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### **Aid and governance in vulnerable states**

### Bangladesh and Pakistan since 1971

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#### **Abstract**

Bangladesh and Pakistan had very divergent experiences with aid after 1971. Politics in Pakistan was less inclusive in terms of opportunities for intermediate class political entrepreneurs. In this context, the significant role of military aid to Pakistan had very negative effects on its political and economic evolution. In contrast in Bangladesh the less centralized organization of political power and less concentrated forms of aid allowed intermediate class political entrepreneurs to access resources and created incentives for productive activities. These experiences challenge conventional ideas about the relationship between aid, good governance and security: better policy requires understanding the relationship between aid and the political economies of recipient countries better.

Keywords: aid, democracy, institution building, governance, security, Pakistan, Bangladesh, South Asia

JEL classification: O16, O53, O170

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## Acronyms

BNP	Bangladesh Nationalist Party
GoB	government of Bangladesh
GoP	government of Pakistan
JP	Jatiyo Party
ODA	overseas development assistance
PML	Pakistan Muslim League
PPP	Pakistan People's Party

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## 1 Introduction

The different experiences of Bangladesh and Pakistan with aid since 1971 allow us to examine the processes through which aid can assist or obstruct the evolution of institutions and governance capabilities in countries where the state has been vulnerable to internal or external challenges. Aid does appear to affect the development prospects of such countries but in more complex ways than assumed in standard theory and policy. Indeed, many simple analytical ideas informing the use of aid to achieve improvements in governance are misleading and in some contexts have had damaging effects. Bangladesh and Pakistan make an interesting comparison because they were the same country till 1971 when a civil war, followed by a war of independence led to the emergence of Bangladesh. Bangladesh was poorer and less developed, and was famously written off by Henry Kissinger as a 'basket case' dependent on aid. Both countries had vulnerable democracies after 1971. Both received roughly US\$50 of foreign aid in nominal terms in the forty years since 1971. While both remain poor and vulnerable to internal conflicts, Bangladesh has arguably made greater progress given its starting point, while Pakistan has become more fragile. Pakistan's per capita GDP was higher in 1971 and remained higher in 2011, but economic growth has been faster in Bangladesh since the 1990s and the gap in per capita GDP narrowed significantly. Bangladesh has also done better in terms of a number of social indicators with more rapid progress in areas such as infant mortality starting from a more adverse starting point. Its manufacturing sector has grown more rapidly, creating jobs for millions in the garments industry, while industrial growth in Pakistan has languished. The most striking difference is that despite intense internal conflicts in its early years, Bangladesh appears to have moved towards relatively lower levels of internal violence and greater political stability (but progress remains vulnerable to reverses) while Pakistan appears to have generally moved in the opposite direction. In the 2010s Pakistan faced more violent and disruptive internal conflicts and more severe threats to its state.

Aid is clearly just one factor amongst many that may explain the divergent trajectories of the two countries. Despite the common elements in their histories, there were important differences in their contexts. These differences included the composition and types of aid the two countries received. Military aid played a more important role in Pakistan due to its geopolitical position and this reinforced the already significant position of the army and security-related interests in the politics of resource allocation in Pakistan. Bangladesh did not have a comparable level of security significance for donors and the absence of security aid meant that ruling elites found it more difficult to establish centralized control over aid. Bangladesh was also a more homogenous country and the war of independence mobilized many people, particularly in the 'intermediate' (middle and lower-middle) classes, to expect greater participation and progress. Many of these expectations were not realized and indeed created much turbulence in the years after independence. But the less centralized organization of political power in Bangladesh allowed more intermediate class political entrepreneurs to enter politics and capture 'rents'. This had a social cost in terms of political corruption but also a social benefit in stabilizing the polity. In Pakistan the social opening under Bhutto was driven from above to a much greater extent and old elites continued to dominate the political process. The failure of the political system to rapidly absorb intermediate class political organizers and the loss of legitimacy of the ruling elites supporting US interventions in the region were to have dire consequences for the internal stability of Pakistan.

Particularly unfortunate for Pakistan was the fact that two periods of military rule in the 1980s and 2000s were periods when the US was involved in regional conflicts and pumped

military and security aid into Pakistan to buy its support. The combination of military governments and concentrated flows of security-related aid to the top leadership had significant and adverse effects on the economic and political dynamics of the country. In contrast in Bangladesh, the allocation of aid could not be tightly controlled from above, and it was easier for new political entrepreneurs from the lower-middle classes to compete with existing elites. In addition, because ruling elites could not control aid resources from above as a strategy of maintaining political power, they had somewhat greater compulsions to support the development of productive capacity. Military regimes in Bangladesh therefore actively supported industrialization to a greater extent as the development of the productive sector was an important part of their own survival strategies.

We discuss the effects of aid on governance using an analysis of rents and rent seeking. State policies and interventions create 'rents', which are incomes for some individuals that would not exist in the absence of the intervention. Rents can have a legal basis (subsidies, welfare policies, protection or aid) but they can be extra-legal or illegal (illegal allocation of public contracts or resources to individuals who would otherwise not get them). Politics in all countries involves organizations mobilizing to maintain or change policies with the purpose of maintaining or changing the allocation of rents. These activities can be broadly described as 'rent seeking' as they seek to preserve or achieve an allocation of rents. Rent seeking in turn can be legal or illegal. In advanced countries, much of politics and therefore rent seeking is legal, and is financed by legal fund-raising for political activities, and legal expenditures on lobbying by companies and interest groups. In developing countries a much larger part of the rent seeking is not strictly legal. Politics is funded by money from grey sources partly because resources from the modern formal sector cannot fully finance politics. In addition, the rents created are often also extra-legal as powerful political organizers and constituencies capture off-budget or illegal rents, partly because legal rents based on allocations of tax revenues or regulatory interventions are often insufficient. There are therefore structural reasons why developing countries generally do not have characteristics of 'good governance' defined as governance according to the rule of law, where government is held accountable for implementing formal policies through formal processes. However, while no developing country scores highly on 'good governance', there are significant differences in the organization of politics across these countries, and these can make a big difference to their development outcomes. Aid can be important in the evolution of the political process because it can change the supply of rents, the ways in which these are allocated, and affect the strategies and relative strength of different political players.

From this perspective, differences in the types of aid can interact with local conditions to affect not just economic trajectories but also the evolution of social and political strategies. The increasing political fragmentation of Pakistan can be examined from this perspective. The political violence in Pakistan in the 2010s has multiple causes but an important one is the exclusion of important segments of its intermediate classes from playing significant roles in rent allocation processes, and their adoption of increasingly aggressive anti-state strategies as a result. At the same time ruling elites failed to generate sufficient economic growth and employment opportunities, so that excluded political entrepreneurs found it relatively easy to mobilize social discontent. A growing number of political groups began to emerge that were no longer demanding inclusion, but increasingly challenging the legitimacy of the state itself, implicitly to achieve a fundamental restructuring of power. In contrast in Bangladesh, while the political competition between opposing parties has been intense and often violent, excluded political entrepreneurs have mostly felt that they would eventually gain access to politically allocated rents and did not feel the need to target the constitution of the state. As a

result, even though ‘live-and-let-live’ compromises have not emerged between competing political parties in Bangladesh, and the system is therefore vulnerable to sudden spikes in violence, there are no structural reasons why such compromises cannot gradually emerge. Moreover, no important political organizations in Bangladesh have so far engaged in violence to overthrow the state.

Two very broad propositions will help to structure our discussion. The first proposition is that a gradual incorporation of politically organized groups into legitimate (though not necessarily legal) processes of political accumulation is a precondition for maintaining social and political stability in developing countries. A second and related proposition is that these political processes should be consistent with (and at least should not block) accumulation and rent allocation to emerging productive sectors developing their competitiveness to survive in a global economy. The different trajectories in our two countries had much to do with their different initial conditions. But small differences in aid strategies had significant multiplier effects by strengthening retrogressive forces in the evolution of institutions and governance in Pakistan and allowing *some* developmental evolution in Bangladesh. However, it is misleading to try to identify the content of what is retrogressive or developmental by using the benchmark of ‘good governance’. Both Bangladesh and Pakistan have scored poorly on all the standard indicators of ‘good governance’. Nor is it a simple question of state capacity. The Pakistani state has significant violence capacity but has been unable to suppress or contain violence in society. It is also hard to argue that the administrative capacity of the Pakistani state has been lower in some aggregate sense. It may be weak in remote tribal areas but not in the population centres of the Punjab or Sind. Instead of these generalizations, our analysis focuses on differences in the strategies of economic and political organizations in these countries and how these were obstructed or reinforced in particular directions by aid. Compared to Pakistan, the rent-capture strategies of ruling elites in Bangladesh were more supportive of productive economic activities and for maintaining political stability (though both remain very vulnerable). In addition, the extensive activities of relatively high quality NGOs sustained a minimal level of service delivery to the very poor.

The analytical narrative of aid and its development impact presented here challenges two different sets of conventional views about the relationship between aid, governance and development. The first is that in developing countries like Bangladesh that score poorly on ‘good governance’, aid should be used to strengthen progress towards ‘good governance’ (Hermes and Lensink 2001). The latter requires the protection of property rights, the enforcement of a rule of law, low corruption and a government that is accountable. However, the experience of Bangladesh and many similar countries suggests that progress on these difficult governance goals is very slow and development has to be achieved with limited prior improvements in good governance. In these contexts, political stability has often depended on an appropriate allocation of rents to powerful political organizations and economic development has depended on support being available for firms and sectors that allowed and compelled them to develop their competitiveness. Aid to Bangladesh has been relatively more developmental because it supported some of these processes and the challenge is to move ahead with incremental institutional and policy changes that can sustain and deepen this progress.

The second consensus view is that in countries like Pakistan that are suffering from severe security challenges, aid should support improvements in security in addition to good governance (World Bank 2011). Many donors such as the UK have included support for security (for instance for policing) in their development budgets. The experience of Pakistan

challenges this view because here increased security-related aid has been associated with a steep decline in the legitimacy of the state and an increase in violence. The achievement of political stability requires a distribution of resources across competing political groups commensurate with their organizational power. Violence breaks out when the ruling coalition does not recognize the true organizational capabilities of some groups and therefore refuses to give them a commensurate access to rents. The problem of violence in these contexts cannot be solved (as the good governance proponents believe) by the state delivering public goods to ‘citizens’ because the state simply does not have enough resources to buy off all discontent in this way. If external security support is provided to a ruling coalition that faces violent opposition (because it has not achieved an acceptable distribution of rents in the first place) it is likely to use more force to sustain the exclusion rather than use the opportunity to renegotiate a more stabilizing distribution of rents. A more serious loss of legitimacy can follow that can provoke even more violence and a challenge to the institutions of the state and not just the government. In Pakistan the legitimacy problem was compounded because the ruling coalition was getting security aid in exchange for supporting the US war in Afghanistan, which was also widely perceived to be illegitimate. This only added to the marked increase in violence associated with growing external security assistance. Section 2 outlines the analytical framework describing how economic development and political stability are related to the competition over economic and political rents. Section 3 provides an overview of the trends in aid flows to the two countries. Section 4 evaluates the likely effects of aid on the economics and politics of the two countries using our analytical framework, and section 5 concludes.

## **2 Governance, institutions, and development**

The relationship between aid, development and institutions has to be located in the context of a broader discussion about governance and development in developing countries. Developing countries typically do not have ‘Weberian’ states that can enforce formal rules to a satisfactory extent. There are many reasons for this. At the level of the economy, societies only become rule-following when there are many economic organizations which need rules to regulate their interactions and when most of them are productive enough to be profitable in rule-following ways and profitable enough to collectively pay for the enforcement of these rules. In politics societies become rule-following when formal political contributions from legal organizations provide enough resources to pay for political organizations and formal taxation yields enough resources for a party to win elections on the basis of formal taxing and spending programmes. These conditions are not met in the typical developing country and so their institutional contexts are typically characterized by significant rule violations (that take the form of informality), together with the weak enforcement of formal rights and rules. In addition, political corruption and clientelism are much more in evidence as these can describe informal rent allocations. As these features characterize all developing countries, the question is why are some of them more developmental than others?

Developing countries that are politically stable and growing rapidly are just as likely to demonstrate rule-violating characteristics as the ones failing to develop. However, there are significant differences in the types of informality, the precise modifications of formal rights, the types of corruption and clientelism, and these differences can help to explain their developmental performance. Developing countries that achieve greater success in development do so because some of their informal governance arrangements are able to support development and maintain political stability. But these developmental governance arrangements are likely to be far removed from the expectations of ‘good governance’

defined as the protection of well-defined property rights, a rule of law, low corruption and a government accountable to citizens. The countries that are able to achieve development in these contexts often do eventually achieve a greater formalization of institutions, better defined property rights, more recognizably accountable democracies and are able to gradually reduce the more egregious types of corruption. Over time there is therefore a relationship between the standard definition of good governance and economic prosperity and political stability. However, this relationship is not a simple causal one and the achievement of political stability and economic development in developing countries often requires governance capabilities that are not easy to understand in terms of ‘good governance’ characteristics (Khan, M. 2000a, 2000b, 2004, 2012b).

We will use an alternative approach that looks at the implications of different types of rights and rents to assess if institutions and governance are evolving in the direction of supporting greater economic and political viability. If formal and informal institutions support rents that maintain sufficient political stability and create opportunities and compulsions for growth, some of the necessary conditions for sustainable improvements in formal governance conditions are likely to be achieved over a longer term. Growth and political stability do not necessarily ensure either the long-term sustainability of a system or its transition towards greater formality and a state with Weberian characteristics. However, if the existing institutions and governance arrangements do not even achieve economic development with acceptable levels of political stability, the long-term sustainability of the system and the achievement of better formal governance are very unlikely.

In a developing country, the institutions and organizations that are relevant for understanding its development dynamics are therefore not just the formal ones that policy analysis typically focuses on. Informal institutions and organizations are just as important for their effects on political stability and economic activity. In particular many political organizations are largely informal and carry out activities that informally modify formal institutions as part of their rent capture strategies. These modifications of formal institutions (for instance the ways in which subsidies are allocated) can influence business and the operations of economic organizations. Economic organizations too have large elements of informality in their operations partly because of the context of informality in which they operate and the necessity of having links with powerful political players and engaging in informal rent-seeking activities with them. In many cases their initial levels of competitiveness are also too low for them to survive without access to rents, and much of this is also provided or captured informally. Thus, even in cases where there is economic growth, there are significant elements of informality and rule-violating behaviour in the relationship between businesses and governments. The impact of aid in a developing country is therefore likely to depend on the pre-existing structure of institutions and organizations in the country, both formal and informal. The types of aid that are available, and the methods of delivery can interact with these ongoing processes to nudge the institutional system in the direction of better outcomes in terms of political stability and economic development or the reverse. This is the impact that we are interested in assessing. The assessment is largely analytical at this stage rather than empirical and is intended to provoke further investigation and research.

The political economy of aid in our two countries will be examined in the next section using a simplified analytical frame looking at the dynamics of political stability and economic development. Both are closely related to formal and informal rent-seeking processes. The level of political stability in a country depends (though not exclusively) on the allocation of rents to powerful political organizations. Political organizations engage in (formal and

informal) activities to gain access to different types of rents, which are in turn distributed within these organizations and to their supporters in line with the internal distribution of organizational power. The rents that political organizations can capture depend on their organizational power, and this depends on the rents they promise to allocate (formally and informally) to their supporters. The informal elements are important and include mechanisms like the preferential granting of contracts and jobs, or overlooking legal violations by supporters. Political organizations can use a variety of ideological, regional, ethnic or religious claims to define the group and its cohesiveness and success in collective action can depend on these non-economic motivations. Nevertheless, at the heart of many conflicts that are ostensibly ethnic, religious, regional or ideological there is often a dissatisfied but organizationally powerful group of organizers who feel their access to power and rents is less than is warranted. The strategies that excluded groups use to organize themselves and challenge others depend on the economic, political and social history of the country. A country that is on a steady growth path and where the structure of political competition allows the gradual inclusion of new groups is likely to have systemic stability even if its politics appears to be disorderly. On the other hand, a country where the ruling coalition uses a more aggressive strategy of suppressing new organizers and buying out some of their supporters with offers from above may appear to be more stable but may build up explosive pressures. This is likely to be particularly the case if the strategies of the ruling coalition are also damaging for economic growth, limiting the resources that are available for redistribution to powerful political organizations.

Developing countries are stable when excluded groups perceive a good chance of gaining access to rents commensurate with their organizational power. Organizational power can be demonstrated in ways that are relatively peaceful, such as public demonstrations or electoral conflicts. But if the groups competing for rents do not accept the distribution of rents that emerges because (in their opinion) it does not reflect the 'true' distribution of power; more disruptive or violent conflicts can break out to establish what their relative power really is. These contests can escalate (as in a Chicken Game) into serious disruptions and violence that can last a long time till the distribution of rents comes into line with a perception of the distribution of organizational power that is accepted by all parties as realistic. Unfortunately, this can involve long periods of conflict, particularly since conflict can itself change the relative power of contesting parties. Societies where challenges to the distribution of rents are incremental and new groups, entering the political fray are similar to the ones that are already the beneficiaries of rents, are more likely to make incremental compromises rapidly and smoothly. However, if excluded groups were excluded for a long time, their sudden mobilization can result in significant violence because very substantial changes in the distribution of rents have to be rapidly organized and no party has a good idea of the underlying distribution of power that is sustainable. In these contexts a long period of intense conflict can easily be the result (Khan, M. 2010). This is why democratic processes associated with political corruption and clientelist politics can be associated with stability in some contexts and sudden escalations of instability in others.

Rents and rent-seeking are also implicated in economic development. Economic organizations (like firms) are engaged in both formal and informal links with government and some of these links may be vital for their survival. Some business-government links may be necessary for protecting property rights and getting access to necessary resources in contexts where the formal rule of law, the protection of property rights and the formal policy framework supporting firms are weak. Some of this support may be essential for firms to develop their technical and organizational capabilities and therefore their competitiveness.

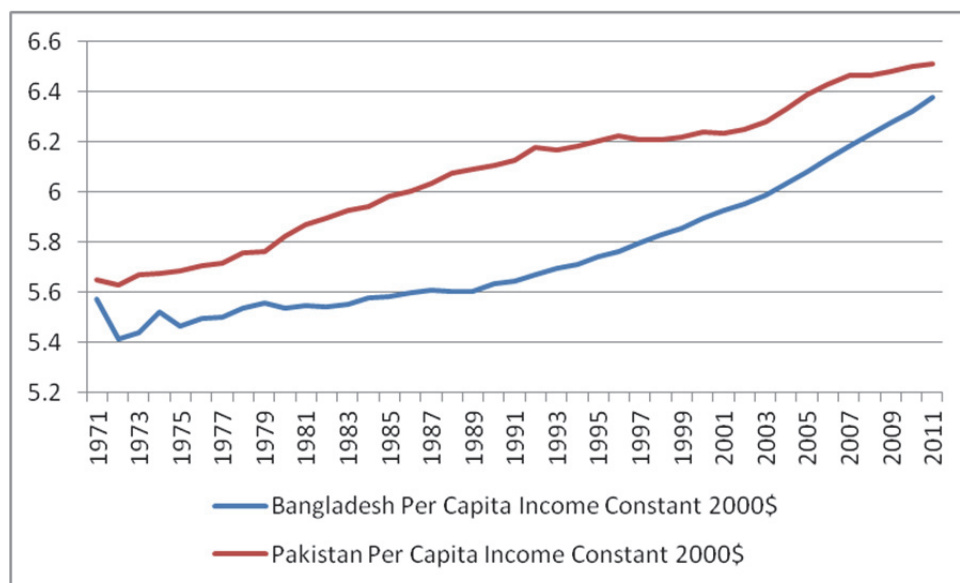


Many firms in developing countries are initially not competitive because they lack the organizational know-how to organize production. Formal and informal rents with appropriate governance conditions can be very important to support the learning-by-doing necessary to develop these capabilities (Khan, M. 2012b). However, the business-government links can also end up protecting inefficiency and preventing competition, and in these cases the result could be economic stagnation and even decline. Here too, the configuration of economic and political organizations is important. A configuration of rents where firms can get selective short-term support to improve their competitiveness can have very dynamic effects. Here the rewards for politicians are the longer-term benefits of economic growth or their participation as individuals in productive profit opportunities. A configuration where firms enter into rent-sharing arrangements with politicians who protect monopolies or help businesses skim public resources is likely to be associated with decline. Since aid is an additional source of rents, the effects of aid on governance have to be understood in the context of an interaction of aid with ongoing processes of economic and political rent allocation.

### 3 Aid to Bangladesh and Pakistan: historical trends

Pakistan had a higher per capita income than Bangladesh in 1971, and the gap increased till the 1980s as a result of higher rates of economic growth in Pakistan. After 1990 the relative performance of the two countries changed and higher growth rates in Bangladesh began to steadily narrow the gap. This is shown in Figure 1. However, even in 2011, the per capita income of Pakistan was 14.2 per cent higher, measured in constant 2000 US dollars. Table 1 summarizes the economic growth in the two countries from the 1960s with India as a comparator. The reversal of Pakistan's fortunes relative to Bangladesh is even more marked relative to India. Pakistan was the fastest growing country in the Indian subcontinent till around 1990 but after that it has trailed both India and Bangladesh in terms of growth rates.

Figure 1: Trends in per capita incomes: Bangladesh and Pakistan



Note: Per capita incomes are in logs.

Source: Based on data in World Bank (2013).

Table 1: Growth in the Indian subcontinent, 1960–2010

Growth rates %	India	Pakistan	Bangladesh
<b>GDP</b>			
1960-80	3.5	5.5	1.7
1980-90	5.6	6.1	3.6
1990-00	5.8	3.7	4.7
2000-05	6.7	4.9	5.3
2005-10	7.8	3.9	6.0
<b>Per capita GDP</b>			
1960-80	1.2	2.6	-0.8
1980-90	3.4	3.5	1.2
1990-00	4.0	1.2	2.6
2000-05	5.2	2.4	3.3
2005-10	6.4	2.1	4.9

Source: Based on data in World Bank (2013).

There are obviously many dimensions to this complex story of relative growth and development and a variety of factors contributed to these outcomes. The types of aid to the two countries are likely to have a relatively small explanatory significance if we look at them as discrete variables affecting significant changes in growth and development in large and complex economies. Our aim is rather to look for likely interactions between aid and broader economic and political economy factors driving growth in the two countries, with aid perhaps playing a bigger role in blocking or accelerating particular types of changes which are also likely to have had other important domestic and international factors driving them.

Table 2 and Table 3 show that in nominal terms aid to Bangladesh roughly doubled between the 1970s and the 2000s while in Pakistan it more than tripled. However, since their populations roughly doubled over this period, per capita aid to Bangladesh in nominal terms remained at around ten dollars at the end of the period as it had been at the beginning, while it increased by around 34 per cent in Pakistan. There is no simple correspondence between changes in the flows of aid to the two countries and the trends in their performance shown in Table 1. In the 1990s when Bangladesh's growth rate began to exceed that of Pakistan, total ODA (overseas development assistance) to Bangladesh declined by 4.3 per cent in nominal terms and grew by 8.3 per cent in Pakistan. In per capita terms, there was a decline in both countries but with a bigger percentage decline in Bangladesh. In constant dollars, in aggregate and in per capita terms, there was a decline in both countries but with a steeper percentage decline in Bangladesh. The contrast was even more striking in the 2000s, with per capita aid continuing to decline in Bangladesh in both nominal and real terms but with a significant increase in aggregate and per capita aid to Pakistan. Yet the gap in the growth rates of the two countries further increased after the 1990s.

Table 2: Trends in total ODA to Bangladesh

	Average annual ODA current dollars (million)	Aid per capita in current dollars	Average annual ODA constant 2011 dollars (million)	Aid per capita in constant 2011 dollars
1971-80	699.0	9.90	2422.2	34.32
1981-90	1452.0	15.73	3182.8	34.49
1991-00	1390.2	11.83	2101.5	17.89
2000-10	1352.5	9.62	1643.5	11.69

Source: Based on data in OECD (2013). Per capita figures based on mid-decade population figures from World Bank (2013).

Table 3: Trends in total ODA to Pakistan

	Average annual ODA current dollars (million)	Aid per capita in current dollars	Average annual ODA constant 2011 dollars (million)	Aid per capita in constant 2011 dollars
1961-70	413.1	7.95	2719.3	52.30
1971-80	640.1	9.35	2348.1	34.29
1981-90	957.5	10.03	2068.5	21.67
1991-00	1037.2	8.14	1508.2	11.84
2000-10	1995.7	12.58	2400.8	15.13

Source: Based on data in OECD (2013). Per capita figures based on mid-decade population figures from World Bank (2013).

Table 4: Aid to Bangladesh, 1971-2010

Millions of current US\$ (percentages are shares of a component in that year)

Fiscal years	Food aid	Commodity aid	Project aid	Average annual aid*
1971-80	2090 (32%)	2768 (42%)	1749 (26%)	660.7
1981-90	2346 (17%)	4435 (31%)	7340 (52%)	1412.1
1991-2000	1537 (10%)	3169 (20%)	10911 (70%)	1561.7
2001-10	613 (3%)	536 (3%)	15104 (94%)	1625.3
Total	6586	10908	35104	1315.0

\*Note there are small discrepancies in the figures for total aid disbursed in the data of the GoB and the OECD, GoB figures being slightly higher.

Source: GoB (2011: Based on Tables 1 and 2).

Table 5: Bangladesh: average annual grants versus loans, 1971–2010

Millions of US\$ (percentages refer to share of that component in that year)

Fiscal years	Grants		Loans		Total aid
1971-80	336.0	(51%)	324.7	(49%)	660.7
1981-90	674.2	(48%)	737.9	(52%)	1412.1
1991-2000	737.9	(47%)	823.8	(53%)	1561.7
2001-10	512.2	(32%)	1113.1	(68%)	1625.3
Total	565.1	(43%)	749.9	(57%)	1315.0

Source: GoB (2011: Table 3).

Table 4 shows the changes in the composition of aid to Bangladesh from 1971 to 2010. In 1971 the war-ravaged nation was dependent on food and commodity aid that constituted 74 per cent of total aid in the 1970s. By the 2000s, food and commodity aid had declined to six per cent of the total, with project aid increasing to 94 per cent. Bangladesh does not get direct budget support. As a share of GDP, aid to Bangladesh declined from around 10 per cent of GDP in the early years to around 1.5 per cent by 2010.

In one respect, however, Bangladesh remains an aid dependent country as almost half of public investment continues to be financed by aid. The Annual Development Programme or ADP finances public infrastructure and developmental projects. The investment component

of the ADP that actually gets implemented accounts for around 80 per cent of public investment in most years (the rest comes from capital expenditure financed through the revenue budget and investments by public sector companies). In the early years, aid disbursements covered all of the ADP (Sobhan 1990; Sobhan and Islam 1990). By 2000 disbursed aid still accounted for 46.8 per cent of the ADP (Obaydullah 2007: 181). This share did not reduce significantly in the 2010s. However, as Bangladesh became less poor over time, the share of grants in total aid declined and more of the aid was in the form of loans on concessionary terms. Table 5 shows that the share of loans in total aid increased from less than half of all aid in the 1970s to almost 70 per cent by the 2000s.

Table 6: Sources of aid to Bangladesh, 1971–2010 (millions of US\$)

Donors	Grants	Loans	Total	Share (%)
World Bank	269	11,664	11,933	22.69
Asian Devt Bank	70	8,114	8,184	15.56
Japan	3,308	3,753	7,061	13.42
USA	2,787	763	3,550	6.75
UN (except UNICEF)	2,744	20	2,764	5.25
Canada	2,087	16	2,103	4
United Kingdom	1,973	89	2,062	3.92
Germany	1,436	268	1,704	3.24
European Union	1,534	48	1,582	3.01
Netherlands	1,078	71	1,149	2.18
Saudi Arabia	587	315	902	1.71
UNICEF	907	0	907	1.72
Sweden	794	24	818	1.57
Denmark	805	68	873	1.66
Norway	709	6	715	1.34
France	325	256	581	1.1
Islamic Devt Bank	22	504	526	1
India	206	235	441	0.85
Australia	388	49	437	0.83
Russia	35	359	394	0.76
Others	538	3,374	3,912	7.44
Total	22,602	29,996	52,598	100

Source: GoB (2011: Table 4).

Finally, Table 6 shows where the roughly US\$50 billion in aid (in current dollars) to Bangladesh has come from over the period from 1971 to 2010. The sources have a significance that will be discussed later in the context of a contrast with Pakistan. Multilateral loans from the World Bank, the Asian Development Bank and the Islamic Development Bank accounted for around 40 per cent of aid to Bangladesh. Of the bilateral donors, Japan was the biggest, accounting for 13.4 per cent of the total. The US followed with around half the share of Japan. The share of the US declined further in the 2000s, accounting for less than 2 per cent of total aid to Bangladesh while the UK became the biggest bilateral donor in 2004, followed by Japan (Khan, S. n.d.: Table 1). In contrast, we will see that US aid played a much more significant role in Pakistan.

At its birth in 1971 at the end of a violent conflict, the Bangladeshi state had weak implementation capabilities. From 1971 to 1975 there was considerable political instability as the first government led by Sheikh Mujib struggled to impose order on the turbulent polity. The economic experiment of ‘socialism’ based on large-scale nationalizations led to

economic collapse as assets and resources were captured by party men of the ruling Awami League, and the disorder culminated in the imposition of one-party rule in 1974. This attempt to curtail democratic rights and a famine around the same time that led to hundreds of thousands of deaths virtually destroyed the legitimacy of the government. In August 1975 Mujib and most of his family were assassinated and the military took over. After a period of uncertainty General Zia-ur-Rahman, a popular freedom fighter, became president in 1977. Zia initiated moves towards what I have elsewhere described as ‘authoritarian clientelism’, a system of controlled democracy that re-introduced multi-party competition (Khan, M. 2012a). Parties were allowed to compete and individual politicians and parties were encouraged to join the ruling coalition but the implicit rule was that the top position could not be challenged. Zia’s period saw an economic turnaround and the emergence of the garment industry that was soon to transform Bangladeshi manufacturing. But Zia too was assassinated in 1981 and he was followed by the less popular General Ershad. He maintained the same political strategy but faced increasing challenges from opposition parties who wanted him to step down. Ershad was forced out in 1990 and since then there has been a competitive democracy with power alternating between the Bangladesh Nationalist Party (BNP) set up by Zia and the Awami League. However, democracy has been vulnerable with occasional crises when parties failed to agree about how to conduct elections.

The political and institutional weaknesses in Bangladesh meant that aid delivery through state organizations was subject to implementation problems and leakages. By the 1980s, NGOs began to be celebrated as a distinctive aid delivery model. They were promoted not simply on the grounds of their comparative advantage in the logistics of some types of aid delivery but also because it was claimed they had governance advantages in representing and empowering the poor (White 1999). These ideas fitted in with the ideological turn in favour of liberalization and against state provision in the 1980s in international policy circles. Some Bangladeshi NGOs such as BRAC did indeed achieve good results in aid delivery, particularly to women and in remote areas. The share of aid channelled through NGOs has continued to grow. In 1990-91 10.5 per cent of total aid went through NGOs, and this grew to around 30 per cent of the total by 2005 (World Bank 2006: Table 3.1). These figures include the indirect receipts of NGOs as the government also purchases services from NGOs using aid funds. However, doubts were expressed in Bangladesh from the outset about the sufficiency of the NGO model of aid delivery. This included a concern about the extent to which NGOs actually represented ‘civil society’ as opposed to pursuing their own economic and political agendas (White 1999; Stiles 2002; World Bank 2006). Equivalent consolidated figures for the share of aid going through Pakistani NGOs are not easily available. This is partly because of the federal structure and partly because data from many donors are not easily available. The share of aid going through NGOs may be comparable to Bangladesh, but there are important differences in the structure of Pakistani NGOs. There are few large and well-organized Pakistani NGOs like BRAC, ASA or the Grameen Bank (which is a bank but with many characteristics of an NGO). Pakistani NGOs are relatively small and much of USAID spending in Pakistan in the 2000s, for instance, was routed through international (primarily US) NGOs (Cheema, U. 2009).

The 1990s saw further important shifts in the analytical ideas informing aid delivery at the global policy level. ‘Good governance’ began to emerge as an important set of conditions required for developmental outcomes (Hermes and Lensink 2001; Khan, M. 2004, 2007). The role of the state was no longer to intervene to correct market failures, but rather to ensure efficient markets through ‘good governance’. Interventionist states were likely to result in adverse outcomes in most developing countries. The good governance state therefore

concentrates on enforcing the conditions for markets to be efficient, such as enforcing property rights, a rule of law and low corruption. By the end of the 1990s these conditions had become an important component of World Bank lending to Bangladesh, and other multilateral and bilateral donors began to follow this lead (Parnini 2009). From 2003 Bangladesh was encouraged to claim ‘ownership’ of good governance priorities in the Poverty Reduction Strategy Papers that provided a framework for coordinating aid (GoB 2003, 2005, 2009). As in Bangladesh, the donor consensus in Pakistan also swung to a focus on good governance and economic liberalization, with a similar focus on Poverty Reduction Strategy Papers (Anwar, T. 2002; GoP 2003, 2010).

Bangladesh’s growth accelerated in the 1980s and further in the 1990s, but not because it made any progress in terms of indicators of good governance. Indeed on some of these indicators it actually retrogressed. This resulted in the World Bank describing the relationship between governance and growth in Bangladesh as a ‘paradox’ or a ‘conundrum’ (World Bank 2007). An extensive literature has also evaluated aid in Bangladesh in terms of its impact on growth and poverty through the lens of standard economic variables like domestic savings. The general conclusion of much of this literature is that aid has had a limited or negative effect on long-term growth. One econometric study found that aid had a negative long-term effect on domestic savings between 1973 and 1998 (Razzaque and Ahmed 2000). In another study, the effect of aid on growth is marginal over 1973-99 because the positive effect of loans (which typically finance investment) is diluted by the consumption-enhancing effects of grants (Quazi 2005). In a similar vein, another study found that over 1972-88 foreign resources made no significant contribution to growth but loans were more effective than grants (Islam 1992). These studies are paradoxical in their own way because they suggest that economic performance may have been just as good or even better if Bangladesh had received no aid.

The implicit conclusion may not be plausible for a number of reasons. First, relationships that hold for small variations in aid may not hold for big changes. If the evidence suggests that a 5 per cent fall in aid is offset by an  $x\%$  rise in domestic savings (where  $x$  may even be more than five) it does not follow that a 100 per cent fall in aid would be offset by a  $20x\%$  rise in domestic savings. Such significant offsetting effects are likely to require major institutional and political changes. A serious disruption of aid would indeed create institutional and political shocks but the outcomes of these shocks are unpredictable and may well result in institutional and political responses that are damaging rather than supportive of developmental outcomes. Second, the econometric identification of the effect of aid works by testing a fixed structure of lagged effects of aid in time series data. This approach may fail to identify the actual contribution of aid if the effects have a changing lag and intensity because the types of aid and policies are themselves changing over time. It may be more useful to examine plausible political economy links between aid, governance and economic performance that may not be ‘testable’ using econometric approaches but may be suggestive enough to support deeper empirical investigation.

The configuration of aid flows to Pakistan displays some significant differences compared to Bangladesh. Four critical characteristics stand out in the data and can be summarized as follows. First, aid from the United States has been a significant part of the overall aid received by Pakistan. Second, military aid has been a significant component of overall US aid to Pakistan. Third, the volume of US economic aid has been strongly correlated with the volume of US military aid. And finally, military aid has fluctuated enormously with changing US perceptions about the geopolitical significance of Pakistan. While there are other donors in

Pakistan, given the leadership role of the US in global geopolitical decisions, US strategies are very likely to influence the strategies of other major donors in Pakistan. While there is always some amount of coordination across donors in a country, for a country that has a strategic position for the sole superpower, the formal and informal coordination of aid conditions is likely to be stronger than is usually the case. Taken together, these characteristics of the Pakistan aid package have meant that aid flows have fluctuated significantly over time and economic flows have been significant in periods when military flows have also been high. The variability of overall aid flows and the dominance of strategic and military considerations are significant features of aid to Pakistan and distinguish it from Bangladesh. In the next section we will examine the significance of this characteristic of aid to Pakistan.

Table 7 shows that from 1971 to 2010, Pakistan too received around US\$50 billion in net disbursed ODA in current dollars. The share of the USA in this was almost 20 per cent overall. In the 1960s the share of the USA was almost 70 per cent and in the 2000s almost 23 per cent. This compares with less than 7 per cent of aid to Bangladesh coming from the USA over 1971-2010 (Table 6) and less than 2 per cent in the 2000s. For Pakistan, the important position of the USA matters because the changing security concerns of the latter can result in very significant swings in aid flows, which in turn affect the types of aid received and the conditions attached. Changes in US aid to Pakistan have sometimes been offset by other sources but have always resulted in changes in the types of aid coming in. In the 1970s when US aid to Pakistan significantly declined, compensating flows from other sources actually resulted in an increase in overall aid flows. In the 1980s the growth of US aid to Pakistan was associated with an even larger growth in overall aid flows to Pakistan. The almost total suspension of US aid in the 1990s resulted in a virtual standstill in total aid flows, while the steep increase in US aid in the 2000s was associated with a virtual doubling of overall aid flows.

Table 7: Net ODA disbursements to Pakistan, 1961-2010 (million current dollars)

	Annual average net ODA disbursements	% change on previous period	Disbursements from USA (% share)		% Change on previous period
1961-70	413.1		277.0	(67.1%)	
1971-80	640.1	+54.9	110.6	(17.3%)	-60.1
1981-90	957.5	+49.6	154.7	(16.2%)	+39.9
1991-00	1037.2	+8.3	1.8	(0.2%)	-98.9
2001-10	1995.7	+92.4	455.9	(22.8%)	+25669.4

Source: Based on data in OECD (2013)

Table 8: Average annual US aid by category to Pakistan, 1948–2010 (millions of dollars at constant 2009 prices)

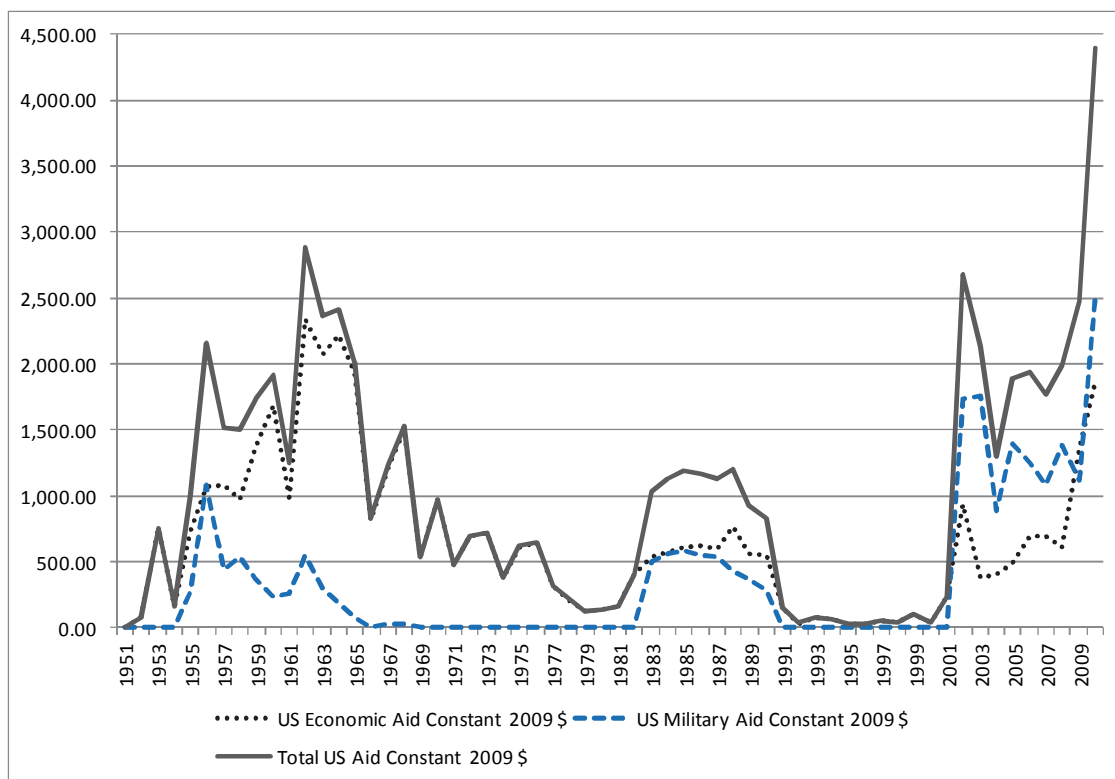
Year	Economic assistance	Military assistance*	Total Aid	Percentage military
1951-60	788.7	292.0	1080.7	27.0
1961-70	1458.4	142.9	1601.3	8.9
1971-80	432.3	0.9	433.2	0.2
1981-90	537.4	380.2	917.6	41.4
1991-00	60.7	0.7	61.4	1.2
2001-10	765.3	1313.1	2078.5	63.2

Note: \* Excluding covert military assistance.

Source: Based on Elhai (2011).

Table 8 shows that the composition of US aid also varied quite significantly across different periods, with the share of military aid rising significantly in periods of increased aid. This simply reflects the fact that US aid to Pakistan has been primarily driven by US security concerns in the region. This is also shown graphically in Figure 2. Military aid was very high in the 1950s when Pakistan became a member of SEATO (the South East Asia Treaty Organization) and CENTO (the Central Treaty Organization) and was a key US ally in the Cold War. Economic aid was also very high in this period, and played an important role in supporting the high rates of economic growth that Pakistan achieved in the 1950s and up to the mid 1960s. The first major decline happened in the mid-1960s when military aid was terminated after Pakistan went to war with India in 1965. US military aid to Pakistan remained negligible throughout the 1970s. Economic aid followed the decline in military aid and kept falling after the 1971 war with India that resulted in the birth of Bangladesh. After the loss of East Pakistan in 1971, Bhutto became prime minister of what remained of Pakistan. His economic strategies of nationalization and populism were in any case unlikely to be supported by economic assistance from the USA. In 1977 Bhutto was overthrown in a military coup led by General Zia-ul-Haq and Bhutto was executed in 1979.

Figure 2: US economic and military aid to Pakistan, 1950–2010



Source: Author's computation based on Elhai (2011).

By an unfortunate coincidence the military takeover in Pakistan coincided with the Soviet invasion of Afghanistan in 1979. Pakistan became a frontline state for the USA in its confrontation with the Soviets. US military aid shot up in the 1980s, as did economic aid. Thus, the return to military rule coincided not only with a steep increase in US aid, but also a steep increase in military aid and an unknown increase in covert military aid. Pakistan played a critical role in the defeat of the Soviets in 1988 and the Soviet Union itself underwent fundamental transformation in 1989. With the fall of the Soviet Union, Pakistan's importance



for US regional strategy also collapsed. In 1988 General Zia died in a somewhat mysterious air crash and was succeeded by the elected government of Benazir Bhutto, daughter of the Bhutto he had executed. Throughout the 1980s while the Afghan campaign was going on, the USA knew that Pakistan had a nuclear programme. Indeed in 1985 Congress passed the Pressler Amendment that made economic and military aid to Pakistan conditional on an annual presidential certification that Pakistan did not possess a nuclear weapon and that US aid would 'significantly reduce' the risk of Pakistan acquiring one. The required annual certification was dutifully provided by US presidents throughout the Afghan war. However, when the war ended in 1989 President George H.W. Bush decided he could no longer provide the requisite certification (ICG 2012: 2-3). Military and economic aid to Pakistan dropped precipitately with a corresponding decline in the trust the Pakistani establishment reposed in the USA.

The 1990s were a period of weak civilian governments marked by intense internal political conflicts and the lowest growth rates in Pakistan's history (Table 1). US economic aid was close to zero through this period, but aid from multilateral agencies and other bilateral donors kept overall levels of aid stable in nominal terms (Table 7). However, as we saw earlier, aid was increasingly linked to good governance goals at this time. The decade ended with another crisis as Pakistan responded to Indian nuclear tests in 1998 with its own nuclear tests and became a nuclear armed country. Economic sanctions followed and Pakistan's isolation increased further with the military coup that brought General Musharraf to power in 1999. However, by another fateful coincidence, September 11th (2001) resulted in another dramatic change as Pakistan once again became a frontline state for the US just after a military takeover within the country. All other concerns were shelved and US military aid shot up again, followed by a rise in economic aid, and this time military aid actually outstripped economic aid. Musharraf stayed in power till 2007 when he was brought down by a movement for the restoration of democracy. While Pakistan enjoyed a small increase in aid in nominal terms in the 1990s and a more significant increase in the 2000s, the aid in the two periods was driven by very different factors. In the 1990s aid to Pakistan primarily came from non-US multilateral sources with a focus on lending for liberalization and improvements in 'good governance'. The increase in aid in the 2000s was driven by US security concerns in Afghanistan and the aid came with a significant military component (Zaidi 2011).

The understandable Pakistani perception that the US was only interested in pursuing its own security interests was, of course, ultimately damaging for US influence in Pakistan. By the late 2000s, and particularly after the restoration of democracy in 2007, the US was engaged in a significant re-evaluation of its aid mix largely because aid was failing to buy the support of the Pakistani people. In 2009 the Kerry-Lugar-Berman bill, also known as the Enhanced Partnership with Pakistan Act, authorized a tripling of civilian aid to Pakistan to US\$7.5 billion over five years. It was also decided to help strengthen government by channelling more of the aid through government institutions rather than (largely international) NGOs. However, the proposed expansion of civilian aid did not take place. The political relationship between Pakistan and the USA deteriorated significantly after the 2 May 2011 US raid that targeted Osama bin Laden in Abbottabad and the NATO airstrikes in November that killed 24 Pakistani soldiers (ICG 2012). Security concerns, Pakistani reluctance to authorize projects involving international NGOs and the weakness of government institutions in delivering aid meant that the proposed increase in civilian aid was not achieved. At the same time stricter conditions were imposed on military aid after the embarrassment to both sides following the Abbottabad incident.

The long history of dramatic fluctuations in military and economic aid to Pakistan raises questions about US strategic calculations. The utility of Pakistan as a launching pad for regional security strategies clearly varied over time but this in itself does not explain why US aid flows to Pakistan should have varied so dramatically in the last four decades. It may have been more rational for the USA to sustain a substantial flow of economic aid to maintain a close relationship with Pakistan over time. The doubts on the Pakistani side about US intentions could well have contributed to the increasingly qualified support Pakistan provided that the US, in turn, found increasingly irksome. One possibility is that successful Indian lobbying in the US and the US interest in maintaining good relations with India for economic and political reasons exerted significant checks on sustained US aid to Pakistan. These pressures may have been strong enough to block aid to Pakistan except at moments of deep crisis (Anwar and Michaelowa 2006). Whatever the underlying cause, the variability of US aid and its correlation with obvious security goals have clearly constrained US influence in Pakistan.

Aid to Pakistan was most developmental in the 1950s and 1960s when it was closely linked to development projects. In 1964 aid amounted to around 5 per cent of GDP, when GDP was growing at almost 7 per cent a year (Zaidi 2011: 3). In the 1960s US aid accounted for around 67 per cent of all ODA (Table 7). Most US aid at that time was economic, with US military aid accounting for less than 9 per cent of the US total (Table 8). Not surprisingly, the first half of the 1960s witnessed the most dynamic growth in Pakistan's history and an appropriate structure of aid was an important contributor to this growth (Amjad 1982). Not surprisingly, support for the US in Pakistan was at its peak during this period. Aid contributed to infrastructure projects and provided finance for lending by development banks like the Industrial Development Bank of Pakistan (IDBP) and the Pakistan Industrial Credit and Investment Corporation (PICIC) that provided long-term credit on easy terms for investors in new sectors. The internal political arrangements in Pakistan in the early 1960s were also conducive for supporting the development of entrepreneurial capabilities in new sectors that were being developed. Both the political arrangements and the aid flows were disrupted in the second half of the 1960s and neither were to be reconstituted in quite the same way again (Khan, M. 1999). Constructive critics of the US aid strategy in Pakistan have pointed out that if US goals in Pakistan are to be realized, aid has to be targeted towards developmental outcomes. This would require, for instance, using more of the aid to co-finance private investments and insure against investment risks in difficult areas as well to support a range of infrastructure projects (Birdsall et al. 2011). In short, it would require a return to the aid strategies of the early 1960s but in a very different global economy and with different internal political challenges.

#### **4 Aid and institution-building in Bangladesh and Pakistan**

The political economy of Bangladesh and Pakistan appear to have a number of similarities in terms of their policies and institutions and dominant types of organizations even after the split in 1971. Immediately after 1971 both went through a period of populist authoritarianism under Bhutto in Pakistan and Mujib in Bangladesh. This was a period of democratic opening after a decade of military rule in the 1960s. The result was great instability as new political forces jostled to capture rents. In both countries charismatic leaders attempted to control these forces using increasingly authoritarian methods. In both cases nationalization was used to create jobs for party supporters and in both cases the leadership turned to increasingly authoritarian methods as political demands outstripped the capacity of the system to deliver rents. In Bangladesh the authoritarianism ultimately took the form of a one-party state while

in Pakistan Bhutto was accused of winning elections by rigging and murdering his political opponents (Burki 1980; Wolpert 1993; Khan, M. 2012a, 2013).

Despite these similarities there were important differences between the two countries. The war of 1971 in Bangladesh had destroyed the political power of the dominant economic and political classes. As many of the old economic and political elites were non-Bengali, they simply left the country at its independence. The few Bengali capitalists were also expropriated through nationalizations in the early 1970s. Political competition was now driven by new political entrepreneurs from the previously excluded lower-middle classes whose higher echelons were now engaged in creating new organizations (initially within the Awami League umbrella) to pursue their own rent seeking strategies. The competition for rents between these groups resulted in political turbulence and violence, initially within the Awami League and then between it and factions that began to defect from it. However, on the economic front, this process also resulted in the emergence of entirely new classes with money, some of whom could potentially become a productive investing class. In Pakistan, Bhutto's populist rhetoric did indeed mobilize the poor as never before but much of the old political classes remained in control of political organizations. The potential upward mobility of new lower-middle class political organizers was, therefore, much less than in Bangladesh. At the same time, Bhutto's attack on big capitalists through nationalizations inflicted a blow on the old economically dominant classes. But here there was no equivalent rupture of political organizations that would allow new classes of moneyed individuals to rapidly emerge from below through rent capture. Thus, Bhutto's strategy in Pakistan had a double negative effect on economic dynamism. The old large capitalist class that may have played a productive role in a new cycle of investment was weakened and demoralized. But a new class of potential medium-sized capitalists, with the potential of developing smaller firms using cheaper labour-intensive technologies, was also constrained from emerging at a rapid pace.

In both countries, the populist authoritarianism of the early 1970s was overthrown by military coups at about the same time, in 1975 in Bangladesh and 1977 in Pakistan. A decade and a half of military rule followed in both. However, military rule in Pakistan turned out to be more authoritarian and centralized, helped by the upsurge in US security aid to the military leadership following the Soviet invasion of Afghanistan. This strengthened an authoritarian and centralized leadership and allowed it to postpone yet again the entry of intermediate class political organizers in the competition over rents. General Zia-ul-Haq ruled initially through an appointed council or *Majlis-e-Shoora* set up in 1980. It appeared that he may be encouraging the mobilization of new social forces because he attempted to create countervailing organizations against Bhutto's Pakistan People's Party (PPP) by promoting weaker political organizations like the Pakistan Muslim League (PML), and by encouraging the formation of new Islamist groups. However, in the end, Zia's strategy did not result in any fundamental change in the groups that dominated political rent seeking in Pakistan despite the fact that in Pakistan, as elsewhere in the Indian subcontinent, new aspirations and mobilizations were developing particularly in the lower-middle classes. The new Islamist parties that sought to mobilize some of these forces were in the end not incorporated into the dominant structures of rent allocation. The biggest long-term beneficiary of Zia's rule was the PML, eventually led by Nawaz Sharif. The Sharif brothers were members of an established business family and the party therefore had greater appeal for the business community, but lower down its organizational hierarchy it depended on political entrepreneurs who were very similar to those in the PPP. Thus, despite Zia's rhetoric of radical Islamism the political classes that led the competition for rents remained substantially unchanged at the end of his rule (Lieven 2011: 76-80). Zia's death in an air crash in 1988 resulted in a 'democratic

transition' which saw the return of the old 'feudal' and upper-middle class elites who were still substantially in control of the two organizations dominating the competition for rents: the old PPP and the PML, now called the PML-N (the PML faction led by Nawaz Sharif).

The failure of Pakistan to achieve a gradual change in its political order at this critical juncture was at least partly due to the steep increase in military aid in the 1980s that happened for external reasons. The Afghan war brought windfalls in the form of overt and covert military aid routed to the top echelons of the army and intelligence agencies. The effects of these flows can be understood by imagining the counterfactual: what would have happened if the highest levels of the military and political establishment did not have access to these rents at this time. Zia was attempting to build new organizations and constituencies to counter the old political leadership of the PPP. In the absence of cash that could be allocated from above to buy off the more pliable lower-level organizers and suppress the others, the bargaining power of new organizers, including the Islamist ones that Zia ostensibly patronized, would have been significantly greater. In a context where the old political organizers were in disarray, new lower-level political entrepreneurs may have found it easier to enter the mainstream and compete for a different set of rents. In the absence of cash rents that could be allocated from above, the lower-level 'Islamist' and other lower-middle class organizers may have competed for accumulation through government contracts, business opportunities and access to finance.

If this had happened, Pakistan's trajectory may have been different. Fewer of the lower-middle classes would have felt so excluded as to support violent activities against the state and against other groups as happened later. Moreover, conservative Islam may have developed a productive base, as in Turkey, that could have moderated its politics, apart from contributing to a sustainable growth of the economy. Instead, Zia achieved what Lieven rightly described as 'shallow' economic growth, based on a service and construction boom financed by cash inflows from aid and remittances from Pakistanis in the Middle East (Lieven 2011: 78). Even more damaging was that organizational power did not shift lower down Pakistan's polity and new lower-middle class organizers failed to develop significant organizational power despite Zia's rhetoric of supporting new Islamist groups against the old political elites.

The contrast with Bangladesh is particularly interesting because the political transitions in the two countries had some common features at this time. Mujib was assassinated in August 1975. General Zia-ur-Rahman in Bangladesh was not directly involved in the coup but emerged as the new leader in November after a series of coups. Although the coups appeared to be similar, Bangladesh's Zia and later Ershad had to devise institutional and political mechanisms for managing a highly mobilized polity organized by a large number of lower-middle class organizers. The war of independence of 1971 had inducted many political entrepreneurs from the lower-middle classes into active organizational roles and military rulers in Bangladesh had no realistic possibility of controlling all of them from above. Instead Zia formed an umbrella party organization to incorporate the most effective new organizers and organizations and managed to achieve political stability by enabling the most powerful organizations to access rents. In this context, the structure of aid mattered. It was helpful that Bangladesh did not receive any significant security-related aid that could be controlled from above. The one party system that the Awami League had attempted to introduce had failed because there were too many aspiring organizers and organizations to satisfy with rent allocations from above given the limited supply of centrally allocated resources. Greater repression or a new supply of centrally-allocated rents may have allowed the one-party

system to survive for a while, but its eventual violent collapse was almost inevitable given the continuous growth in the number of organizations and their demands.

Zia's strategy was to encourage multi-party competition to identify the most powerful and effective organizers and to incorporate them selectively within the ruling party that he created, the Bangladesh Nationalist Party, or BNP. Political competition established the relative bargaining power of competing claimants and the demands of the most effective organizers were met by allowing decentralized rent capture in the form of allocations of contracts and business opportunities (Khan, M. 2012a, 2013). The characteristic of this system of 'authoritarian clientelism' was that the organizational power of new groups including those that had been suppressed in the one-party system was recognized and rents selectively allocated to powerful groups. The only restriction was that the position of the president could not be challenged. Ershad continued this arrangement and set up his own party the Jatiyo Party (JP), but he enjoyed much lower legitimacy to begin with. By the late 1980s political organizations had become sufficiently powerful to reject the implicitly permanent position of the president and Ershad was forced out by a movement for the restoration of democracy in 1990. However, by then quasi-military rule in Bangladesh had enabled a transition from a system of constrained political competition to one where a wider range of patron-client political organizations were recognized and finally allowed to engage in open competition with each other in a 'competitive clientelist' democracy (Khan, M. 2012a, 2013).

The periods of quasi-military rule in Bangladesh under Zia's BNP and later Ershad's JP were important for the democratic transition because new political entrepreneurs gained confidence that they could compete for access to political rents without recourse to extremist or violent politics. As a result, political violence involving political organizations paradoxically declined over this period even though the competition for the presidency remained violent in the form of repeated coup attempts within the army, which eventually resulted in the assassination of Zia. No less important was that there were limited cash rents that could be allocated from above and so many powerful organizers and their supporters could only be accommodated by allowing them to capture rents from the creation of business opportunities. This resulted in the emergence of a new smaller asset-owning class that could potentially replace the old large capitalists who had been destroyed by war and nationalization.

In this context, the structure of aid to Bangladesh was fortuitous because it did not go against the grain of these potentially favourable social processes. Very little of the aid was security-based and so the president did not control significant rents at the centre. This affected the balance of power between the president and the organizations that he needed to accommodate. Cash could not be allocated from above to create or destroy organizations nor could national security arguments be easily used to suppress powerful organizations. The most effective mechanism of maintaining the ruling coalition was to recognize the actual organizational power of different organizations and allow them to capture rents available in the local economy, for instance through business opportunities. The aid that was coming in was for general development purposes and the rents available in organizing delivery were open to competition and capture by a much larger group of organizations. A growing share of this aid was also channelled through a range of local NGOs that rapidly developed their capabilities. The socially committed leaderships of these NGOs were also a product of the liberation war. The NGOs provided rents to their motivated and organizationally competent leaders who (apart from being good at delivering services) may otherwise have engaged in

political competition. The aid flows to Bangladesh were therefore stabilizing in a number of respects given the organizational evolution of politics and economics in the country.

Apart from stabilizing politics, the broad-based political accumulation in Bangladesh also created a base of potential capitalists. Promoting economic investments did not cost much in terms of centralized resource allocation and was politically beneficial because it created a potential flow of future revenues. President Zia provided critical policy support for investors in a variety of sectors, seeking productive investment outlets for them, finding foreign partners and introducing selective policy measures to support investments in new sectors. These steps were critical for the emergence of the garments industry in the late 1970s (Khan, M. 2012a, 2013). This would eventually become the most important manufacturing sector in Bangladesh, providing jobs for almost five million workers and earning 80 per cent of Bangladesh's foreign exchange by 2011. Pakistan's President Zia displayed no similar compulsion in pushing his capitalists towards global competitiveness. He did support the Sharif brothers in the PML but as political entrepreneurs to balance the PPP, not as economic entrepreneurs who would bring in new technologies to create new jobs and earn foreign exchange. The structure of aid was at least one factor explaining the weaker compulsion for promoting new economic activities in Pakistan. The policy support for productive sectors in Bangladesh should not be exaggerated. Nevertheless, there was a greater compulsion for military rulers in Bangladesh to support productive investments during the critical period of the late 1970s and early 1980s.

The 1990s saw a return to democracy in both countries, but a democracy that was vulnerable because of intense conflicts between competing parties. The 1990s also witnessed a policy shift amongst donors to provide stronger support for liberalization and good governance reforms. Both countries supported liberalizing policies but their achievements in terms of improving 'good governance' were negligible as we would expect in terms of our discussion in section 1. Liberalization had different effects in the two countries. In Bangladesh the garments industry was emerging out of the policy support provided in the late 1970s and 1980s and its rapid growth throughout the 1990s helped to raise the overall growth rate of the economy. In Pakistan there were no new globally competitive industries that could drive growth. The greater access to markets and exposure to competition which liberalization brought was of little benefit to a country that had no significant productive sectors that were globally competitive or close to achieving competitiveness.

While the US security aid to Pakistan in the 1980s is likely to have had adverse effects on the incentives and strategies of the ruling coalition, the steep and sudden cutback in US aid in the 1990s had a different set of adverse effects. Political stability was adversely affected as established patterns of rent distribution were disrupted at the very moment when political competition intensified. No elected party managed to complete its term in office. The weak ruling parties of this period had neither the ability nor the time horizon to support rent allocation for productive capability development. Aid from multilateral agencies increased so that nominal aid inflows were maintained but an increasing part of this was now general support for governance reforms like decentralization, a process that was further accelerated under Musharraf's rule in the 2000s (Cheema et al. 2005). Aid supporting 'good governance' reforms of this type is unlikely to make a significant contribution to economic development. Improvements in 'good governance' are unlikely to be big enough to significantly improve the efficiency of markets given the structural constraints limiting the enforcement of good governance in developing countries. Nevertheless, aid to Pakistan in the 1990s is likely to have had marginally positive effects on poverty reduction and also on political stability by

providing some additional resources to the political system in the form of margins and leakages to meet some of the demands for rent allocation. However, economic growth was low and this made the political corruption of both the PPP and the PML-N increasingly intolerable to the public and prepared the way for Musharraf's coup in 1999.

Many features of democracy in Bangladesh in the 1990s were similar to those of Pakistan with the important difference being that in Bangladesh a globally competitive garments and textiles industry continued to drive growth. Once set up, the sector grew through the replication of firms regardless of poor governance. However, poor regulation would eventually take a toll in industrial accidents like the Rana Plaza collapse of 2013 that killed more than 1100 workers. As in Pakistan, intense political competition between weak political parties created a broadly shared perception of poor governance and high levels of political corruption. In Bangladesh too, external assistance for good governance reforms and the linking of aid to conditions such as anti-corruption measures achieved very little in terms of actually reducing corruption or improving the rule of law. Moreover, competing political parties failed even to achieve 'live and let live' compromises in the organization of elections so that elections continued to be periods of violence and uncertainty.

Both countries suffered suspensions of democracy in the 2000s. Democracy in Pakistan was suspended for eight years under Musharraf from 1999 to 2007 while Bangladesh had a two-year emergency government with military backing from 2007 to 2009 following an electoral crisis in Bangladesh in 2007. This government, led by an ex-World Bank bureaucrat, Fakhruddin Ahmed, enjoyed the support of donors as it promised to carry out a raft of good governance measures under emergency laws. These included an anti-corruption drive that swept up the leaders of the two main parties and thousands of others. The end result was a missed opportunity because the emergency government attempted to enforce good governance rules that were actually unenforceable but failed to identify feasible enforceable reforms that may have made a difference to political and economic outcomes in the country (Khan, M. 2012a).

In contrast the Musharraf interregnum in Pakistan lasted much longer, from 1999 to 2007, and arguably did much more serious damage to Pakistan's developmental prospects. Once again, it was unfortunate for Pakistan that a military coup was closely followed by a significant change in US strategic interests and a massive upsurge in military aid. This time the security aid did not just enable a top-down allocation of rents with its damaging political consequences. Pakistan's engagement with the US now led to a gradual but growing crisis of legitimacy for the state and growing extremist violence. One reason why this episode was much worse for Pakistan was that this time US aims in the region were not easily achievable and the war in Afghanistan was probably not even potentially winnable. This resulted in a complex and ultimately self-defeating game being played by the military-bureaucratic elite in Pakistan that sapped its own legitimacy over time.

Access to American aid in the post 9/11 context required the Pakistani regime to sign on to the US-led 'war on terror' that went against the military's own perception of its strategic interests in Afghanistan and the sentiments of many Pakistanis in the border areas who shared the Pashtoon ethnicity of the Afghan Taliban. The Pakistani state found itself in the worst of all possible worlds. Its own strategic concerns prevented it from supporting the US agenda fully or unconditionally and this displeased the Americans. But its military and political support for US goals went far enough to lose it support at home in the strategic and weakly governed border areas. Musharraf later argued in his memoirs that the USA had given him an ultimatum after 9/11 to fall in line or 'be bombed back to the Stone Age' (Musharraf 2006:

200-1). Even if true (and the US denied making any such threat), the targeting of significant security aid to the top leadership was undoubtedly a strong incentive and once again this had severely adverse effects on economic and political developments in Pakistan. The security rents allocated to the centre skewed the relative power of the ruling coalition vis-à-vis all other political organizations. Once again, substantive accommodation could be delayed and strategies of by-passing powerful organizations with a combination of repression and buying in of support from weaker organizations could be attempted. In the end, these strategies have always failed in Pakistan, yet a supply of cash to the centre repeatedly creates the temptation to try such a strategy one more time. Indeed, even after 2008 when a weak PPP government was elected to power, the US alliance was not substantially challenged and the flow of aid rents continued.

Pakistan in the 2000s was an extreme case demonstrating the distorting effects of aid. Its ruling coalition voluntarily accepted payments to support foreign policies that it did not fully believe in, and which were unlikely in any case to succeed, and as a result suffered from declining legitimacy. At the same time, the access to centralized rents allowed it to continue with top-down policies of limiting political access that were ultimately unsustainable. A Pakistani government dependent on its own resources and needing to construct a sustainable coalition would be rapidly forced to allow the many more political organizations to enter the competition for rents. It would also be unlikely to attempt to forcefully suppress organizations that were politically opposed to foreign policies that the ruling coalition itself was not fully committed to. The loss of legitimacy that followed, on top of the exclusion of significant elements of the lower intermediate classes in Pakistan resulted in growing internal violence and sectarianism as excluded groups mobilized to challenge the system as a whole. The PML-N that formed a coalition government after the 2013 elections was committed to a renegotiation of the security alliance with the US and this may become possible as the US interest in Afghanistan wanes and the possibility of a change in its regional strategy emerges. Thus, in Pakistan while the good governance rhetoric of Musharraf was similar to that of Fakhrudin, the implications were much more severe than just wasted opportunities of feasible reform. The outcome was a growth in violence and a loss of state legitimacy that continued to plague the country even after the return of democracy in 2008.

## **5 Conclusions**

Aid can contribute to determining economic and political outcomes by modifying some of the macro-political incentives facing economic and political organizations. The economic and political outcomes that follow can in turn affect the ongoing strategies of organizations, thereby setting up cycles of cumulative causation that can be good or bad for the gradual attainment of economic and political development. The effects of foreign assistance in vulnerable countries characterized by weak formal governance structures are best evaluated in this type of dialectical analysis, taking into account differences in the initial structure of formal and informal organizations and the ways in which they are competing for rents, differences in geopolitical positions determining the composition of aid and therefore of aid-based rent opportunities, and the path-dependent effects of these differences on the further evolution of economic and political strategies. While aid was a relatively small part of the GNP of both countries, when we look at these interactive effects, it probably had significant multiplier effects on the evolution of social stability or fragility in these countries.



The policy implications of our analysis are complex. In the case of countries like Pakistan facing significant internal violence, the new analysis of security and development suggests that development aid should have a greater security focus (World Bank 2011). However, the initial conditions in the country and the adverse effects of centralized rents on political strategies have meant that military and security aid to Pakistan has had very damaging long-term implications. Security-related aid in the 1980s blocked the incremental inclusion of political organizers from the lower-middle classes building up potential conflicts for the future. The second upsurge of security-related aid in the 2000s had even more serious consequences by undermining the legitimacy of the state and allowed excluded groups to mobilize along extremist agendas. Donors are clearly wrong if they believe that their security interests can be furthered by ramping up security-related aid to clients who promise to help in the achievement of donor security goals. Aid always interfaces with internal political and economic processes of competition over rents that are country specific and need to be understood. Of course countries like Pakistan could renegotiate or opt out of assistance that is so damaging. But aid creates powerful constituencies who benefit from it, and opting out may be difficult, as the Pakistani experience repeatedly demonstrates. It is therefore also important to persuade donors that a simple-minded security strategy justified by a simplistic association between security and development may harm their own long-term interests if the countries they are assisting become more fragile and violent as a result.

In less violent countries like Bangladesh, the challenge is to understand better the vulnerable processes through which economic and political progress has been achieved. The challenge is to identify feasible institutional changes that build on these successes without attempting ambitious ‘good governance’ reforms that evidence suggests cannot be implemented. Attempting to use aid as an instrument to achieve ‘good governance’ has repeatedly proved to be a misguided strategy. These attempts resulted in missed opportunities of supporting feasible institutional improvements to sustain development. Sustaining development may in turn be the most feasible way of strengthening ‘good governance’ over time. In particular, the development of new productive capabilities requires rent allocation strategies to firms and sectors to enhance their competitiveness. These strategies have to work with the formal and informal governance structures of the country and with feasible improvements in these conditions. Since developmental rent allocations did succeed in creating new sectors such as garments and textiles in Bangladesh, the challenge is to understand these examples properly so that policy and assistance can be appropriately targeted to new sectors like electronics (Khan, M. 2013). A better understanding of the formal and informal rent allocation mechanisms through which incremental developmental outcomes were achieved in countries like Bangladesh can help to design feasible institutional changes that aid could support. Once again, country specificities are important and the possible interactions of aid and domestic accumulation processes need to be much better understood.

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