Chapter 2
Review of Literature

The present chapter is divided into two sections.

**Section I:** Presents an overview of the literature relating to foreign capital and economic development.

**Section II:** Attempts to review various studies on the relationship between International Financial Institutions (IFIs) and economic development.

**SECTION – I**

2.1 Foreign Capital and Economic Development:

Foreign capital takes several form, namely loans and grants through inter-governmental flows (bilateral flows), foreign assistance through institutions (IFIs), foreign equity capital through capital market transactions and Foreign Direct Investments (FDI). In addition, there is flow of foreign capital in the form of transfer of technology and technical know-how. The main aim of foreign capital is to augment the economic development of an economy. Capital is affirmed as an engine of economic growth, and it is held that, foreign capital may bridge the set of gaps like Savings-Investment gap, Export-Import gap, and Technological gap, which constrain the development of the present developing economies.

However, there is no unanimity among the economists regarding the growth effectiveness of foreign capital, and conflicting views have been put forwarded both on theoretical and empirical grounds about the precise role of foreign capital in the process of economic development of developing economies.
Griffin and Enos (1970) analysed data on fifteen African and Asian Countries for the period 1962-64 and estimated the following regression equation:

\[ Y = 4.8 - 0.18 \frac{A}{Y} \]

\[ \left( 0.26 \right) \]

\[ r^2 = 0.33 \]

Where,

\( Y \) = Average rate of growth of Gross National Product.
\( \frac{A}{Y} \) = Ratio of foreign aid to Gross National Product.

The study found the negative but statistically insignificant relationship between financial assistance and the rate of growth of Gross National Product.

In another cross-section study, Griffin and Enos (1970) took the thirty-two developing countries for the period 1962-64 and following regression equation was formed:

\[ S_0/y = 11.2 - 0.73 S_1/y \]

\[ \left( 0.54 \right) \]

Where,

\( S_0/y \) = Gross Domestic Saving as a percentage of Gross National Product
\( S_1/y \) = Foreign Savings as a percentage of Gross National Product.

Study found the inverse relationship between Gross Domestic Savings as a percentage of Gross National Product and foreign savings as a percentage of Gross National Product.

Nurual Islam (1972) discussed the impact of foreign assistance on the rate of mobilization of domestic resources (savings and investment) for the development purpose over the period 1950-1970 in the Pakistan economy. By using regression analysis, it was concluded that foreign assistance has helped to achieve a higher rate of saving and investment. Further, assistance has important influence in strengthening the machinery and process of planning in Pakistan.

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Papanek (1973) used cross-section data for thirty-one countries for 1960s, to find the relationship between foreign private investment and economic growth. Regression resulted into the following equation:

\[
\text{Growth} = 1.5 + 0.21(S) + 0.46(A) + 0.35(FPI) + 0.13(OFI)
\]

\(R^2 = 0.46\)

Where,
\begin{align*}
S &= \text{Gross Domestic Saving,} \\
A &= \text{Aid} \\
FPI &= \text{Foreign Private Investment and} \\
OFI &= \text{Other Foreign Inflows}
\end{align*}

All independent variables were expressed as percentages of GDP. Figures in parenthesis are 't' values. Study found a positive relationship between foreign private investment and economic growth.

Alamgir Mohiuddin (1974) using Ordinary Least Square technique for Bangladesh for 1960 to 1970 resulted into following equations:

\[
S_D = 494.0 + 1.876** (F)
\]

\(t\)-values: * Significant at 5% LoS

\[
\hat{Y} = 7.79 - 0.00456* (F)
\]

\(R^2 = 0.46\)

Where,
\begin{align*}
S_D &= \text{Direct estimate of saving} \\
F &= \text{Net foreign capital Inflow} \\
\hat{Y} &= \text{Annual rate of growth of GDP at constant factor cost.}
\end{align*}

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Study found a significantly positive relationship between foreign capital inflow and savings, while a significantly negative relationship between foreign capital inflow and growth rate of GDP.

Gupta K.L. (1975)\textsuperscript{6} took the cross section data for forty developing countries for the 1960s. Using simultaneous equation method, following equation was framed:

\[
G = 3.5708 + 0.0839 \frac{S}{y} + 0.15553 \text{Aid} + 0.19531 \text{FPI} + 0.29788 \text{RFI}
\]

\[
(1.415) \quad (2.691) \quad (1.362) \quad (2.097)
\]

\[R^2 = 0.296\]

Where,

- \(G\) = Growth rate of GDP
- \(\frac{S}{y}\) = Gross Domestic Saving rate,
- \(\text{FPI}\) = Foreign Private Investment
- \(\text{RFI}\) = Other Foreign Inflow

Study found all foreign resources had a positive relationship in the growth rate of GDP, especially Foreign Private Investment.

Seung Park (1977)\textsuperscript{7} using correlation and regression analysis on forty one countries of Asia (19 labour-surplus and 22 non-labour-surplus countries) for 1968-70 found that net inflow of foreign capital had a significant positive impact in the economic development in the labour-surplus countries, while an insignificant role in the economic development of non-labour-surplus countries. The study also found that foreign capital plays more important role in the economic development of labour-surplus economies while in case of non-labour-surplus economies, domestic savings plays an important role in the economic development.


In their study, Dowling and Hiemenz (1983) tried to find the effects of aid on savings and rate of growth of real GDP for the period 1968-79 in the Asian region economies. 2SLS technique resulted into the following equation.

\[ Y = 0.47 + 0.46 \text{FA} + 0.72 \text{KM} + 0.24 \text{S} \]

\[ (2.46) \quad (2.72) \quad (4.5) \]

\[ R^2 = 0.43 \]

Where,

- \( Y \): Rate of growth of real GDP
- \( \text{FA} \): Foreign financial aid, measured as percentage of GDP.
- \( \text{KM} \): Private capital inflow, measured as percentage of GDP.
- \( \text{S} \): Gross domestic savings, measured as percentage of GDP.

The results were positive and statistically significant. The coefficients showed that foreign aid contributed to GDP growth.

Rana and Dowling (1988) using panel data for nine developing countries in Asia namely, Burma, India, Nepal, Phillipines, Singapore, Thailand, Republic of China, Republic of Korea, Sri Lanka for the period 1965-82, tried to find the impact of foreign resources namely Aid, Foreign Private Investment and Change in Exports on growth. Simultaneous equation resulted into the following equations.

\[ \text{GR}=5.248**** +0.009*\text{Aid} + 0.768***\text{FPI} + 0.185*\text{CX} + 0.438**\text{CLF} + 1.001\text{GDPN} \]

\[ (3.765) \quad (1.044) \quad (2.065) \quad (1.455) \quad (1.994) \quad (1.872) \]

\[ \text{S}=11.375**** - 0.084*\text{Aid} + 0.492*\text{FPI} + 0.124\text{CX} + 0.224\text{CLF} + 0.004**** \text{GDPN} \]

\[ (4.994) \quad (1.318) \quad (1.008) \quad (0.731) \quad (0.782) \quad (3.935) \]

\( t \)-values: 

- **** - Significant at 1% LoS
- *** - Significant at 5% LoS
- ** - Significant at 10% LoS
- * - Marginally Significant

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Where,

\[ GR = \text{Growth rate of GDP} \]
\[ S = \text{Gross domestic saving as percentage of GDP} \]
\[ FPI = \text{Foreign private investment as percentage of GDP} \]
\[ \text{Aid} = \text{Foreign aid as percentage of GDP} \]
\[ CX = \text{Change in export as percentage of GDP} \]
\[ CLF = \text{Change in labour force} \]
\[ GDPN = \text{Per capita gross domestic product.} \]

Equations show a significantly positive impact of Aid, Foreign private investment, Change in labour force and Change in export on growth while, Foreign private investment and Per capita gross domestic product had significantly positive impact on Saving, while Aid has a marginally significantly negative impact on Saving.

S. Ahmad (1990) \(^{10}\) tried to find the impact of foreign capital inflow on the economic growth of Bangladesh. By using simultaneous equation method for the period 1960-80, it was found that foreign capital inflow had a significant positive effect on economic growth.

Naheed Z. Khan and Eric Rahim (1993) \(^{11}\) applied OLS methodology to examine the impact of annual changes in the net economic assistance receipts on changes in savings and economic growth in Pakistan's economy for the period 1960-1988. The study had further divided foreign capital inflows into three distinct categories namely FDI, grants and loans. Separate analysis was carried out to see the impact of individual category of foreign capital in the economy. Coefficient of both foreign loans and FDI were found to be negative but insignificant with respect to domestic savings. The value of coefficient of the foreign loans and the FDI with respect to growth was positive and significant. In addition, the grant in aid had a positive effect on economic growth, but the coefficient was insignificant.

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Rahim M. Quazi (2000) had tried to find the effects of foreign aid on economic growth and domestic savings of Bangladesh economy for the period 1973-1996. Using 2 SLS methodology, following equations were framed:

\[
GR = 9.74 - 1.19^{**}\text{Aid} - 1.40^{**}\text{S} + 0.08\text{MX} + 0.90^{**}\text{CLF} - 4.62^{**}\text{D}
\]

\[
R^2 = 0.28\%
\]

\[
S = 8.26 - 0.78^{**}\text{Aid} + 0.03\text{GR} + 1.54^{**}\text{CX} - 0.66\text{D}
\]

\[
R^2 = 0.53\%
\]

** = Significant at 1% LoS

Where,

GR = Gross domestic product growth rate
Aid = Foreign aid as % of GDP
S = Gross domestic savings as % of GDP
MX = Imports plus exports (net volume of trade) as % of GDP
CLF = Increments in labour force
CX = Increments in exports earnings as % of GDP
D = A dummy variable for natural calamities and/or political disturbance.

The study found significantly negative impact of foreign aid, gross domestic savings, and dummy variable on GDP growth rate, while net volume of trade and increments in labour force have significantly positive impact in GDP growth rate. In case of domestic savings, gross domestic product growth rate and increments in exports earnings have significantly positive impact while, foreign aid and dummy variable have significantly negative impact.

Patrick Guillaumont and Lisa Chauvet (2001) using OLS and 2SLS tried to find the relationship between aid and growth over two-pooled twelve-year period namely 1970-81 and 1982-93 for 66 countries. Net Official Development Assistance (ODA) to GDP was taken as a measure of ODA flow. Results

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supported that growth was positively influenced by a good environment, good macroeconomic policy and high value of aid.

Yujiro Hayami (2001) has also recognised the importance of capital imports for developing economies, which provides a possible escape from a vicious circle of slow economic growth and low saving. By taking the example of Kenya and Korea, he has supported the importance of foreign capital in the development process.

Mohsin H. Ahmad and Qazi M. Ahmed (2002) have conducted Cointegration techniques and Vector Error Correction Model (VECM) on the Pakistan economy for the period 1972-2000 to find the relationship between foreign capital inflows (current account deficit, foreign loans, FDI, foreign aid), per capita gross national product and domestic savings. Equation found long-run estimates as

$$SR = -2.33 + 0.003\ PY - 6.88\ FC$$

\(R^2 = 0.53\%\) \(D.W. = 1.38\)

Where,

- \(SR\) = Domestic saving rate
- \(PY\) = Per capita Gross National Product
- \(FC\) = Foreign capital inflow as percentage of GDP

The study found a inverse relationship between saving rate and foreign capital. Hence, external flows serve to impede public savings as well as private savings, thereby encouraging and increasing consumption.

Ghatak Subrata (2003) has also highlighted the importance of foreign resources as a catalyst in promoting economic development in Least Developed Countries (LDCs). He asserts that foreign resources played an important role in the economic development of many economically advanced countries of today namely Canada, Australia, Norway, Japan and USA. He further adds that the

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LDCs of today are at the same stage of economic development as the Developed countries in the 18th and 19th centuries. Hence foreign resources could play vital role in promoting the economic development in the LDCs.

Ghulam Mohey-Ud-Din (2005) using quadratic regression model, found the relationship between Gross Domestic Product and Official Development Assistance. Following equation was framed:

\[
\text{GDP} = -4371.2492 + 64.4** \text{ODA} - 0.014* \text{ODA}^2
\]

\[ (3.48) \quad (-1.69) \]

\[ R^2 = 58\% \]

** = Significant at 1% LoS  
* = Significant at 10% LoS

Where,

GDP = Gross domestic product

ODA = Official development Assistance.

The study shows a statistically significant positive relation between ODA and GDP (as the coefficient of ODA is positive). On the other hand, both GDP and ODA increases but at the decreasing rate (the coefficient of ODA\(^2\) is negative). In addition, the study found that the debt burden has been increasing over the period 1970-2002 for Pakistan's economy, thus showing both positive and negative effects of foreign aid in economic development.

Fielding, McGillivray and Torres (2006), tried to find impacts of aid on a range of Human Development Index measures like health, education and fertility of forty-eight countries. Using cross section data, and Indexation methodology, paper found a positive effect of aid on development outcomes.

According to Doucouliagos and Paldam (2007) over the years, foreign aid-growth mechanism has evolved in the following manner.

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In the 1st stage, foreign aid influenced the economic development through filling the Savings-Investment gap, which further would lead to economic growth. This wave started in around 70s, when economists used Harrod Domar model to explain the economic growth process. From the analysis of this stage, results thus found were unclear with respect to the relationship of foreign aid and development.

In the 2nd stage, which started in the mid 80s, it considers the direct relation between foreign aid and economic growth without any intermediary. The results of regression coefficients were positive but insignificant.

Since 1995, the 3rd stage has emerged, in which foreign aid influences economic growth, by imposing conditionalties along with the assistance, on the recipient countries. Such conditionalties are supposed to trigger economic growth by curing macro-economic variables like, investment, current account deficit, budget deficit, and government revenue and expenditure and output level of an economy. The results of the study for this time period imply that, the aid is beneficial for the countries with good policies, while aid harms the countries with bad policies. Figure 2.1 explains all the three waves of aid effectiveness literature since 1970s onwards.

**Fig. 2.1: Aid Effectiveness Literature: 3 Waves**

Source: Adapted from Doucouliagos, H. and Martin Paldam (2007), CWPE0773, Pg. 09.
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Aid Effectiveness Literature (2007) consists of empirical studies of the effects of development aid on real economic growth. The study considered 156 LDCs and regression was run on the data collected for 1960-2000. The result states that aid was more effective in Asia and Latin America than in Sub-Saharan Africa. The average effect found was positive but insignificant.

Khan and Ahmed (2007) using the Auto Regressive Distributed Lag (ARDL) cointegration model over the period 1972-2006 on the Pakistan economy. The long-run estimates are as follow.

\[
Y_t = 0.08^{**}FDIY_t + 1.09^{*}INVY_t - 0.005AIDY_t + 1.11^*L_t + 0.24^*X_t - 0.05^*D_t
\]

\[
(2.07) \quad (2.77) \quad (1.64) \quad (32.26) \quad (8.10) \quad (4.14)
\]

Error-Correction Representation

\[
\Delta Y_t = 0.03^{**}\Delta FDIY_t - 0.29^{*}\Delta INVY_t - 0.002\Delta AIDY_t - 0.34^{*}\Delta L_t - 0.06^{*}\Delta X_t - 0.02^{*}\Delta D_t - 0.43^{*}ECt
\]

\[
(2.33)^{**} \quad (1.17) \quad (1.71) \quad (2.52)^{**} \quad (2.10)^{**} \quad (4.13)^{*} \quad (6.59)^{*}
\]

Where,

- Y = Real gross domestic product
- FDIY = Net foreign direct investment as share of GDP.
- INYY = Domestic investment as proportion of GDP.
- AIDY = Aid as a share of GDP
- L = Labour force
- X = Real value of exports
- D = Dummy for political instability

The paper found that in the long-run, foreign aid does not influence economic growth, while there is significant positive impact of FDI, labour force, real value of exports and political instability on the economic growth of Pakistan economy. Further, in the short-run the policy variables of FDI, real value of exports exert positive impact on the economic growth, while labour force exerts negative impact on the economic growth. In addition, the negative value of Error

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Correction (EC) shows that the model converges back to the equilibrium in case disequilibrium arises.

Sugema and Chowdhury (2007) have attempted to find the impact of aid on the fiscal behaviour of the Indonesian government. The data for period 1966-99 was regressed using Vector Auto Regression Model (VAR-M). The study found a negative correlation between programme aid and development expenditure of government. Further, no strong correlation was found between foreign aid flows and growth.

In his paper, Girijasankar Mallik (2008) using cointegration analysis for six poorest African countries namely the Central African Republic, Malawi, Mali, Niger, Sierra Leone and Togo has tried to find the relationship between foreign aid and economic growth for the time period 1977-2004. The long-run equation using Johansen’s cointegration is as follow

Central African Republic: 1977-2004
\[
\ln RGDPC = -0.172\ln AIDY + 0.188\ln IY + 0.115*\ln OPEN - 0.014*t \\
(29.75) \quad (14.75) \quad (5.21) \quad (21.62)
\]

Malawi: 1965-2005
\[
\ln RGDPC = -0.851*\ln AIDY - 0.282\ln IY + 0.369\ln OPEN - 0.021**t \\
(6.27) \quad (1.56) \quad (0.84) \quad (2.25)
\]

Mali: 1965-2005
\[
\ln RGDPC = -0.442*\ln AIDY - 1.15*\ln IY + 1.67*\ln OPEN - 0.062*t \\
(4.09) \quad (4.70) \quad (5.20) \quad (5.04)
\]

Niger: 1965-2005
\[
\ln RGDPC = -0.211** \ln AIDY + 0.066\ln IY - 0.068*** \ln OPEN - 0.013*t \\
(11.52) \quad (2.35) \quad (1.80) \quad (14.77)
\]

Sierra Leone: 1970-2005
\[
\ln RGDPC = -0.418 \ln AIDY + 0.969 \ln IY - 0.491* \ln OPEN + 0.007 t \\
(4.27) \quad (13.61) \quad (4.99) \quad (1.09)
\]

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Togo: 1980-2004

\[
\ln\text{RGDPC} = 0.443 \times \ln\text{AIDY} - 1.993 \times \ln\text{IY} + 2.454 \times \ln\text{OPEN} + 0.082 \times t
\]

\[
(4.12) \quad (13.94) \quad (10.14) \quad (7.11)
\]

Where,

\(\ln\text{RGDPC}\) = Natural log of real gross domestic product per capita time \(t\).

\(\ln\text{AIDY}\) = Nominal Aid (ODA) as a percentage of nominal gross domestic product at time \(t\).

\(\ln\text{IY}\) = Natural log of investment as a percentage of gross domestic product at time \(t\).

\(\ln\text{OPEN}\) = Natural log of openness (exports plus imports as a percentage of gross domestic product at time \(t\)).

The study found significantly negative long-run effect of aid on economic growth of all the economies except the Togo where, aid effect was significantly positive. Openness and investment as a percentage of GDP had mixed effects on \(\ln\text{RGDPPC}\). \(\ln\text{IY}\) had positive and significant effects on \(\ln\text{RGDPPC}\) for Central African Republic, Niger and Sierra Leone, but negative and significant effects for Mali and Togo. The \(\ln\text{OPEN}\) had positive and significant effects on \(\ln\text{RGDPPC}\) for Central African Republic, Mali and Togo; but negative and significant effects for Sierra Leone only. Further, in the short-run also, no significant effects of aid on economic growth has been found.

Raghuram G. Rajan and Arvind Subramanian (2008) 24 using regression methodology on the data collected for the period 1960-2000, of all developing countries of sub-Saharan Africa and East Asia, tried to find the evidence of any kind of relationship between aid and growth. The study took the average annual growth rate of per-capita GDP as the dependent variable and average ratio of annual external aid to GDP as the main independent variable. The paper found insignificant impact of aid inflows on the economic growth.

From the foregoing, it is clear that no definite conclusion regarding the importance of foreign capital on the various indicators of economic development emerges.

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2.2 Role of International Financial Institutions (IFIs) in the Economic Development

Over the years, a number of studies have been conducted to explore the effectiveness of IFIs in achieving their objectives. Brief review of important studies till date is given below.

Balassa Bela (1988)\textsuperscript{25} paper presents a quantitative analysis of Adjustment programmes in developing countries that received adjustment loans from the World Bank. A total of hundred and four Countries’ data was taken for the period 1981-1987. For investigating, the paper took a large number of indicators, grouped under nine headings: economic growth (GDP, per-capita GDP, industrial production, agricultural production, consumption, per-capita consumption, investment, and aggregate expenditure), export performance (export growth), import substitution (import-GDP ratio), savings and investment (domestic savings/GDP, private saving/GDP, public saving/GDP, investment/GDP, and foreign saving/GDP), balance of payments (current account balance/GDP, basic balance/GDP, and overall balance/GDP), external debt (external debt/exports, debt service/exports), inflation (wholesale prices, consumer prices), monetary policy (money supply growth, real discount rate), fiscal policy (government revenue/GDP, government expenditure/GDP, budget surplus/GDP). For appraisal of lending programmes, the ‘Before and After’ approach was chosen. Conclusions support the fact that the relative position of loan recipients improved with respect to per capita income. Furthermore, inflation (Consumer Price Index) had decelerated in a majority of countries receiving lending. In terms of all economic growth indicators, all the programmes came out to be successful.

Using ‘With-Without Approach’ Faini, Melo, Senhadji-Semlali and Stanton (1990)\textsuperscript{26} collected data for ninety-three developing countries, over the period 1982-86, out of which fifty received aid, and forty-three did not receive aid.


It was found that there was no real effect on output growth on the countries participating in IMF and World Bank Programmes.

Zafar Iqbal (1994) using both ‘With and Without’ approach for 1970-79 (without adjustment) and 1980-91 (with adjustment) and Multiple Step Regression analysis (1979-91) tried to analyse the macroeconomic effects of adjustment lending by the World Bank and the IMF on the economy of Pakistan. The paper, while using the ‘With-Without approach’ found that growth in real GDP and capital formation had positive relation with adjustment lending. On the other hand, the results of Multiple Step Regression analysis found a significantly negative coefficient of growth measured in real GDP.

Anne O. Krueger (1998) had put forward the view that the IFIs original rationale no longer fits, and their activities have altered, as the World economy has grown. In this paper, an attempt has been made to provide a selective review of the World Bank and the IMF’s current roles and the choices that confront them for the future. Regarding the future role of the Bank, the paper suggests that the World Bank should refocus on development with emphasis on the poorest countries. Furthermore, Bank lending should be confined to basic infrastructure (including education, health, and development of agriculture, research & development and extension capabilities and so on) which can, simultaneously, improve people’s earning streams even under a poor policy and make an improved resource base available when policy reforms do come through. For IMF, the focus should be more on avoidance of large exchange rate misalignments. Further, some changes in individual programmes are suggested.

Yunjong Wang (1999) had tried to answer the following questions in the context of the Korean economy. How relevant is the diagnosis of the Asian crisis by the IFIs? Do we need to restructure as set forth by IMF conditionalities? Is there a catalytic effect of lending by IFIs? Do we need an international lender of last resort? It was observed that, following the restructuring programme, the

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Korean economy has rebuilt market confidence and regained international rating. IMF promised the funding of US$ 24 billion, World Bank promised US$ 10 billion, and ADB promised US$ 4 billion. As a result, the foreign reserves of the Korean economy increased from US$ 3.9 billion on 31st Dec 1997 to US$ 64 billion on 31st July 1999.

Zafar Iqbal, James Jeffery and Pyatt Graham (2000) conducted a study on the impact of World Bank and IMF programmes on the macroeconomic indicators of Pakistan's economy. Simulation method was used on the data collected for the period 1970-93, and it was found that, these programmes had improved various macroeconomic indicators like output level, exports and imports of goods and services, public sector investment and private savings.

Mohammed Ali Aziz (2001) has supported the Meltzer Commission's suggestion to restructure the role of the IMF, as it could not avert the Asian crisis and the Mexico crisis. Further, it suggests certain reforms like, Extended Fund Facility (EFF) should be eliminated and IMF should provide short terms loans only. In addition, the commission recommended improving Contingent Credit Line (CCL). Regarding IMF Surveillance system, the paper states that, there is a need to evaluate as to how it works to influence exchange rates. Lastly, it suggests that there is a need to eliminate Poverty Reduction and Growth Facility (PRGF).

Willem Buiter and H.P. Lankes (2001) discussed two fundamental transformations that have taken place at the global financial level, which have changed, the role of IFIs. Firstly, because of globalization, foreign trade and private capital is now playing a greater role in the economic development than before. Secondly, the private sector and private international finance have become

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main agents of economic development. The paper concludes that in the 21st century, IFIs will have to frame a strategy to support private sector development along with the existing strategy to work with the governments of member countries for their development.

Allan H. Meltzer (2003) has suggested that the future of the IMF and World Bank depends on how they change and how they achieve the goals of enhancing incentives for member countries for growth, giving incentives for attainable public goods and improvements in quality of life and reduction of poverty. It was further suggested that the IMF should act as a quasi-lender of the last resort to reduce the risk of global financial crises and should provide accounting information and financial data at lesser cost to member nations. The World Bank should provide technical assistance to member nations at subsidized price. It should provide monitored grants, in place of loans, with payments to vendors for performance. Further, the Bank should finance global/regional public goods by getting member countries to agree on environmental safeguards, disease eradication or reduction. Lastly, Bank should develop incentives to pursue members for introducing the structural reforms like the rule of law, democratic accountability, protection of private property, openness to trade and economic stability.

Parkinson M. and A. McKissack (2003), review the role of IMF since its inception and discuss some of the challenges for the IMF and the international community. The paper reveals the major achievements of the IMF and the architects of the Bretton Woods System (BWS) in a way that the fund remains relevant even today despite the momentous changes in the global economy.


Michael, Bordo and Ashoka Mody and Nienke Oomes (2004) examine the IMF’s role by empirically studying the access of emerging-market economies (29 countries) to international capital markets over the period 1980 to 2002. It was found that both macroeconomic aggregates and capital inflows improved following the adoption of the IMF’s programmes, although they may have initially deteriorated somewhat. The study concludes that IMF’s programmes were most successful in improving capital flows to countries with bad but not very bad fundamentals. Furthermore, in such countries, IMF’s programmes are associated with improvements in the fundamentals.

Dreher Axel (2004) analyzed the impact of IMF programmes on the economic growth of various countries. Paper took data for ninety-eight countries over the period 1970-2000. Pooled time-series and cross-section data was used for an average of 5 years. Nine dependent variables were considered, which are as follow:

Log (per-capita GDP), Secondary School enrollment, Log (life expectancy), Log (fertility rate), Investment, Government consumption, Index of globalization, Inflation rate, Growth rate of Terms of Trade were taken as dependent variables. For independent variables, Stand-By Arrangements (SBA) and Extended Fund Arrangements (EFA) have been taken as IMF programmes for the member countries. Regression by OLS and 3SLS has been used for estimation. It follows a ‘General to Specific approach’, eliminating the variables with the lowest ‘t-values’. The determinants significant at 10% LOS are retained. By using OLS and 3SLS it was found that economic growth on average was 7.48 percent lowered, when an IMF programme has been in effect over the whole five-year period. Therefore, it concludes that an IMF programmes does not contribute to the economic growth.

Liebscher Klaus (2004) 38 Governor, Oesterreichische National Bank, Austria, in his speech, has supported Bretton Woods Institutions on the assumption that if the IMF, World Bank had not existed, it would not have helped to resolve the various crisis, occurred at the international level from time to time. He considered the BWS very innovative for various reasons such as it was for the first time that the international monetary system was created, and it provided a mechanism for inter-governmental consultation. Moreover, BWS has successfully come through the crisis of gold exchange standard and the string of crises since the early 80s. He further suggests that countries should place their policies properly and self-surveillance system in the most effective way for the economies to prevent a crisis.

Akyuz Yilamaz (2005) 39 discussed that original rationale of the IMF, namely to safeguard international monetary and financial stability is now even stronger than in the immediate post-war era, given the size and speed of international capital flows. Further, the paper suggests the following reforms:

The IMF needs a greater focussed strategy. It should stay out of the development finance policy and poverty alleviation programmes. In addition, the Fund should focus on macroeconomic and exchange rate policies and stay away from trade policies to promote a stable system of exchange rate. Regarding Crisis management and resolution, the paper states that it is an increasingly important area of responsibility of the Fund. For meeting payment imbalances resulting from external shocks, the paper suggests that there should be greater automaticity and less emphasis on policy adjustment. Further, it suggests that the Fund’s resources need to be increased, to keep up with growth in international trade. To prevent unsustainable capital flows to emerging markets, the paper recommends that the fund should improve its ability to identify risk and fragilities and develop policy tools. In addition, paper suggests for setting up of a separate surveillance system,

assigned to an authority that would be independent of the board, which could improve IMF’s quality, legitimacy and impact.

James L. Butkiewicz and Halit Yanikkaya (2005) considered data for 100 developing countries. Paper used 3SLS and Seemingly Unrelated Regression (SUR) technique for 1970-1997, to see the effect of IMF and World Bank lending on long-run economic growth. The paper concludes that, both the World Bank lending and the IMF lending had a negative and significant effect on real growth. For IMF lending a 1% increase in lending results in reducing growth by 0.1% while 1% increase in World Bank lending results in 0.01% reduction in growth.

Anwar Mumtaz (2006) analysed the determinants of multilateral aid from International Financial Institutions (IFIs) to Pakistan, focussing on the world’s three major IFIs namely the World Bank, the IMF and the ADB. Pooled Tobit estimation analyses confirm the following hypotheses.

Hypothesis 1: IFIs’ lending to Pakistan is positively related to the country’s economic needs.
Hypothesis 2: IFIs’ lending to Pakistan is positively related to an improved performance of the country’s economy.
Hypothesis 3: IFIs’ lending to Pakistan is positively related to good political Governance.
Hypothesis 4: The higher the number and the stronger the bureaucratic power of Pakistani nationals at IFIs, the higher the probability of Pakistan receiving more and larger loans.
Hypothesis 5: The higher Pakistan’s debt to IFIs, higher the probability for new lending and a higher volume of lending.
Hypothesis 6: Closer economic links between Pakistan and the US and/or Japan, or higher political or strategic relevance of Pakistan for these countries will increase Pakistan’s chances of obtaining more and higher loans from IFIs.

Each institution (IBRD, IDA, ADB, and IMF) was considered in the study, starting from the year in which it’s lending to developing countries was established. In order to, empirically test these hypotheses, nine dependent variables are considered. These are: Gross Domestic Product Per Capita (GDPPC), Current Account Deficit (as percent of GDP), Budget Deficit (as percent of GDP), Pakistan’s debt to all multilateral institutions as a percentage of total debt (MultiDt), Annual GDP growth, Political instability (Pol Instabst), Pakistani executive director voting power (Pk_ed_vp) as a percentage of total voting power of all the executive directors on the board of IFIs, the numbers of Pakistani top officials like bureaucrats, Vice Presidents and Directors (Pk_off) were taken as the percentage of total officers of each institution, Bilateral trade (exports + imports) between US, Japan and Pakistan (as a ratio of Pakistan’s GDP). Using Tobit estimation, based on the cases of the World Bank, IMF and ADB lending to Pakistan, the paper provides evidence for political-economic determinants of multilateral lending. Further, it has revealed that the bureaucratic and shareholders’ economic interest affects the lending decisions of ADB, IDA, IBRD and IMF in the Pakistan economy.

Rehman Sobhan (2006) has expressed his views for South Asia as a new emerging centre. The paper emphasises that South Asia must integrate in order to be part of the new dynamism by integrating its capital markets, its labour markets, its transport and other infrastructure. It suggests setting up of South Asian Development Bank (SADB) in the South Asian region.

Devesh Kapur and R. Webb (2007) analysed the insurance role of IMF and argues that the developing countries are turning to alternative insurance mechanisms in the form of keeping higher level of reserves, regional co-insurance facilities, remittances etc as a counter-cyclical source of foreign exchange. The paper states that the IMF has lost its role as the World’s Central Banker as countries like Argentina, Pakistan, Serbia, and Ukraine are returning their debt amount. Further, the member countries prefer other alternatives like financial

markets, regional banks to raise foreign capital. The paper concludes that, IMF is showing decline in its relevance in recent years and for the member countries, many supplementary mechanisms like financial markets, especially bond markets, regional cooperation and integration are emerging as a more suitable option for raising required foreign capital.

Titik Anas and Deni Friawan (2008) analysed the rescue programme provided by IMF in three Asian economies i.e. Thailand, Korea and Indonesia at the time of Asian crisis, in fiscal 1997. The findings of the paper emphasise that the rescue programme was not smooth and in many cases, it worsened the conditions. In addition, paper provides a detail of regional integration, existing within Asia like South-East Asia Central Banks (SEACEN) 1982, ASEAN Surveillance Process (ASP) 1998, Economic Review and Policy Dialogue (ERPD) 2000, Asian Bond Market (ABM) 2003, Development Finance and Macroeconomics Surveillance Unit (DFMSU) framed to monitor and review the macroeconomic and financial development of the member countries. Paper suggests the need for reforms in IMF, as it did not succeed in helping Asia to come out of Asian Crisis. Further, it suggests for developing a self-protecting mechanism for dealing with the financial crisis in Asia and setting up of a separate Asian Monetary Fund, which can specifically look at the financial needs of the Asian region.

Summing up the review of literature, it has been found that, there emerges no definite conclusion regarding the role of foreign capital/IFIs in the economic development of member countries. Moreover, while finding the relationship between foreign capital/IFIs and economic development, the studies have considered either GDP or savings as an indicator of economic development. To our knowledge, none of the studies have covered economic, social, infrastructural, and environmental indicators of development together. Present study attempts to fill this gap by undertaking the role of International Financial Institutions in the economic development of South Asain economies with special reference to India.

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Table 2.1 Summary of the Empirical Evaluations of the Role of Foreign Resources in Economic Development

<table>
<thead>
<tr>
<th>Study</th>
<th>Period</th>
<th>No. of countries</th>
<th>Methodology</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>N. Islam (1972)</td>
<td>1950-70</td>
<td>Pakistan</td>
<td>Regression analysis</td>
<td>Foreign assistance has helped to achieve a higher rate of saving and investment.</td>
</tr>
<tr>
<td>K.L. Gupta (1975)</td>
<td>1960’s</td>
<td>40 developing countries</td>
<td>Regression (2SLS)</td>
<td>Foreign resources have a positive role in the economic growth.</td>
</tr>
<tr>
<td>S. Park (1977)</td>
<td>1968-70</td>
<td>41 countries</td>
<td>Co-relation &amp; Regression</td>
<td>Foreign capital has positive impact on economic development in the labour surplus economies.</td>
</tr>
<tr>
<td>S. Ahmad (1990)</td>
<td>1960-80</td>
<td>Bangladesh</td>
<td>Regression (Simultaneous equation method)</td>
<td>Foreign capital has positive effect on economic growth and negative effect on domestic savings.</td>
</tr>
<tr>
<td></td>
<td>1982-193</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M. Gulam (2005)</td>
<td>1970-2005</td>
<td>Pakistan</td>
<td>Regression (Quadratic equation)</td>
<td>Significantly positive relation b/w ODA and GDP.</td>
</tr>
<tr>
<td>D. Fielding, M. McGillivray and S. Torres (2006)</td>
<td>Surveys for different years</td>
<td>48</td>
<td>Indexation</td>
<td>Aid contributes to human development.</td>
</tr>
<tr>
<td>G. Mallik (2008)</td>
<td>1977-2004</td>
<td>6 Poorest African countries</td>
<td>Cointegration analysis</td>
<td>Negatively significant long run effect on growth was found.</td>
</tr>
</tbody>
</table>
Conclusion

World Bank Adjustment programs have positive impact on all the undertaken indicators of economic growth.

No effects of World Bank & IMF programmes on Output growth of the countries, participating in these programmes.

Positive effect of World Bank & IMF lendings on GDP (With-Without approach).

Negative & significant effect of WB & IMF lendings on GDP (Multiple Step Regression).

World Bank & IMF programs have resulted in improvement in the macroeconomic indicators (output level, exports & imports of goods & services, public sector resources & investment, private savings & investment).

IMF programs have positive impact on macroeconomic aggregates.

IMF programs do not contribute for the economic growth.

Both MF and World Bank lending has a significant negative impact on real growth.

There exist political economic determinants of multilateral lendings.

Source: Constructed on the basis of Review of Literature, Chapter-2.