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RESEARCH PAPER

Impact of Foreign Aid on Pakistan: A Study on Economic Perspective

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ABSTRACT

This paper investigates foreign aid in Pakistan. Poorer nations rely on external assistance to bridge the savings-investment and import-export deficits. Foreign resources take several forms, including FDI (Foreign Direct Investment), foreign credit and loans, technical assistance, project and non-project aid. However, UDCs, including Pakistan, do not have investment-friendly policies. They rely on foreign aid and debt instead of FDI and portfolio investments. The function of these external resources is always uncertain. The present study examines the structure and patterns of foreign aid in Pakistan, as well as its impact on economic development in Pakistan. The method is based on an analytical and descriptive Import-Export gap model derived from a survey of theoretical and empirical literature, which leads to reflective analysis. It is concluded that the function of external resources in Pakistan's economic development is always confused and ineffective.

Keywords: Aid and Growth, Economic Development in Pakistan, Foreign Aid, Foreign Debt Burden, Trends and Structure of Aid

Introduction

A country is poor because poverty is also the cause and the result of poverty. As a result, underdeveloped countries (UDCs) such as Pakistan are locked in a Vicious Circle of Poverty. Low incomes lead to low savings and investment levels. However, low income leads to a lesser taxable capability, government profits remain low (Burki, 2009). In these situations, UDCs have to manage a balance-of- deficit payments in addition to an imbalance between savings and investments. The Two-Gap Model states that developing countries need on foreign direct investment (FCI) to close two gaps: import-export and investment to savings discrepancy(Khan & Ahmed, 2007). Foreign Community Interventions (FCIs) take many forms, including grants, loans, FDI (foreign direct investment), export credit, project and non-project aid, technical support, and disaster relief. Despite the fact that every single FCIs are required for UDC expansion, and the amount and kind of the concept of foreign economic aid, or FCI, differs per country(Kamran, Syed, Amin, & Ali, 2014). The two main factors that determine the magnitude and structure of the FCI are the size of the nation and its economic conditions. For example, the developing nations of East Asia are the main recipients of foreign direct investment (FDI), but the LDCs (Least Developed Countries) of Africa have been dependent on international aid (Zaman, Khan, Ahmad, & Shabir, 2012). Regarding Pakistan, foreign aid constitutes a substantial portion of foreign capital inflow and plays a crucial role in the nation's economic growth. Patterns and trends have demonstrated that FDI, portfolio investment, and additionally, borrowing from private sources has drastically expanded (Omer & Jafri, 2008). However, Pakistan is still unable to draw in these FCIs. Pakistan is devoid of human, financial, and material capital in addition to political and macroeconomic stability. Thus, it is dependent upon foreign debt or foreign assistance (Mushtaq, , Muzaffar, & Ali, (2017); Zaman, Khilji, Awan, Ali, & Naseem, 2014). The following reasons support the necessity for overseas aid: First, the primary justification for foreign aid is the "Two-Gap Model," which states that shortfalls in savings and BOP are important justifications prior to, Second, by producing more domestic savings as a result of the higher growth rates (which are thought to be induced by the appropriate utilization of foreign aid), the external help is also assumed to facilitate and expedite the process of development. It is anticipated that eventually, the necessity because soon local resources are able to earn enough money, the concessional help will end self-sustaining growth. Thirdly, to guarantee that the helped funds are used as effectively as possible to spur economic growth, technical support in the form of high-level worker transfer must be added to the financial assistance. As a result, the Financial-Gap-Filling process and this Labor-Gap-Filling procedure become comparable. Lastly, the receiving nation's absorbtive capacity need to be the deciding factor for the aid quantity.1.Usually, the donor nations determine which LDCs will get help, as well as how much, what kind of aid, why it is needed, and under what circumstances. This decision is based on the donor nations' evaluation of LDC's ability to absorb(Ali, Barrientos, Saboor, Khan, & Nelson, 2017).

This paper's primary goal is to analyze how well foreign aid has contributed to Pakistan's economic progress. This study is structured as follows: it begins with a thorough review of the relevant literature, which addresses the types and patterns of foreign aid given to Pakistan. The last section provides the conclusion and policy suggestions, whereas the analysis focuses on the effects of foreign aid in Pakistan.

Literature Review

In economic literature, opinions on the contribution of foreign economic aid to economic growth and development are still divided. While some research emphasized its negative consequences as well, others provided actual evidence of its favorable impact on economic development.

Based on actual data from LDCs, Chenery and Strout, 1966 came to the conclusion that foreign capital had a favorable impact on economic growth. Subsequently, various more research made the same claim—that foreign economic aid promotes economic growth(Zaman & Ahmad, 2008). Other economists, such as Leff, 1969 and Griffin, 1970, have examined its detrimental effects on growth, nevertheless. They contended that by dispensing with local savings, foreign aid might have a negative impact on economic growth (Kakwani, Son, Qureshi, & Arif, 2003). The effectiveness of foreign aid illustrates both its benefits and drawbacks for economic development. Hansen and Tarp 2000, did a regression study examining the relationship between aid and growth(Essama-Nssah, 2005). Aid has been demonstrated to accelerate growth, and this effect is independent of "good" policies. Nonetheless, help has diminishing returns, and the collection of control variables and the estimator choice have a significant impact on the aid's projected efficacy(Harmáček, Syrovátka, Schlossarek, & Pavlík, 2016).When considering investment and human resources, aid has no positive effect. Nonetheless, aid continues to exert an investment-based effect on growth. Result emphasizes the importance of doing further theoretical research before employing cross-country regressions for policymaking purposes (Zaman, 2015). In order to better understand how foreign assistance interacts with policies, Burnside and Dollar have created an index of three policies (fiscal surplus, inflation, and trade openness), as well as an instrument for both types of interactions. They discover that when developing nations have sound trade, monetary, and fiscal policies, help increases growth in such nations. Conversely, help does not contribute to growth when bad policies are in place (Ichoku, Agu, & Ataguba, 2012). Each nation has a different role for international aid. Since gaining independence, Pakistan has relied on foreign help to fund its development initiatives. Furthermore, Pakistan continues to get a higher share of foreign capital inflows from assistance. Numerous economists in Pakistan have attempted to determine how foreign aid contributes to the country's economic progress (Haq & Zia, 2009). Shabbir & Mahmood, 1992 and Khan & Rahim, 1993 came to the conclusion that aid has quickened the GDP's growth rate. Aslam,1987 investigated how the private FCI filled the domestic saving-investment gap whereas the public FCI had no discernible impact on domestic investment(Khandker & Koolwal, 2006). Further study was done to investigate the impact of help on savings in Pakistan. According to Khan, Hasan, and Malik's, 1992 estimates, the FCI reduced Pakistan's national savings between 1959-1960 and 1987-1988. During the same time period, Shabbir and Mahmood, 1992 observed that foreign currency had a negative impact on Pakistani savings(Cheema & Sial, 2012). According to Khan 1993, foreign aid has had a substantial influence on how swiftly development has progressed, notably in terms of investments and imports, which are strongly dependent on the amount of assistance received. On the other hand, this reliance on foreign aid has resulted in a mounting debt burden that country may face severe financial issues as a result of macroeconomic mismanagement, misallocation of aid, and ineffective policies (Ali et al., 2017).

In summary, this study's analysis of the literature on the efficiency of foreign aid in Pakistan leads it to the conclusion that, while it has replaced local savings, it has also promoted economic growth in the country. And it led to serious issues with debt service in Pakistan. As a result, in developing nations with sound policies, help boosts growth. Nonetheless, aid has no beneficial impact on growth when bad policies are in place.

Material and Method

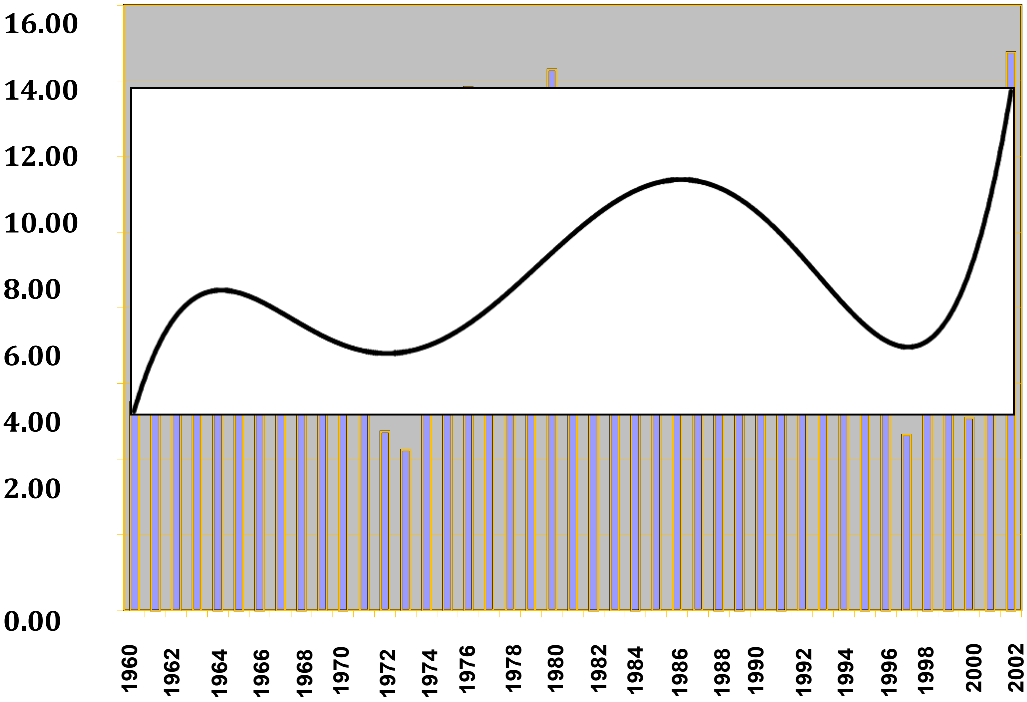
This study's primary goal is to verify any empirical connections between Pakistan's economic performance and foreign aid. The series of data used in this investigation are from the literature. Multivariate analysis is used to estimate the necessary functions. The available data is considered necessary for the estimating process. Thus, variables such as the variance and mean likewise stay constant across time. The World Bank's world development indicators served as the source of the data set for each of these variables. Each of these factors has been presented in a different way to assess how foreign aid has affected Pakistan's economic metrics. Gross domestic product is used as a stand-in for Pakistan's economic success. Total official help provided to Pakistan is referred to as foreign aid. Trade openness is defined as Pakistan's GDP divided by the total of its imports and exports. Research indicates that trade openness has a beneficial effect on economic growth, with both government spending and investment contributing to this development.

Results and Discussion

Pakistan's Foreign Aid Patterns

Foreign aid was the subject of practically the first controversy in Pakistan, taking place inside the cabinet of the country's first Prime Minister, Liaquat Ali. The Pakistani government declined the United States' offer of aid three times in 1950. The same year, there was a disagreement among the cabinet about asking for World Bank financing. Hasan 1999 argued that Chaudhry Mohammad Ali's influence ultimately led to the decision in favor of accepting loans and help. Nonetheless, the Colombo Plan's pledge of Common Wealth funding was approved. Pakistan thus agreed to take Common Wealth Aid under the Colombo Plan for the first time in the 1950s. Then, in the 1960s, the so-called "Growth Man-ship" emerged, arguing that growth rates should be high—at least twice as high as the rate of population expansion. The population growth rate in the majority of UDCs, including Pakistan, was about 3%. Thus, it was believed that a growth rate of 6% would mark the achievement of rapid economic progress. The Harrod-Domar Growth Model states that savings (investments) must equal 18–20% in order to reach the objective growth rate of 6%.

Figure 1: Aid to Pakistan Per Capita (1960-2002)



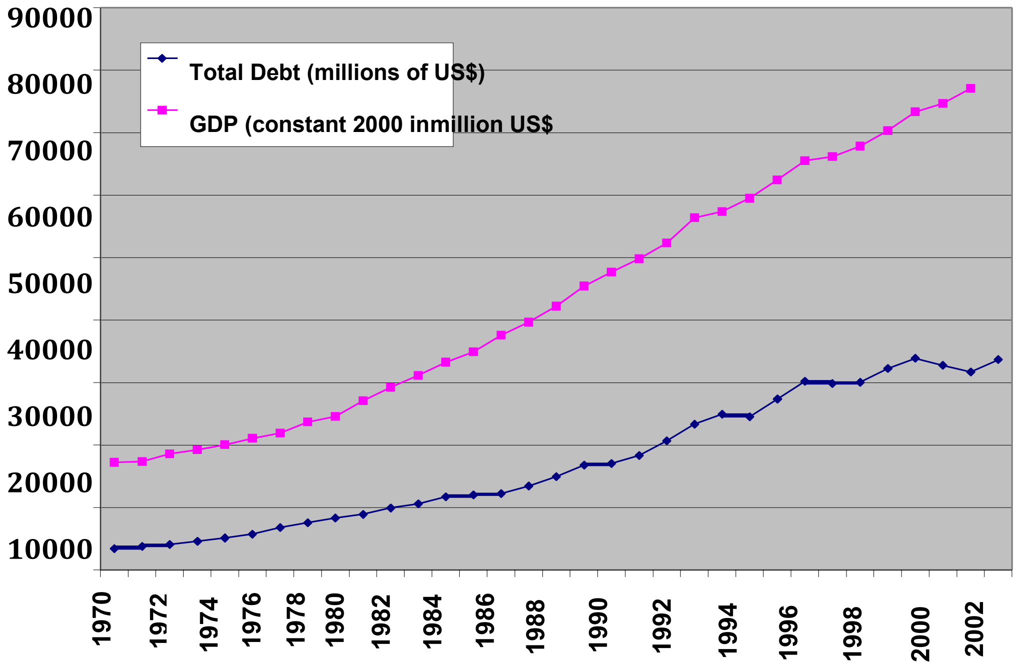
Source: World Bank Online Database.

However, because all UDCs had a huge saving-investment gap, they were compelled to rely on foreign aid and loans to bridge it. As in the 1960s, Pakistan received significant sums of foreign money for its second five-year plan. Aid increased between 1978 and 1988, decreased between 1968 and 1973, and increased again between 1960 and 1966. Aid fell again between 1990 and 1998, but grew rapidly after 2000 in terms of both ODA and per capita aid. However, between 1960 and 2002, Pakistan received more foreign aid overall. Project aid and non-project assistance are the two main types of foreign aid offered to Pakistan; non-project help is further divided into food, non-food, BOP, and relief aid. A breakdown of Pakistan's total foreign aid by kind. It is clear that the project aid portion remained higher between 1952 and 1953. The United States remained Pakistan's largest contributor, contributing $656 million in 2002-03. After studying the top ten donors, it is clear that Pakistan is highly dependent on the United States, IDA, IMF, and Japan, which were the top four contributors to Pakistan in 2002-2003. It is evident that the majority of bilateral ODA is directed toward "debt-related action," while education, infrastructure and services, health and population, and other social sectors continue to get relatively little funding. As a result, the following research shows that Pakistan's economy relies largely on foreign aid from the United States, Japan, and the International Monetary Fund. The majority of foreign economic aid is used to repay loans and service debt.

Impact of Foreign Aid on Pakistan

Several studies were undertaken in an attempt to better understand the effects of foreign capital inflows (FCIs) on Pakistan's economic development. A variety of methodologies and factors were used to examine the impact of foreign aid on economic development. While some studies examined how help influenced domestic capital formation, investments, and savings, others focused on how aid affected GDP growth, debt burdens, and other aspects. Other studies investigated how aid affects other social and economic spheres, such as health and education, as well as industries such as energy and agriculture. It is very difficult to evaluate the influence of foreign aid on all of the aforementioned areas and elements in a single research. As a result, this study focused on only variables: GDP growth and debt load, and sought to evaluate the impacts of foreign aid on GDP and the total debt burden. First, the shift in the composition of foreign aid from grants to hard loans has resulted in a relatively substantial percentage of gross aid going toward debt payment, limiting the amount of net aid available to finance imports and investments. This has resulted in an overreliance on foreign help. Second, the country has had to bear political and economic consequences as a result of the terms and circumstances linked with such credits. The growing debt load of Pakistan may be shown as an increase in external debt from 1970 to 2002. It is obvious that the overall debt load likewise grows as the flow of foreign money grew during the same period.

Figure 2: Pakistan's External Debt (1970-2002) in US Dollar Millions



Source: World Bank Online Database [http://devdata.worldbank.org/wbquery]

Table 1
Foreign Aid Trends in Pakistan

Years	Aid (% of central government expenditures)	Aid (% of GNI)	Aid (% of gross capital formation)	Aid (% of imports of goods and services)	Aid per capita (US$)
1960	..	6.630544	58.86302	..	5.499771
1961	..	6.026101	36.66479	..	5.309186
1962	..	8.653854	48.84152	..	7.742896
1963	..	10.36798	50.87576	..	9.673129
1964	..	9.618161	48.03884	..	9.874679
1965	..	8.217436	39.15985	..	9.40908
1966	..	5.409806	34.88032	..	6.665194
1967	..	6.283821	38.55457	..	8.58583
1968	..	4.894044	27.48405	..	7.014392
1969	..	3.72502	25.76191	..	5.578901
1970	..	4.15307	26.59925	..	6.950022
1971	..	3.842998	24.96731	..	6.616287
1972	..	3.256564	23.10448	..	4.722751
1973	..	4.352538	34.58876	..	4.244139
1974	..	4.918707	37.91818	..	6.464308
1975	..	5.80789	36.08843	..	9.349175
1976	..	7.472723	44.08217	36.05414	13.83108

1977	..	3.724027	20.20004	18.30464	7.78537
1978	..	3.309863	19.9656	15.51175	8.147615
1979	..	3.336377	20.18548	13.13402	8.849579
1980	..	4.621305	27.02224	17.64009	14.3008
1981	..	2.708115	15.60128	11.79125	9.672253
1982	..	2.763463	15.46923	12.6166	10.4705
1983	..	2.28931	13.49384	10.12581	8.102468
1984	..	2.139483	12.8145	9.092813	7.903295
1985	..	2.285517	13.48767	9.885303	8.118409
1986	..	2.795182	15.3038	11.51779	9.414314
1987	..	2.312238	12.85213	9.671507	8.205538
1988	..	3.377564	19.55715	14.21463	13.20789
1989	..	3.473894	19.03757	14.14852	13.73872
1990	14.42912	2.705744	14.90538	9.917955	10.45843
1991	16.57111	2.947265	15.85465	11.18443	12.38004
1992	10.75443	2.063545	10.3031	7.303484	8.929486
1993	10.04679	1.938512	9.381165	7.377136	8.633924
1994	15.91664	3.086107	15.82893	11.70765	13.4472
1995	7.301299	1.3484	7.325476	5.050495	6.731525
1996	7.253874	1.400889	7.349579	4.960971	7.049366
1997	5.110678	0.9627382	5.329852	3.779949	4.641853
1998	9.213367	1.708757	9.560105	7.334169	8.002918
1999	6.500468	1.174072	7.47747	5.379303	5.43757
2000	5.733341	0.9843713	5.516449	4.852044	5.089586
2001	17.63112	2.809873	15.85268	13.6622	13.77326
2002	16.94498	3.090837	17.83099	14.17616	14.75607

Source: World Bank & GDN Online Database http://devdata.worldbank.org/wbquery

Conclusion

The current study shows that foreign aid has an impact on Pakistan's economic development in both good and bad ways. Positively, foreign aid has contributed to GDP growth by structurally altering the economy, establishing the foundation for the agricultural and industrial sectors, offering modern technology, policy advice, and technical support, helping to resolve budget and BOP deficits, and financing social sector development initiatives. According to several research' conclusions, an examination of GDP and ODA verifies the favorable impact of Official Development Assistance (ODA) on GDP. GDP grows at a slower pace as the influx of foreign capital increases. Thus, altogether, help has a favorable influence on economic development. On the negative side, assistance appears to have supplanted domestic savings and raised debt levels. The various debt indicators indicate that Pakistan's debt burden has increased over time, and if macroeconomic management, international trade, and domestic saving strategies are not established and executed appropriately, the government may have serious difficulties in paying down its debt. As a result, aid can only serve to increase economic growth if suitable monetary, fiscal, and trade policies are in place.

Recommendations

Effective trade, monetary, and fiscal policies are required to ensure the efficacy of foreign aid. When policies are poor, support has only a minor impact on growth. As a result, in order to avoid the misuse and exploitation of foreign financial resources, tight laws must be followed, as well as their execution and adequate management of projects involving assistance.

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