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Passage to Pakistan

Hyman P. Minsky

An American economist discovers that United States aid stifles indigenous enterprise and imposes a lasting burden on an economy that can ill afford it

When I was approached to join the Pakistan Institute for Development Economics for the summer of 1968, I viewed it as an adventure. I am neither an expert in the economics of development nor particularly knowledgeable about the special problems of international trade, industrial, agricultural and labor organization that might be relevant to a country such as Pakistan. My special interest is in the economics of advanced capitalist countries, what is usually called Keynesian economics. My most recent work has dealt with financial institutions and economic policy in the United States. I suppose I was to act as a gadfly, to get the staff to think about problems they weren't attacking. I don't feel I was successful.

Karachi, the headquarters of the Ford Foundation sup-

ported institute, was not a major seat of British power in India prior to independence. As a result it lacks many amenities of colonial life. At the time of independence, 1948, Karachi was a city of 350,000. Last summer the population was estimated around 3.5 million.

As the city has grown, developments of detached homes have been built. Many, including those in the area of the Ford Foundation staff flat, are built on a scale that would be considered lavish in the affluent West. By contrast, little in the way of modern workers' housing was visible. Uncounted numbers live in huts built out of straw and mud, or often in lean-tos placed up against garden walls of the lavish homes.

It was claimed that there weren't many street sleepers



Cloth on the international market brings profits to Pakistani intrepeneurs, but raw cotton in the same market would bring more profits to the whole country.

(as there are, notoriously, in Calcutta). I didn't do much wandering around Karachi at night, but when I did, I usually saw a good many people sleeping in doorways and vacant lots. In the morning and afternoon, nap-takers were always visible in the green centerstrips of the boulevards.

Pakistan is a most unnatural state. The two parts, East and West, are separated by 1,200 miles of India. The peoples of East and West are different in language, culture, way of life and appearance. The West Pakistani, tall and often handsome by European standards, identify with Persian culture; the East Pakistani, the people of Bengal, are shorter and darker. They look toward the subcontinent: one might say they are Indian rather than Persian.

To both East and West Pakistan, partition was an economic calamity. In the east, Calcutta, the principal city of Bengal, was cut off from its hitherland in East Pakistan. The jute mills and the jute plantations were separated. In the west, the Punjab, potentially one of the world's richest agricultural lands, was split. The headwaters of the rivers that water the Punjab are in India, and the land of the Punjab is in Pakistan. Prior to the twentieth century, the British had built a vast barrage system which takes water from the five rivers of the Punjab to irrigate the adjacent low-lying plain. The Punjab was the largest stretch of irrigated land in the world. It could be the base of a very

prosperous agriculture. But India has moved to divert these waters to its own uses. Partition made a very poor part of the world poorer.

Most of East Pakistan, moreover, is the alluvial plain of the Ganges and the Brahmaputra, two mighty tropical rivers carrying huge amounts of water, regularly flooding beyond their banks. The control of such rivers, like the Amazon and Orinoco of South America, is beyond present competence. In addition, if the rivers of East Pakistan were to be controlled, the dams and reservoirs would have to be in India and China.

The government and especially the military are dominated by the people of West Pakistan, mainly the people of the Punjab. This is a legacy of British discrimination—the Punjab was settled by Moslem and Sikh veterans of the British legions. Many in East Pakistan view independence as having substituted a Punjabi for a British colonial overlord: a change that was not an improvement. Economically, the exploitation of the East by the West takes the form of using the foreign exchange earnings of the East—mainly derived from jute production—to finance the economic development of the West.

Dramatic stories have been told by people such as Gustav Papanek of the Harvard Advisory Service about the success of the development programs in Pakistan. Like most dra-

mas, these stories are fictitious. The numbers used to detail the growth in Gross National Product are to a large extent the result of arbitrary valuations by government and foreign statisticians. For example, as a result of the procedure used to determine these numbers in a heavily populated poor country, an increase in the number of troops shows up as a growth in national income.

Negative Value

Furthermore, some of the substantial increases in manufacturing output that took place in the 1960s really decreased income. American and Pakistani economists at the institute showed that much of the industrial progress in Pakistan has resulted in negative value added, if international prices are used to measure the value of commodity inputs and outputs. Let me explain. West Pakistan grows cotton. Cotton has a good international market; the dollar price of a bale is known. The government encourages the development of manufacturing of cotton goods. It sets a tariff on cotton goods; in addition it gives a bonus in the form of a favorable exchange rate to the exporter of cotton goods. But as a result of the inefficiency of manufacturing, the raw cotton would have earned more dollars on the international market than the domestically produced cotton goods.

In many parts of Pakistan a thriving and skilled bazaar-type of industry is in danger of being wiped out by a governmental desire for "modernity."

A complicated system of multiple exchange rates and export bonuses makes it profitable for the manufacturer to engage in such uneconomic production. For example, raw cotton worth \$100 in the international market is turned into cotton cloth worth \$90 in the international market. However, if the effective exchange rate is four rupees to the dollar for raw cotton and eight rupees per dollar for cotton goods, \$100 of raw cotton would bring 400 rupees, \$90 of cotton goods would yield 720 rupees. To an exporter, given these exchange rates, if it only cost 100 rupees to manufacture the cotton goods, private profits would result from the processing of cotton even though to the national economy a \$10 loss takes place. In addition to using multiple exchange rates, the government raises the domestic price of cotton goods by import licensing and tariffs so that manufacturing for the local market is profitable. The protection of West Pakistan's manufactures in East Pakistan's markets is one way in which the East Pakistanis believe they are being exploited by the West Pakistanis.

Pakistan was a major recipient of American aid. Part of this aid was military. It was a "bulwark against Communism" in the Dulles scheme of the world. Part of the American and other Western aid was used to replace the waters of the Punjab that India had diverted to irrigation in India. This need to offset the impact of partition sent a billion or more dollars of aid down the drain in terms of effecting a substantial increase in productive capacity.

American aid is viewed by many Pakistanis as a racket. This is so because AID (Agency for International Development) fosters an industrial structure inconsistent with capabilities of the economy; it stands in the way of the development of indigenous industry and it is often blatantly corrupt.

Destructive AID

One of the standard operating procedures in Pakistan is the systematic overinvoicing of aid consignments. Aid takes the form of an official authorization of a Pakistan enterprise to spend money on American machinery. What price is charged for, let us say, the textile machinery to be purchased? Evidence indicates that one price is quoted by American manufacturers when the funds are free to be spent on Japanese, German, Swiss, etc., textile machinery. Another, higher price is quoted when funds must be used to purchase American machinery. These prices are typically higher than what the same equipment sells for in the States. Thus there is a difference between what the American manufacturer would charge if he were selling under world market conditions and what he charges in the protected AID market. As for the Pakistani manufacturer, it is not his own money, and so he is not especially concerned about getting the minimum price. This is especially true once it is recognized that funds in New York, London or Switzerland are worth much more to a rich Pakistani than the official exchange rate indicates.



What happens to the difference between the price at which the firm would be willing to sell and the price at which they do sell? A remarkable fact in this corrupt situation seems to be that the AID officers who initial such projects (and pass over the overinvoicing) don't seem to get any of the funds that are floating around credited to their own bank accounts. Pakistani business and government people are not so scrupulous. American AID is an honest administration that winks at local corruption and at the corrupting of the local economy.

Pakistan is a country of many cities. In these cities there exist many small native handicraft and manufacturing enterprises in and around the bazaar. The Pakistani artisan in wood is often very good; the Pakistani metal worker has a reputation of being able to copy anything put before him. Even machine tools of various descriptions are made by local mechanics. The gun "copiers" in the tribal hills of West Pakistan are well known; it is also known that the beautiful replicas they make are not effective weapons. The metal used is so soft that if fired the weapon would explode. They are good for show but not for action. Sporting goods (tennis rackets, cricket bats) and stainless steel surgical instruments are well-known products of Pakistan handicrafts that have made their way into world markets.

Not so well known is the story of the tube wells and industry-producing diesel engines of primitive design that have developed without official encouragement in West Pakistan. The story is as follows:

As a result of many years of irrigation in the Punjab, the water table has risen. A high and rising water table brings salinity problems to the soil. It also makes it possible to draw water for irrigation purposes by pumping from the water table. During the past half-dozen years throughout the Punjab, a large number of private tube wells have been sunk. These tube wells are simple pipes plus filters with an attached pump and a source of power. The tube wells are much more efficient than the ancient open well, Persian wheel irrigation system. They came about as a spontaneous market-generated reaction of the village landowners. Local industries (shops) have grown up manufacturing a simple, old fashioned (obsolete by our standards) diesel engine, as well as the pumps and other equipment necessary for these wells. The estimate is that about 30,000 tube wells were being dug each year. The equipment, including the 30,000 diesel engines or electric motors, is being produced in tiny factories throughout the Punjab.

These tube wells are not as pretty nor as efficient in the eyes of a Western advisor as deeper tube wells, dug by government agencies, capable of irrigating many more acres per well. However, the deep tube wells must use imported pumps and modern western diesel or electric engines. Thus there is a conflict between deep and shallow tube wells. There is also a conflict between indigenous enterprise and the large importing or "modern" firms, set up from the top with AID funds, granted monopoly positions by gov-

ernment and staffed with large-scale native promoters as middlemen and "profiteers." The deep tube well development is profitable for the dominant oligarchy in Pakistan, the shallow tube well is not.

It is obvious that in the indigenous tube well development—in the manufacturing of components, sales of equipment and the digging of the wells—there is the prospect of a dozen native "Fords" and "Firestones." There is no want of local enterprise in Pakistan; there is no lack of mechanical skills that could produce equipment that will expand output. There *is* a lack of an economic climate receptive to such a development, as well as a financial structure that could facilitate the growth of smaller enterprises. And for this the government and United States AID must be held responsible.

But what is wrong with the deep tube wells and the modern engines and pumps? The deep tube wells require replacement and maintenance parts which are beyond the capabilities of the Pakistan economy to produce. At Pakistan's stage of industrial development, equipment is not maintained very well. The life of modern equipment, of automobiles, etc., is shorter in Pakistan than in a developed country. Thus the imports required to maintain the AID gifts will be a recurring problem. What AID does is to stifle enterprise that should be promoted and impose upon the economy an import burden in future years. No program can be called a blessing, as AID is touted to be, when it in fact imposes an expensive industrial structure upon the recipient country.

Fashion and Profits

The "route" to economic growth has been a matter of fashion: industrialization was Pakistan's preferred path, until, by the accident of the Ford and Rockefeller foundations' efforts in agriculture, agricultural output grew. During the past year or so, there arose the prospect for a great revolution in agriculture due to new seeds for wheat and rice, Mexi-pak and Irri-3 as they are called. These seeds are a real blessing, in the sense that they can, if used correctly, help increase production manyfold. They require nitrogen fertilizer of course, but the country is capable of producing nitrogen fertilizer from natural gas. They also require a controlled application of water. With the irrigation system and the development of tube wells this is possible. As a result, in West Pakistan it was possible to foresee the solution of the country's food problem.

But at the same time there was a sudden emphasis upon agricultural mechanization. The cry from the government leadership in the summer of 1968 was for the introduction of modern agricultural techniques into the country. Once again the techniques that were pushed by the foreign advisors and appealed to the ruling "elite" demanded sophisticated modern machinery whose production was beyond the capabilities of the economy. Moreover, with this kind of mechanization there inevitably arises a serious dis-

placement of the peasants. But at the same time as they are being pushed off the land, there are no industrial jobs for them in the city. In addition there is a real question whether sophisticated mechanization would work in Pakistan.

There may be a rule that is worth postulating. An economy, such as Pakistan, has a per capita income of, say, \$80 a year. The least affluent economies of Western Europe have a per capita income of about \$640 per year. This means that three doublings of per capita income, the first to \$160, the second to \$320 and the third to \$640, stand between the threshold of affluence and poverty.

There are two ways, not mutually exclusive, to achieve a growth in income. One is to introduce parts of the \$640 economy into an \$80 economy. This enclave approach will yield a per capita income that depends upon the relative weight of the modern and the primitive parts of the economy. Presumably by making the affluent part a larger and larger fraction of the total, in time affluence will be achieved.

But long before this goal has been met, this path will have created large differences in the standard of life in the modern and the traditional sectors. Because of this, and because we live in an era when peasant unrest seems endemic, the enclave approach seems especially unstable politically. Another way is to attempt a broad front incremental strategy for improvement. It is my impression that a movement of \$80 to \$160 per capita income per year along a broad front is both more feasible economically and more humane socially and thus preferable to the enclave path. It is also my impression that the modernization drives fostered by American aid are enclave approaches. A little bit of the West can act as a barrier to further improvement and modernization, because of the dependence of what is modern upon foreign replacement parts and continuing aid.

In the Pakistan case, the movement toward agricultural industrialization was both premature and unwarranted. The simple improvement of the capabilities of the bullock by changing from an over-the-shoulder to a chest harness would perhaps double the horsepower per bullock and permit the substitution of a steel-tipped turning plow for the primitive forked-stick wooden plow. This could lead to substantial increase in output and would not require a specialized input that is beyond the production capabilities of the local economy.

The Japanese have been very ingenious in developing mechanized hand farrows, plowing devices and other things. Many of these could be readily copied and manufactured by a bazaar-type industry. Yet the AID "western" or "modernization" mentality scoffs at the feasibility of these incremental approaches. The Pakistanis who were most intrigued with the development of bazaar industries and the incremental additions to production capabilities in agriculture by deep plowing, by new harnesses and so forth, often called themselves Leninists.

There is no reason in economics or in culture for Bengal and West Pakistan to be the same country. Indeed, aside from the fact that it shares a common religion with the Bengals, much of West Pakistan is culturally underdeveloped compared to the East. We should not look upon it as a loss, as a defeat for American policy, if Pakistan divides. We should not look upon it as a great defeat for the West if either or both parts of Pakistan goes socialist or even "Maoist." In the power equation of the world, Pakistan is a cipher; any country foolish enough to conquer Pakistan, conquers a burden. We should turn our backs upon the policies of the past and substitute for the AID program a very simple and trivial foreign aid program—access to American markets.

Pakistan and India

One should be prepared, however, for serious divisive forces to erupt in India if East and West Pakistan should separate. For a Bengal state will be attractive to many who now live in India. There would be a great pressure to unite West Bengal, now part of India, and East Bengal. This would necessarily have to be a secular state; it would mean burying the communal and religious passions. It would mean giving Calcutta its hitherland again. It would mean the creation of a state with a Bengal cultural unity.

Separation of West Bengal from India could start a process of dissolution in the Indian nation. In terms of local capabilities for managing large-scale organizations, India is unmanageable. It is obvious that there is no reason for a unified Indian state to exist except for the possibility that if division occurs the subcontinent will be rent by innumerable and continuous local wars, as it was prior to the British conquest.

The best way to anticipate and mitigate the worst possibilities of this development would be for the U.S. and other nations to agree that India might be best governed as a most simple federation, with the national sovereign having very limited powers. A completely disarmed and pacified subcontinent should be our policy aims; it is criminal for a national state at the economic level of India and Pakistan to use resources on national defense.

There is a distinct prospect that the breaking up of India and Pakistan will see the emergence of left wing governments. Even now I can hear cries for American intervention in, say, Bengal if division occurs. But intervention can only occur if we view the development of Indian states that call themselves communist as a threat. A "communist" Bengal state, or any other state on the subcontinent, would be a union of the poorest and a threat to no man. As I indicated earlier, many of the so-called communists in the subcontinent might in truth be more market oriented than our AID officials and the beneficiaries of American largesse, the 200 families of Pakistan.