 1977/78 and 1982/83. For an account of how Pakistan financed her increased public expenditure programme during this period, see; Pakistan. A Review of the Sixth Five Year Plan. A World Bank Country Study (1984), p. 31. World Bank, Washington, D.C.} This infusion of external funds kept deficit to a minimum average of 3 percent during this period. Inflation was also modest with an average rate of 6 percent. Since deficit was not a serious problem policymakers did not have to make any significant cuts in expenditures. Fiscal policy continued to remain modestly expansionary. As a result, public consumption remained at a fairly high rate of 93 percent of the GNP during the early 1980’s. Private
consumption and Gross Domestic Investment were respectively 82 and 21 percent of
the GNP. These rates contributed to enhance the growth in output of Pakistan.

Sri Lanka has taken up large increases in its Capital expenditures during the
early 1980's as part of a broader programme of expanded public investment. Much of
these expenditures went to two projects: One, the accelerated Mahaweli Development
Project; and two, a housing-cum urban development scheme (including the building
of a new capital and a monumental parliament house). Together these two projects
accounted for 43 percent of all government expenditures during the years 1979-85.
The Sri Lankan government's decision to undertake such huge projects with weak
economic rationale was influenced by several considerations. For instance, a large
public sector infrastructure cum-settlement project offered a mechanism for political
patronage by enabling the government to provide employment on a large scale to
youth and a promise of land to the rural poor; that is to say political objectives were
paramount. While the capital spending was increasing, revenues were declining
because of lower receipts from export duties, contributing to a fiscal deficit of an
unprecedented 20 percent of the GDP during 1983-85. Foreign assistance funded a
large portion of it, but this was inadequate to finance the large deficit fully, and the
government was compelled to borrow heavily from the central bank. This inevitably
led to a higher rate of inflation which rose to nearly 10 percent during this period.
Government of Sri Lanka took several measures to mobilize resources while curtailing public expenditures in order to hold down the deficit. For instance, it attempted to raise import duties and other indirect taxes. However, an important point to note is Sri Lanka’s refusal to make currency devaluation that was necessary to avoid overevaluation, which dampened its efforts to raise export tax revenue. The main thrust of her effort was to restrain expenditure, which was to be achieved mainly through cuts in other capital expenditures, while leaving the Mahaweli and housing projects virtually untouched. In 1983, cutbacks in other projects amounted to 16 percent of the total public expenditure. Major reductions in consumer subsidies were also effected. These significant reductions in aggregate demand slowed growth in Sri Lanka.

We will now examine the differences in growth rates across country for the years 1983-86. Malaysia’s effort to reduce its deficits and launch the country on the path of higher growth was made easy by fortuitous circumstances, and was not the result of any conscious policy decisions. Funds in large amounts to finance the expenditures were available from the surpluses of NFPES due to profits generated from petroleum exports. Since funds were available, Malaysia was able to adopt an expansionary fiscal stance leading to a high level of aggregate demand. This resulted

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42 For a detailed account of the various measures taken by the Sri Lankan government during this period to mobilize resources so that it can hold down its deficit, see: Macroeconomic Policies, Crises and Growth in Sri Lanka, 1969-1990, p. 84. (Op. cit.)
in higher consumption and investment which in turn led to higher levels of output growth which averaged 8.8 percent for Malaysia during 1983-86.

Pakistan's resource position also was strong, but not as strong as Malaysia's. The country had remittances from workers abroad and assistance from multilateral institutions to finance an increasingly larger volume of development expenditures. This inflow of funds kept Pakistan's deficit the lowest of the three countries at an average rate of 3 percent. Higher aggregate demand led to a higher level of consumption and investment than the other two countries leading to a growth rate of 6.8 percent. Sri Lanka's experience with the PSIB was in sharp contrast to the other two countries. It could not maintain the higher levels of public expenditures associated with this boom over a long period of time and had to drastically reduce expenditures, including capital expenditures. Her efforts to mobilize resources internally proved rather inadequate as the policymakers were reluctant to devalue the currency to boost export revenues. The revenue shortfalls and the resultant huge deficit of 20 percent forced the government to borrow heavily from the Reserve Bank raising inflation to an unacceptable 10 percent. With meager resources faltering aggregate demand, growth rate in Sri Lanka slowed to an average 4.8 percent.

To sum up, Malaysia's growth rate was higher than the other two countries during 1983-86 mainly because of the availability of profits from the sale of petroleum products that financed and expanded its public expenditure program. It was not due
to any significant policy initiative. Nonetheless, policy also may have contributed to growth by continuing to build up aggregate demand for an extended period of time.

Sri Lanka's growth rate was the lowest among the three due to the inability of that country to mobilize resources internally to pay for its expenditure program. Pakistan's growth rate was in the middle, and its deficit and inflation rates were much lower than Sri Lanka's. However, Pakistan's growth was lower than Malaysia's, even with a lower deficit than the latter's. This may be due in part to the shorter duration in which the tempo of investment was kept high in Pakistan, and partly to its large public sector. Malaysia kept overall public investment high through 1984, whereas Pakistan began to slow down its investment programme as early as 1982.

4.4 A COMPARATIVE ANALYSES OF GROWTH RATES WITH EMPHASIS ON NONECONOMIC FACTORS

In the preceding sections we have interpreted differences in growth rates in terms of policy differences. Some of those rates have also been compared across countries. In this section, we will extend further the analyses of comparative growth differences focusing on the contextual (non-economic) factors that shaped each country's policy responses as we presume differences in these factors both among and within the SACs to be the sources of differences in growth rates.

First, we will take up for comparison period-wise growth rates. Three countries that experienced drop in growth rates from a previous period will be selected and their policies compared to see whether they have been following similar policies
among them. Next, we will select two countries whose rates increased over the previous period and their policies will be compared to see whether they have been following similar policies, and also whether such policies were different from those pursued by the countries whose rates dropped. This type of comparison will establish the link that exists between policies and growth rates. Three countries whose rates dropped are: One, Bangladesh with a rate of 5.9 percent for the years 1970/71 to 1979/80 which dropped to 3.8 percent during the years 1980/81 to 1989/90; two, India with a rate of 4.1 percent for the years 1950/51 to 1959/60 which dropped to 3.2 percent during the years 1960/61 to 1969/70; and three, Sri Lanka with a rate of 6.3 percent for the years 1960/61 to 1969/70 which dropped to 4.6 percent during the years 1970/71 to 1979/80.

We will compare the growth rates in terms of each country's policy differences in the fiscal and trade sectors over the relevant periods.\textsuperscript{43} For Bangladesh, fiscal policy was expansionary in both periods. However, the size of SOEs became larger during the years 1970/71 to 1979/80 and increasing amount of resources were being transferred to them regardless of Major Zia's attempt to reduce its size. Since the increasing role of public enterprise in development is an issue we often encounter in the context of growth analyses, the reason why many states don't wind up such loss-making enterprises must be made clear. It is that governmental authorities often

\textsuperscript{43} Monetary policies of these countries were mainly passive during these periods; therefore, they are not included in our analyses here.
regard public sector enterprises as mechanisms for political patronage by enabling them to provide employment to people. Ideology of the Awami Party also supported state intervention in economic activities. During Lt. Ershad’s regime, transfers to SOEs continued to increase (see section 4.1.1), but external funding became difficult to get, requiring internal borrowing that distorted growth. In the trade sector, the terms of trade fell more steeply during the years 1980/81 to 1989/90 creating a severe balance of payment problem. Nonetheless, policymakers were reluctant to follow a flexible exchange rate to increase exports, and relied instead on controls to stem the volume of imports reducing growth. Therefore, it appears that the two main reasons for reduced growth in output over time were the increasing transfers the country made to its SOEs accompanied by a decline in the volume of external aid to finance such transactions and the existence of controls that distorted the trade regime.

During the years 1950/51 to 1959/60, India’s fiscal policy was expansionary. Resources were readily available to finance public sector projects from the sterling funds and internal borrowing was not necessary for this purpose. Whereas, during the years 1960/61 to 1969/70 fiscal policy became restrictive leading to substantial reductions in capital expenditures slowing growth. The government adopted this fiscal stance because of the fear of inflation due to sectoral short fall in production. This short fall in production because of adverse weather conditions was a factor unique to India during the years 1960/61 to 1969/70 (see section 4.1.2). In the trade sector, two
factors contributing to lower growth rates during the same period were continued reliance on controls as an instrument of balance of payment adjustment and the devaluation of the rupee. As noted earlier, devaluation did not prove successful to stimulate exports. Since controls were a permanent feature of India’s trade regime reducing its growth in output it requires explanation as to why they became permanent. Controls were the product of an interventionist ideology. Once introduced, they grew more elaborate because dominant groups in society were able to manipulate them to their own benefits. Controls generated rents, and those who received them had a vested interest in keeping the system going. Business classes in India had a vested interest in perpetuating the controls as they reaped profits from them. The two major reasons for reduced growth were, therefore, the pursuance of a restrictive fiscal policy and the growing reliance on controls as an instrument of balance of payments.

Sri Lanka followed an expansionary fiscal policy during the years 1960/61 to 1969/70 because it received large amounts of concessionary funds due to the pro-Western stand of its UNP government and this promoted growth. Besides, the increased emphasis given to private sector activities (a stance closely related to UNP’s ideology), also enhanced growth. Whereas, during the years 1970/71 to 1979/80 the SLFP government adopted a restrictive fiscal policy to balance the budget and thus strengthen Sri Lanka’s economy. However, for several reasons it did not work out
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that way (see section 4.1.6). The reductions made in the Capital expenditures to balance the overall budget and the growing reliance on domestic financing of public sector projects, in fact, reduced growth in output. In the trade sector, the SLFP government’s policy of stringent import controls (a factor related to SLFP’s interventionist ideology) created a severe scarcity of critical inputs needed for production leading to reduced growth.

The two countries whose growth rates increased over the two periods are:
One, Nepal with a rate of 2.4 percent for the years 1970/71 to 1979/80, which increased to 4.8 percent during 1980/81 to 1989/90; and two, Pakistan with a rate of 2.4 percent for the years 1950/51 to 1959/60, which increased to 7.2 during 1960/61 to 1969/70. We will compare the period-wise growth rates of Nepal and Pakistan also in terms of their policy initiatives in the fiscal and trade sectors, bringing out clearly the contextual factors that underlie such policy initiatives.

For Nepal during both the periods, fiscal policy was expansionary. However, development expenditures were lower than current expenditures during years 1970/71 to 1979/80 (see sections 4.1.4). During 1980/81 to 1989/90, this trend was reversed and the proportion of total expenditures allocated to development expenditures increased. This was mainly due to political pressures exerted on the policymakers by the middle classes at a time when the power of the traditional elites was weakening. The substantial improvements made in the quality of expenditures also contributed to
growth. Whereas, for Pakistan, fiscal policy was conservative in both periods and the
gap in resources was financed out of aid funds. However, in the years 1950/51 to
1959/60 there were unique factors other than those induced by policy that were
causing lower rate of growth (see section 4.1.5). For instance, the partition of the
sub-continent, a historical factor, left Pakistan with virtually no manufacturing base.
Besides, the years 1950/51 to 1959/60 was also characterized by political instability.
Under these circumstances, the CSP was firmly in charge of policy-making and it
preferred to create a strong industrial base. This increased growth (especially in the
manufacturing sector). With respect to the trade sector, Pakistan in the years 1950/51
to 1959/60 had an overvalued currency that was part of its import-substitution
industrialization policy and this reduced both imports and exports. On the other hand,
the CSP under the direction of Ayub Khan who did not believe in interventionist
ideologies, relaxed the rigidity of controls during 1960/61 to 1969/70 which permitted
more imports and this in turn raised total output.44

Those countries with decreasing period-wise growth rates were having similar
policies, except for Bangladesh. This country adopted expansionary fiscal policies
during both the periods, but a drop in the volume of external aid made it necessary to
borrow internally slowing growth during 1980/81 to 1989/90. This shows how a
policy is implemented is also equally important when it is used to interpret differences

44 For an analyses of fiscal and trade policies during Ayub Khan’s regime, see; Pakistan: A Country
in growth rates. India had an expansionary fiscal policy during the years 1950/51 and 1959/60 and a restrictive one during 1960/61 to 1969/70. In the trade sector also, policies were different over time, with controls becoming more pervasive during the years 1960/61 to 1969/70. Sri Lanka had a similar pattern with an expansionary fiscal policy and a liberalized trade regime during the years 1960/61 to 1969/70 compared to a restrictive fiscal and protectionist trade policy in the years 1970/71 to 1979/80. Nepal and Pakistan, whose period-wise growth rates increased over time, were also following the same set of policies. The two countries had expansionary fiscal policies during both periods and relaxed their respective trade regimes over time. These findings convincingly show that expansionary fiscal policy (funded externally) and a liberalized trade policy together promote growth. On the other hand, a restrictive fiscal policy and a protectionist trade regime will slow growth.

We may also look into the analyses of growth rates across country for evidence that will support our basic premise that differences in growth rates can be explained in terms of differences in policies and the contextual factors that shape those policies. We will consider growth rates involving four countries: Bangladesh, Malaysia, India, and Sri Lanka. Bangladesh’s 3.8 percent and Malaysia’s 7.0 percent have been compared for the years 1980/81 and 1989/90 and those differences explained in terms of differences in two major policy initiatives (see section 4.2.1). Bangladesh was following an expansionary fiscal policy and as a part of it was transferring large
amounts of funds to SOEs. The country also adopted a restrictive monetary policy with higher interest rate. On the other hand, Malaysia was following a restrictive fiscal policy with smaller amounts of funds being transferred to its NFPSEs, and an easy money policy that injected liquidity into the financial system. India’s 3.2 percent growth rate has been compared to Sri Lanka’s 6.3 percent for the years 1960/61 to 1969/70. This shows that India followed a restrictive fiscal policy fearing inflation and its devaluation measure did not raise exports, while Sri Lanka followed an expansionary fiscal policy with a liberalized trade regime (see section 4.2.2). These findings also seem to add support to our basic premise.

Another source of support for our premise can be found in the comparative analyses of growth differences of the four episodes given in section 4.3. We will draw on two of these episodes, the first and second oil shock, to see what role contextual factors played in policy formulations and implementation and whether they contributed to growth differences. The two oil shocks are selected as they provide the opportunity to look into the policies of all the six countries. In the aftermath of the first oil shock, Bangladesh, India, and Malaysia had more or less similar growth rates (Malaysia was not seriously affected by the first shock). Bangladesh had an expansionary fiscal policy which was supported by external aid, whereas India pegged her rupee to the pound sterling, thus cushioning the impact of the oil price increase (see section 4.3.2.6). Pakistan had the highest growth rate immediately following the first oil
shock and this was mainly due to its conservation policy and the remittances it received from Pakistan’s workers abroad. On the other hand, Sri Lanka relied on direct controls to restrict imports and failed to devalue its rupee, registering a rate that fell in the middle of other growth rates.

We shall now compare the growth rates following the second oil shock and the related policies. Bangladesh and India recorded the lowest growth rates and they both were following restrictive fiscal policies. India also failed to adopt an active exchange rate policy contributing to a lower growth rate. Malaysia, Nepal, and Pakistan all had similar growth rates and active policies to stimulate those rates. Nepal, for instance, devalued its currency and instituted several measures to liberalize its trade regime. Pakistan delinked its rupee and adopted strict conservation measures to reduce the consumption of gasoline (see section 4.3.3.5). These observations certainly show that policies do shape growth rates.

It is also instructive to look into the contextual factors that shaped the various policies we have discussed in relation to the oil price shocks. We will discuss two instances; each relating to the first and the second oil shocks. Pakistan had the highest growth rate among all the SACs after the first oil price shock. In response to the first shock, the country adopted several conservation measures as it thought they would help save the foreign exchange needed to import gasoline. Pakistan has gone through a civil war around this time, and therefore, the Bhutto regime thought it easy to
demand sacrifices from the people in the national interest. A second factor, which was unique to Pakistan was the remittances of its workers from abroad that provided the necessary foreign exchange. These two contextual factors contributed to reduce the severity of the first oil shock and enhanced growth. Sri Lanka’s growth rate after the second oil shock was somewhere in the middle of the growth rates of other countries. Sri Lanka was able to achieve this rate as a result of an expansionary fiscal policy funded in large measure by external aid. The UNP government’s pro-Western stand was a major reason why international donors extended large amounts of concessionary foreign funds to its public sector projects. In many cases, donors announced their commitment well before the completion of feasibility studies and estimation of project costs. This was a factor unique to Sri Lanka that promoted growth after the second oil shock.

From the above analyses three major conclusions follow:

One, there is a link between policy and growth rate and therefore differences in growth rates can be explained in terms of differences in policies. Sri Lanka’s growth rates during 1960/61 to 1969/70 and 1970/71 to 1979/80 provide a clear example among others to support this conclusion. In the years 1960/61 to 1969/70, the UNP government was following an expansionary fiscal policy financed largely by concessionary funds from abroad and this promoted its higher growth rate. Whereas

during 1970/71 to 1979/80 since external assistance was not forthcoming Sri Lanka had to follow a restrictive fiscal policy and this, in turn, reduced its growth rate.

Two, contextual (noneconomic) factors do shape the macroeconomic policies of the SACs. Pakistan’s policy-making during the first period is a clear instance in which contextual factor(s) can be shown to have influenced policy. A historical factor, viz, the partition of the sub-continent, left Pakistan with no manufacturing base and this persuaded the policymakers (the CSP) to concentrate on building a strong industrial base for it to the neglect of other pressing economic problems. This neglect resulted in a lower rate of growth for the country.

Three, in most periods selected for comparison contextual factors were different, both within and among the SACs lending support to our premise that these differences can be used to explain differences in aggregate growth rates. In this regard, we will mention specific contextual factors that influenced policy-making within India over time and among Bangladesh and Malaysia. During the years 1950/51 to 1959/60, India’s expansionary fiscal policy that led to a higher rate of growth was shaped by the availability of ample resources from the sterling funds (in Britain). This is a historical factor that pertains to the years 1950/51 to 1959/60. However, in the years 1960/61 to 1969/70 growth slowed because of a restrictive fiscal policy necessitated by fear of inflation which in turn was precipitated by poor harvest and lack of development funds due to increased defense expenditures. These
factors were different from those that impacted on macro policy during the years
1950/51 to 1959/60. Bangladesh, during the years 1980/81 to 1989/90, was following
an expansionary fiscal policy financed with less foreign assistance and transferring
large amounts of government funds to its SOEs. Malaysia on the other hand, followed
a restrictive fiscal policy and allocated less resources to its NFPSEs. The different
contextual factors that underlie the policies of two countries were: For Bangladesh, a
decline in the volume of external assistance (dependence on foreign aid) and for
Malaysia, receipt of income from the sale of petroleum products (less dependent on
foreign aid). The former reduced the growth rate for Bangladesh and the latter
enhanced it for Malaysia.

The evidence presented above in support of the three conclusions seem to
confirm our premise (also spelled out elsewhere in this chapter) that policy differences
can be used to explain differences in growth rates.