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# In Memoriam

**Professor M. Rashid**
**1919-2007**

# GCU
# ECONOMIC JOURNAL

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# A Profile of Prof

Khalid Aftab and Pervez Tahir*

Prof, as Muhammad Rashid, Distinguished Professor of Economics at GCU, was fondly addressed by his students, colleagues and admirers, breathed his last on 19th August, 2007. His sharp mind, masterly delivery of lectures, mannerism of a gentleman and awe-inspiring leadership will be sorely missed by the thousands he taught in and out of the classroom in a career spread nearly over six decades. Not a Ravian himself, he was a true embodiment of the Ravian spirit – COURAGE TO KNOW. The decision of the editors of the GCU Economic Journal to pay a befitting tribute to Prof by dedicating this issue to his life and works is most appropriate.

Prof was born on December 1, 1919 in Qasur, the city of the the great Punjabi poet-saint Bulleh Shah and the Melody Queen Noor Jehan. Here lay the origins of his unceasing love for poetry and music which he shared with the saintly Dr Nazir Ahmad, another GC leader of great distinction. He passed his Matriculation Examination from Islamia High School, Qasur. For his B.A., he moved to Sialkot, the city of Iqbal and Faiz, and graduated from Murray College in 1940. In 1942, Prof completed his M.A. in Economics from the University of the Punjab through Islamia College, Lahore in first class. He started his teaching career from M.A.O. College, Amritsar as a Lecturer and later Government College, Ludhina which he served until 1947.

Lahore became his abode for the rest of his life when he joined Government College on 14 August, 1947 as Lecturer in Economics. Soon in October 1947, he was officiating as the Head of the Department of Economics. In November 1947, he was allowed to teach M.A. classes in Punjab University on a part-time basis and also to supervise research. He rose to become Professor and Head of the Department of Economics. This

* The authors, respectively, are Vice Chancellor and Mahbub ul Haq Professor of Economics, GC University, Lahore.

period of teaching is spread over 1947-1965. In 1954, he had gone to England for an M.Sc. in Economics from the prestigious London School of Economics and Political Science.

On December 19, 1965 Prof assumed the leadership of the institution he so loved. He became Principal, Government College, Lahore. The College historian, quoting the editorial of The Ravi of May 1966 described him in these words: "Bright and handsome, the new principal had the characteristics of an austere economist and a strict disciplinarian." With this began a distinguished administrative career. Although the Chair of Economics in the Government College was sanctioned as early as 1911, it was during Prof's tenure that the College was allowed by the Punjab University authorities to start classes in M.A. Economics. This was the culmination of the long struggle he had to make because of what he used to call "the monopolistic practices" of the Punjab University. He was bitterly critical of Dr S.M. Akhtar, the chair of economics at Punjab University for what he described as "bad economics" taught and promoted by him. His vision of greatness about the Government College found expression in the Working Paper prepared by him in 1966. His strong advocacy for a special treatment to the Government College, which was almost a university in academic terms but treated as any other college in terms of facilities, led to a row with the Secretary of Education, Punjab in 1967. As a result, he had to leave Lahore to serve as Director of Education, Rawalpindi Region. Eventually he himself occupied the seat of his tormentor and worked as Secretary of Education and Additional Chief Secretary, Punjab during 1972-76. His last official posting was as Member, Punjab Public Service Commission (PPSC) and Dierctor, National Institute of Public Administration, Lahore.

Some very illustrious names were Prof's friends and students. Among friends were counted such names as Sir Austin Robinson and Harry G. Johnson from both sides of the Atlantic. His students included Dr Mahbub ul Haq, one of the few internationally acclaimed economists from Pakistan. When Mahbub ul Haq became Deputy Chairman of the Planning Commission in the eighties, Prof had retired and was writing every week in newspapers on topical isssues of economy. Mahbub ul Haq invited him to Islamabad and asked him to write a report on education for the Sixth Five Year Plan 1983-88. Mahbub ul Haq differed with the approach Prof Rashid wanted to follow. This made Prof very unhappy and he declined to write the report. However, even Mahbub ul Haq, paid him the most eloquent tributes in print as well as privately.

Prof was actively involved with a large number of national and international associations of economists, including Pakistan Economic Association, International Economic Association and the Pakistan Society of Development Economists. As early as in 1956, Prof was elected Assistant Secretary of the Pakistan Economic Association.

He belonged to an early tradition of scholars in South Asia who taught more than they wrote and researched. He was an extremely effective speaker. A master orator, he was also a popular dinner-time speaker at the annual conferences of the Pakistan Economic Association.

His major interests were monetary economics and education, the former because he was trained in the discipline at the London School of Economics and taught a whole generation of students and the latter because he was a practicing educationist. His constant refrain in the class was that "the central bank is like a nagging wife". The lecture on international monetary experience started with an indictment: "The story of IMF is not a story of wonderful achievements." Some students nick-named him "Mr. Gold Standard", not only because he delivered his lectures on the fall of gold standard with a great passion, but also because he maintained a golden standard in dress, the way he walked and talked, his own conduct and the conduct expected from students and colleagues.

Two papers in the field of monetary economics and two in the field of education are included in this issue of the GCU Economic Journal. The first paper, presented at the Eighth All Pakistan Economic Conference of the Pakistan Economic Association held in Lahore in Jnauary 1958 and published in the Pakistan Economic Journal of March 1958, was on "Inflationary Pressure in Pakistan." It is an extremely well-written and incisive article, using literary quotes to explain complex economic phenomena. He asks why did Goethe "represent money as the Devil's own invention?" and then answers: "Very simply because it gave up its neutrality under pressure from its masters [which] raises all kinds of problems. Inflation is one of these problems." And Browning's famous line is used to good effect to illustrate how inflation comes about in developing economies: "Inflation is always round the corner in poor countries because their 'reach exceeds their grasp'." Prof was known for his I-ness, which appeared when he came to the redistributive effects of inflationary financing for development: "Inflation redistributes incomes from the poorer sections of the community to the richer classes...We are urged to accept inequality as part of the cost of development...The protagonists of the view.... are impressed by the abstinence of the rich. I reject this view." Work harder and produce more was his prescription, comprising progressive taxation with agricultural incomes assessed *in the same way as non-agricultural incomes* [Emphasis original], end of "non-functional landlordism," greater reliance on "non-bank borrowings."

In the discussion following the presentation of this paper, Prof was criticized by Tariq Zaheer Faruqui for being inconsistent as he advocated higher food production on the one hand and cutting down of large irrigation projects on the other. Mr Faruqui also questioned Prof's opposition to deficit financing. Prof clarified his position by saying that "he criticized such large scale projects because of their long gestation period and stressed, instead, the need for small-scale quick-yielding schemes, not to mention other low-cost reforms to bring about a quick increase in production, such as an increased utilization of uncultivated lands." Finally, he said, "he preferred old Marshallian virtue of thrift rather than deficit finance."

Control of inflation requires effective regulation of credit by the central bank. Prof read a paper on "The Techniques and Problems of Credit Control in Pakistan" at the Businessmen's Seminar held in Lahore in November 1961. Elaborating the characteristic features of a less developed economy and its poorly organized money and capital markets and the related preference for government securities, Prof concluded that the conventional quantitative techniques of credit control – bank rate, open market operations and reserve requirements - written into the State Bank law were just "a tribute to tradition." They were there perhaps "for future use." For instance, seasonal demand for credit following the crop cycle "creates a problem of monetary management for the State Bank." Conservative banking practices and excess liquidity kept the commercial banks largely autonomous of the State Bank. His abiding concern for equity was reflected here also: "One of the striking features of the credit system of Pakistan is an uneven distribution of credit facilities."

The 12th annual session of the Pakistan Economic Association was held in March 1965 in Peshawar before the launch of the Third Five-Year Plan 1965-70. Various aspects of the Plan strategy were discussed in the sessions. Prof chose what had become his first love – education. Education, he pointed out, was much more than measurable returns. "The historical evidence is at least reassuring. There has been no case in economic history of an educated society having been left behind in the race of economic growth. And there has seldom been a case of an illiterate society forging ahead in economic development." The low and falling allocation to education – 6 per cent in the First Plan and 4 per cent in the Second Plan – led to a situation where "the country which started with a literacy rate of 18 per cent at the time of its inception, slipped back to 15 per cent according to 1961 census of population." Lower allocations and higher population growth had made "unattainable" the goals of achieving universal primary education by 1970 and universal education up to 8th class by 1975. He recommended that the allocation to education in the Third Plan should be raised to 10 per cent. Involved in higher education himself, he was appalled by the "inverted pyramid" promoted in the First and the Second Plans. A reexamination of priorities "should lead to a much higher priority for technical and primary education in the Third Plan and a lower priority for higher and secondary education."

Higher allocations, launching of important projects and some other "improvements in education are desirable in themselves but they do not add up to an educational plan nor do they represent an integrated programme of social and economic development." In his article on "Planning for Education" published in GC Economic Journal in 1973 and reproduced in this commemorative issue, Prof grappled with the issue of integrated educational planning. It was based on his research for the United Nations Economic Commission for Asia and Far East, presently the ESCAP. The problem, in his view, arose from "the absence of a general theory of development," confronting the educational planner with a multiplicity of objectives such as preservation of national culture, equality of opportunity, forging of national unity and economic development. The modernizers, which included economists, wanted "to ensure that education for development takes precedence over other goals of education. On the other hand, conservative educationists accuse the economists of a narrow vision and emphasize the broader aims of education which include the development of total human personality." Prof's proposal was iconoclastic which "involves a delicate marriage of the old and the new, not necessarily replacing one with the other." This would require consensus building, determination of desired priorities, commitment of resources to reflect these priorities and reform of the educational system. "To say that education is a social force integrating the individual into society ...tells us precious little about the practical issues in education" which the planners have to deal with. The planners are interested in avoiding human and material waste resulting from indiscriminate investment and to relate it to social and economic needs.

While monetary economics and education were his first love, Prof was a keen participant in some other debates as well. This is reflected in the proceedings of the Pakistan Economic Association and his extensive newspaper writings after his retirement. In a symposium on the "Place of Agriculture in Economic Development" held during the eighth annual meeting of the Pakistan Economic Association in 1958, Prof suggested that "any change in the land tenure system should be based on the objective, rational and statistical analysis of the situation." In the ninth annual meeting of the Pakistan Economic Association, he defended to sterling area. "He argued that London does not stand to lose if any country like Pakistan comes out of the union. He pointed out the convenience and service rendered ... e.g. Pakistan's cotton export was protected by inconvertibility."

Chairing the third session of the same annual meeting, Prof "drew attention to a fallible position of the economists, their inability to think of production without distribution and their consequent bringing in of ideological implications in production to effect a dichotomy between private and public sectors. Of administrators trained by the British, he said that they were competent but need to be oriented to development and planning. Not merely integrity but a high order of technical ability is also required in the administration. He re-affirmed the general belief that private sector enjoyed no real freedom under a system of licences, permits, and in an uncertainty about future commercial and industrial policy."

The symposium in this meeting was on the Second Five-Year Plan 1960-65, which was under preparation at that time. Prof "spoke of the problems of shortfalls but cautioned against being panicked by them. He referred to the need for quick yielding projects, but felt that long term projects should not be neglected. He fully emphasized the need to curtail non-development expenditure." The disparity between East and West Pakistan was now a matter of serious debate among the economists. Regarding regional balance, "he [Prof] pointed out the need for maximizing growth in terms of one economy and criticized the adherence to a mechanical concept of parity."

In 1960, the Tenth All Pakistan Economic Conference was held in Chittagong. Again, the subject of symposium was the Second Five-Year Plan. It was presided over by Prof, who opened it by stating that "the Second-Five Year Plan was not available in a final form. What was available was merely an outline and therefore all that we could do was to discuss the major economic issues in the Plan."

Summing up the debate participated by such luminaries as M.N. Huda, Gustav Ranis, Anwar Iqbal Qureshi, S.A. Abbas, and A.F.A. Hossain, Prof "stated that the symposium was a lively and critical discussion of the Plan He said that any Plan would have limitations, after all a Plan was an estimate of resources and of utilization of such resources to social and economic objectives set in the Plan. In his opinion the Plan had made reasonably satisfactory assumptions regarding population growth, behaviour of balance of payments, internal savings and external sources etc. If a Plan had to wait for precise data in respect of these, perhaps it would never be drawn up. The work had to be started in spite of insufficient data and the Second Plan had made good efforts at expanding resources, at allocating them to best possible uses. The economists' responsibility was not only to raise questions but also to provide better answers for questions already raised."

"In his opinion, the choice before the [Planning] Commission was one between stagnation and growth. If growth was to be preferred, the Philosophy of economic growth must be accepted and price of economic growth must be paid."

"He mentioned that adequate flexibility would be introduced in the Plan through annual development programmes."

"Referring to agriculture, Prof Rashid said that there was scope for further taxation of this sector in the form of higher revenues and water rates and agricultural income tax. In a rural economy, the rural sector must make its due consideration. He suggested the imposition of a betterment levy and an estate duty on agricultural land for this purpose. In conclusion, Prof Rashid reasserted that development would be possible only when people were willing to make necessary sacrifice for it."

Prof looked aloof and distant but not so once you came to know him. He had a good sense of humour, but was sometimes nonplussed by two others, the saintly Dr Nazir Ahmad and the mystical Dr Muhammad Ajmal. Prof had undertaken United Nations assignments in Bangkok and Chile. When he returned from Chile and Dr Ajmal from the United States, students and colleagues gathered in Sir Fazle Hussain Theatre to hear their impressions. Prof spoke first and made a serious speech with his typical professorial touch. Taking the rostrum after him, Dr Ajmal drowned the awe inspired by Prof into spontaneous bursts of laughter with these opening remarks: "Prof Rashid gave you an account of Chile. I will give you an account of Sheikh Chili."

May his soul rest in peace.

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# Inflationary Pressure in Pakistan*

Karl Marx did exaggerate when he defined human relations as economic relations. However, men have been inextricably involved in money-relations ever since money was first put into use for facilitating exchanges. Cash-nexus is a reality which affects our lives and we should not be surprised if money has become not only an all-absorbing but a decent subject of conversation and discussion. Something that money cannot buy is one of the definitions of spiritual value which we are not considering here.

Money is a most remarkable institution and has developed gradually over a very long period through trial and error. Some of its functions and characteristics are common to all societies. It is used as a means of payment, for the measurement of values and their expression in the form of prices, for the determination of future liabilities; and as a medium in which wealth can be accumulated. It is a medium through which the price-system operates and thus serves to establish a balance between demand and supply for goods and services. In this capacity money acts essentially as a 'neutral' device.

But why did Goethe, in his *Faust* (Part II, First Act), represent money as the Devil's own invention? Very simply, because it gave up its neutrality under pressure from its masters, the imprudent and improvident governments. It was abused and led to many a crises in the financial history of a number of countries. What was intended to be a convenient and a neutral device for facilitating the smooth working of the economy became a thoroughly bad system at various times. This failure of money to remain neutral raises all kinds of problems. Inflation is one of these problems which I wish to discuss with special reference to conditions in Pakistan. "Too much money chasing too few goods" is a one- sided definition of inflation, although it brings out one of its essential elements. It is a state in which the value of money is falling and prices are rising. Fundamentally, it is due to a state of disequilibrium in the demand for and supply of goods and services. An

* Prof M. Rashid presented this paper at the Eighth All Pakistan Economic Conference organized by the Pakistan Economic Association in Lahore during January 24-27, 1958 and published in its journal, *Pakistan Economic Journal* 8(1), 180-186, March 1958.

excess of demand over available supply may result from either a rise in effective demand or a reduction in available supply. Examples of changes in demand conditions are increased investment by firms and increased government expenditure on the basis of borrowing. Such a change in demand conditions has as its consequence an initial price rise and a rise in money incomes. The initial price rises in turn cause further price rise. An inflationary process sets in in which prices, monetary requirements, costs of production, wages and cost of living, etc., chase and tend to influence one another in an upward direction. The dominant result of this expansionary pressure is an upward movement of prices, but it must be remembered that the root-cause of inflation is the existence of excess demand for goods and services over available supply. The resources of the country cannot, or at any rate do not, provide all the goods and services that the government and the people set out to buy with the money at their disposal. So prices rise, restricting people to consume and buy what is available.

We shall now consider the genesis of inflationary pressures in less developed countries of the world with special reference to conditions prevailing in Pakistan. Inflation is always round the corner in poor countries because their "reach exceeds their grasp." Browning was certainly not thinking of the problem of monetary instability when he wrote the famous line "A man's reach must exceed his grasp", but it applies to countries like Pakistan in so far as they wish to carry out programmes of development involving large scale expenditures and lack the necessary resources for doing it. Governments of these countries are overwhelmed with projects for spending on transport and communications, irrigation and flood control, electric power and factories, schools, housing, hospitals and so on and on. They have launched upon a policy of sponsored and deliberate economic development. Attempts are being made to keep investments at a higher level than the level of savings in these countries. It is estimated that the current capacity to save in poor countries is as low as 5% of the national income whereas programmes of public investment of say 12 to 15% are required to carry their economies forward. Hence, if the money were created to finance the difference between the actual rate of saving and the desired rates of investment, people who received the money thus created would spend a large percentage of it in the consumer markets, and there would emerge an inflationary trend. If, on the other hand, people would save more voluntarily, larger investments would be possible without created money, i.e. inflation.

In view of the low levels of real incomes and high propensity to consume, the level of voluntary savings in poor countries is at a level which does not permit any increase in net investment. One of the most difficult tasks of governments in poor countries is to force national savings to the level of investments that are necessary for the desired rate of economic development. A policy of 'forced savings' through inflationary financing presents itself as a tempting and an expedient way out of the difficulty. The term 'deficit-financing' is sometimes used to describe this policy of filling the gap between saving and investment. It denotes the direct addition to gross national expenditure through budget deficits, whether the deficits are on revenue or on capital account. The essence of such a policy lies, therefore, in government spending in excess of the revenue it receives in the shape of taxes, earnings of State enterprises, loans from the public and other sources. The Government may cover the deficit either by running down its cash balance and /or by borrowing from the banking system and thus creating money.

## Causes of Inflation in Pakistan

Deficit financing is one of the most important single cause of inflationary pressures now gathering momentum in Pakistan. From 1950 to 1955 the volume of Public Borrowing increased from Rs. 10 crores to Rs. 150 crores. The total figure of Public Debt of the Central Government stood at Rs. 183.31 crores on 30th June, 1957. The total of Provincial Governments' debt (East and West Pakistan) was Rs. 30.09 crores on 30th June, 1957. (Most of it is held by institutional investors,) The First Five-Year Plan provides for a further dose of Rs. 150 crores under the above head. The average of 'created money' thus works out to about Rs. 30 crores a year. The effect of this policy of deliberate deficit financing is reflected in the figures relating to the money supply. From Rs. 150 crores in June 1950, the up-trend in money supply continued throughout this period, carrying it to the peak level of Rs. 511.54 crores in April 1957. Of this, no less than Rs. 110 crores were injected into the economy during the last two years from June 1955 to June 1957.

Deficit-financing is not necessarily inflationary. It has been widely used, since Keynes wrote his General Theory, for offsetting economic depression, for compensating inadequacy of private investment and for financing defence expenditures. Roosevelt, Hitler and Mussolini used this weapon for achieving different objectives in their respective countries. Roosevelt, who was exhorted by Keynes to live dangerously, resorted to deficit-financing for lifting the American economy out of the Depression in 1930s. Hitler and Mussolini, on the other hand, employed the technique as an instrument of war.

The use of deficit-financing for fostering economic growth in less developed countries is a post-War development. These countries are unwilling to wait indefinitely for voluntary savings to catch up with the desired rate of investment. They want to develop their potential resources in the shortest possible period of time so as to eradicate poverty, hunger and unemployment. They believe that their growing economies require some increase in money supply in order that their resources in men and materials maybe brought into fuller use. They have drawn up their plans of investment on the assumption of a flexible taxation system which they expect to bring in additional revenues. In the Pakistan Five-Year Pan, for example, whereas the national income is expected to rise by 20% during the Plan period, the total Government revenues are expected to rise by 30%. The Plan asserts that "As prosperity grows, it would be desirable that receipts from taxation and other normal sources should be regarded as a growing means for financing *the programme of development* (Source: Plan, Vol. I, p. 162).

The above contention is valid so long as the economy has reserve capacity in the form of idle resources which can be readily taken up for expanding current output in 'the short period.' However, inflationary pressures are bound to emerge when deficit-financing exceeds the availability of real resources. Deficit-financing has also been defended as a sound economic policy on the ground that a substantial part of *internal* savings takes the form of hoards and, therefore, Government merely activises the unproductive mode of saving by the public into socially desirable investment. In other words, the Government by borrowing from the Central Bank and the commercial banks is adding to the capital stock of the community when it invests in real terms what the people have accumulated in the form of currency and bank deposits. This contention is valid only if the amount of deficit-financing is exactly equal to the current additions to the currency and deposits. The absence of data on hoardings makes it impossible to verify the assumptions. Furthermore, the investment financed from such borrowings creates additional money without withdrawing it from the owners of these hoards. If idle money does not stay idle but comes out as a claim on current output, prices must rise.

In Pakistan deficit-financing on the basis of borrowings from the banking system had some justification during the years before 1954 when the food situation was satisfactory, industrial production was rising and foreign exchange resources had not been depleted to the minimum and the balance of payments position was not precarious. Conditions have, however, changed and the economy is not in a position to absorb any further injections of money. The food situation has deteriorated markedly over the last few years, necessitating large imports of foodgrains. About 15 million tons of foodgrains have had to be imported last year (1956-57). Apart from the food imports under the aid-programme, the Government had to purchase foodgrains from other sources which entailed heavy foreign exchange expenditure. Besides upsetting the balance of payments position, the food shortage led to the rise in the prices of cereals and other items. It must be remembered that the demand for foodgrains has been increasing with the increase in population and the growth of money incomes. This has resulted in the reduction of the marketable supplies of foodgrains and the resulting rise of prices.

The deteriorating terms of trade, by lowering our capacity to import goods and services in exchange for our exports, is another factor adversely affecting the internal price situation. The Devaluation decision of 1955 has also been a price stimulating factor. It has made imports more expensive in terms of rupees and increased the money incomes of growers by raising rupee prices of our cash crops. The Central and Provincial Governments have also been spending on an ever increasing scale on administration without regard to the need of the economy.

We shall now consider an aspect of the development expenditure in the public sector which has led to inflationary pressures. A large parentage of development expenditure has gone into the creation of what is termed as "capital overheads." These are long-lived investments which include irrigation works, electric power projects, public works in the form of communications and transport facilities, etc. The benefits of such investments are realised after a long period. In technical jargon, the gestation period of such investment is long because of the "time-lag" between such investments and the consequential increase in the output of the economy. Government outlays on such capital projects add to the money supply without adding much in the interim to current output. The Governor of the State Bank of Pakistan, in his Annual Speech on the 7th September, 1957, referred to it when he said, "Though considerable sums have been sunk into various development projects since Partition, the result in terms of increased production has not been encouraging... the increase in the area under cultivation has not been commensurate with the increase in irrigation facilities. This is because the progress on various colonisation schemes has been disappointingly slow."[1] Examples of the Thal Development and Ghulam Muhammad Barrage could be cited to support the Governor's contention.

The result of all these developments is that, on the one hand, Pakistan economy is saturated with money and, on the other, it is faced with the problem of adverse balance of payments and falling reserves of foreign exchange. Thus we are having the worst of both worlds.

## Effects of Inflation

We are all aware of the harmful effects of inflationary pressures. Inflation redistributes incomes from the poorer sections of the community to the richer classes. The incomes of the profit-making entrepreneurs, industrialists, commercial classes and landowners are inflated with every rise in the price level. Profits tend to rise relatively to other incomes. An increase in the inequality of income distribution is sometimes justified by saying that it leads to capital formation and thus helps in economic growth. In other words, we should be grateful to the richer sections of the community for accumulating wealth and capital, who like bees save and accumulate to the advantage of the whole community. We are urged to accept inequality as part of the cost of development and warned against undue preoccupation with the distributional aspect of economic policy. The

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[1] Speech delivered by Governor, State Bank of Pakistan at the Ninth Annual General Meeting on 7th September, 1957, pp. 3-4.

protagonists of the view outlined above are impressed by the abstinence of the rich. I do not share this view.

In Pakistan investors have made fortunes not by their entrepreneurial ability so much, as by restrictive import policies and Government's industrial promotion measures. They have made windfall gains by exploiting shortages in a protected market and indulged in black-marketing and conspicuous consumption on an extensive scale. They have evaded taxation and encouraged corruption, contributing little to national revenues or social welfare.

On the other hand, the large masses of people which include wage earners, salaried classes, fixed income groups and lower middle and middle classes in general, have all been affected adversely by the rising cost of living. Their real incomes have been falling relatively to their money incomes. Inflation by raising the cost of living has imposed severe burdens on those sections of the community who are least able to bear them. It is difficult to disagree with the view that "Inflation is a socially costly and economically wasteful means of increasing investment. It encourages excessive investment in inventories, real estate, and foreign balances and it discourages investment in agriculture....Thus inflation diverts the limited resources available for development to sectors where their effect on production is negligible."[2] Furthermore, inflation, by encouraging the general movement out of money into goods, undermines financial and economic stability.

## Measures to Control Inflationary Pressures

Policy-makers in Pakistan, while formulating policies, should recognise three main principles for dealing with inflationary pressures:

(a) the taxation system should be used for the mobilisation of domestic savings in much greater measure than in the past;

(b) greater stress should be laid on non-bank borrowings ; and

[2] International Monetary Fund, "Development with Stability," *I. M.F. Staff Papers*, p. 316

(c) deficit-financing should be regarded only as a marginal policy weapon.

Higher tax yields could be expected if only the widespread tax evasion could be stopped. Tax concessions at present being given to industrialists for stimulating investments should be granted on a selective basis. A re-examination of the fiscal incentives is indicated in view of the fact that the main bottleneck in the way of further industrial growth is the paucity of foreign exchange.

It is in the agricultural sector, however, where a reorientation of policies is badly needed. Taxes in this sector have shown great inflexibility in the past. Land revenue, for example, is a proportional not a progressive tax and is assessed every 25 yeas. Possibilities should be explored to assess agricultural incomes *in the same way as non-agricultural incomes.* An examination of our antiquated land system is long overdue. This non-functional landlordism should give way to a more rational and progressive system. In the short period an ad hoc increase in land revenue and imposition of an agricultural income tax is the minimum which should find its way on the Statute book.

There is a great need for expanding non-bank borrowings. In so far as the present hoarding habit reflects a lack of suitable institutions in the small towns and villages, a rapid extension of cooperative banking facilities seems to be the answer.

There should be no further deficit-financing based on borrowings from the banking system. Any further addition to money supply will aggravate inflationary pressure. Central and Provincial Governments should live within their means and curtail their expenditures. A lead in this direction has been given by the Central Government who has appointed an Economy Committee to survey the Central expenditure and to suggest measures of economy. It could well be followed by the Provincial Governments.

Measures must be taken in hand to increase food production and to keep food prices at a reasonable level. Food prices are a strategic element in our price structure and if these are not allowed to rise, inflationary pressures can be contained and checked. This raises an important issue of the successful implementation of the policy of price control. The level of integrity of our business men and of the officials is so low that one hesitates to put too much faith in the effectiveness of economic controls in Pakistan. The West Pakistan Government should also take a decision on colonisation of the barrage lands in Sind which will bring new lands under cultivation and increase food supply in the country.

In the years to come, the Central and Provincial Governments should frame their tax proposals with a view to absorb idle money and direct it into capital formation. They should introduce new taxes on profits, on land and accumulated wealth and on conspicuous consumption. These proposals are rather general in character giving more a stress on principles. Well-developed specific proposals can result only from a thorough empirical research by a committee of experts like the Taxation Inquiry Committee which has started work already. Meanwhile, everyone should work harder, produce more and avoid excessive consumption for increased production is, in fact, the only effective solution of the problem of inflation.

# The Techniques and Problems of Credit Control in Pakistan*

*This paper analyses the principal objectives of central banking in Pakistan. It also examines in detail the effectiveness of the instruments of credit control, viz: Bank Rate Mechanism, the Open Market Operations and the Variable Reserve Requirements.*

*Professor Rashid observes that commercial banks in Pakistan 'prefer to remain independent of Central Bank assistance.' The securities market is in rudimentary state of development. The system of flexible reserve requirements could be more effective than the other traditional instruments cited above.*

*While describing the chief characteristics of the commercial banking system of Pakistan, uneven distribution of credit facilities, conservative lending policies and seasonal patterns of advances and excess liquidity, are underlined. The question of mixed-banking and specialized credit agencies is also discussed.*

*Professor Rashid pinpoints the use of 'moral suasion' rather than 'coercion' by the State Bank of Pakistan in its relation with commercial banks.—Editor* [Editor's Introduction in original]

Broadly speaking, the principal objective of the central banking in Pakistan, as elsewhere, is to promote monetary stability by measures designed to offset inflationary or deflationary movements in money supply and in prices which are detrimental to high levels of production, real income, and employment. For this purpose, the State Bank of Pakistan enjoys wide powers of credit control to influence the availability, cost and use of credit. These powers may be considered under the broad headings of quantitative and qualitative controls. The former are normally used to influence the quantity of money and the latter to affect its distribution in particular

* Prof. M. Rashid presented this paper at the Businessmen's seminar held in Lahore during November 20-23, 1961. It was published in Agha M. Ghouse, ed., *Studies in Economic Development with Special Reference to Pakistan.* Karachi: Institute of Development Economics, pp. 130-139. At that time he was Professor and Head, Department of Economics, Government College, Lahore.

directions although it must be noted that selective and qualitative monetary controls do have their quantitative effects.

Three major quantitative instruments of credit control are embodied in the State Bank of Pakistan Order[1], namely, the Bank Rate Mechanism, the Open-market Operations and the Variable Reserve Requirements. The first two instruments are clearly ineffective for regulating credit conditions in an economically backward financial community like ours,- for the following reasons:

The rediscounting powers are unlikely to be used because of the dearth of eligible assets in the portfolios of commercial banks in Pakistan[2]. They usually lend in the form of overdraft and cash credits which provide no tangible instruments for rediscounting. Regular rediscounting of bills presupposes the presence of three conditions viz, (a) commercial banks do not regard it as a sign of weakness, (b) they keep stable cash reserves and (c) they possess eligible bills and other instruments which the Central Bank is willing or is allowed to re-discount. None of these conditions is satisfied by commercial banks in Pakistan; they are not normally indebted to the State Bank and prefer to remain independent of the central bank assistance. They are in the habit of seeing large variations in their cash reserve figure and, except for the busy season, on the whole, maintain a high proportion of liquid assets. Stable cash ratios are probably impossible to achieve in Pakistan in view of strong seasonal demand for banking funds. Finally, they do not possess re-discountable assets.

The other major technique of quantitative credit control is the use of open-market operations. These are important in countries which possess a broad and active market for government securities and where the commercial banks follow the policy of maintaining a stable ratio between their cash

[1] The Order was replaced by the State Bank of Pakistan Act, 1961.

[2] According to clause 13 of State Bank of Pakistan Order, the Bank is permitted to " purchase, sell and re-discount bills of exchange and promissory notes drawn on and payable in Pakistan and arising out of bona-fide commercial or trade transactions bearing two or more good signatures one of which shall be that of a scheduled bank and maturing within 90 days of purchase or re-discount." Thus the eligible commercial paper is strictly defined. Similarly, conditions are attached to agricultural paper drawn or issued for the purpose of financing seasonal agricultural operations or marketing of crops but the time-limit in this case is extended to nine months.

reserves and their deposit liabilities. The theory underlying this technique is easy to comprehend. When a central bank buys or sells Government securities (other securities which central banks handle these days are insignificant) it causes an increase or decrease, as the case might be, in commercial banks' deposits at the central bank. Thus a change in the reserves of commercial banks makes possible a multiple change in the quantity of money: the banks lending liberally when the reserves increase and contracting loans and investments in the opposite case. These underlying conditions which ensure the effectiveness of open-market operations do not obtain in Pakistan. These are serious limitations which arise out of the fact that the securities market is in a rudimentary state of development and operations can only be undertaken on a small scale. Under such conditions, purchases and sales of securities on a large scale are neither possible nor feasible. The market for securities is narrow because the country is poor and the flow of savings for investment is small. The initial task of the State Bank is to try to broaden and stabilize the market for government securities by preventing or moderating fluctuations in their prices and to advise the government in respect of maturity pattern of new issues such that these will be attractive to investors. If and when a broad enough market can be established, the Bank will able to use open-market operations for the purpose of affecting the volume of commercial bank reserves and the money supply. As it is today, the use of this instrument has limited significance since dealings take place in government securities, whose supply is limited and whose prices must be maintained.

The utilization of credit control techniques of the 'conventional' type assumes, among other things, the existence of a well developed short term money market. To introduce such provisions into the charter of the State Bank is to disregard the realities of the money market conditions as they exist in Pakistan today. Detailed sections dealing with the rediscounting business allowed to the Bank and the clause relating to the Bank Rate are very much out of place. It is a tribute to tradition. It is most unlikely that the conventional weapons will be used by the State Bank for regulating money and credit in Pakistan. They are in the nature of 'mere embroideries' or for future use.

A system of flexible reserve requirements is another major weapon of quantitative control by the State Bank. Commercial banks that accept certain obligations,[3] have a minimum capital of Rs. 500,000 and are known to be conducting their business on sound lines are placed on what is known as the "second schedule" of the State Bank. These banks are required to maintain with the State Bank, a balance not less than 3 per cent of their demand liabilities and 2 per cent of their time liabilities in Pakistan. The Bank is empowered to change the ratio of reserves which banks must maintain against their deposit liabilities. This a powerful weapon of credit control and is likely to be more effective than the traditional instruments discussed above. By raising the reserve requirements, the State Bank can reduce the commercial banks lending potential by neutralizing a portion of their central bank deposits. But a major difficulty with this instrument of control is that it is more effective in checking an unsound, than in stimulating a sound, expansion. By raising reserve requirements, the State Bank can eliminate the excess reserves that make an expansion possible but by lowering them, it cannot force commercial banks to lend liberally.

Realizing that these original powers were inadequate the Government amended the State Bank of Pakistan Order in April 1949 and conferred upon the Bank the authority for direct discounting. This was done to accommodate the trade and commerce, without the intervention of a scheduled or a cooperative bank. It was claimed that these amendments brought the legislation of the Bank "in line with the latest developments of thought on central banking".[4] A further extension of its powers came with the passing of the commercial banking legislation which granted the Bank wide powers of quantitative and selective credit control over the policies of the commercial banks. Under the legislation (Banking Companies Control Act, 1949) the Bank is authorized to control commercial bank advances either through general policy directives and/or through specific instructions to an individual bank regarding a particular transaction or group of transactions. It can require commercial banks to maintain a certain percentage of cash margins in respect of secured advances, fix the rates of interest to be charged and indicate the purposes for which advances may or may not be made. In addition, the Bank has been given powers to inspect and supervise banking institutions and to control the opening or closing of

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[3]Every scheduled bank is required to send a weekly return of its position showing its demand and time liabilities and the amounts of its advances and bills discounted to the State Bank of Pakistan.

[4]Report of the Central Board of Directors for the year ending June, 1949, p.6.

bank branches or the amalgamation of banks. Further, commercial banks are required to maintain with the State Bank, cash balances, gold and approved securities aggregating not less than 20 per cent of their total liabilities in Pakistan and are obliged to maintain on a daily basis a high 80% proportion of their assets against their total liabilities within Pakistan. All these provisions not only ensure safety of deposits and controlled expansion of advances but also a measure of control over foreign banks which form quite an important element in Pakistan's banking system. Thus the Bank is armed with a wide array of powers of control over the banking system, most banking practices and to ensure safety of deposits. In other words, by using these powers the State Bank can discourage or even prohibit the use of bank credit for purposes prejudicial to the public interest. They are not meant for use, however, in the normal course of business. We shall now describe the chief characteristics of the commercial banking system of Pakistan and consider some of the problems that arise in the field of credit control on account of institutional inadequacies in credit structure of the country.

Pakistan is a poor country whose natural and human resources are less fully developed than is possible. In other words, there is a gap between its existing economic development and the potential development of its resources. It has a large population, low per capita income and all that goes with it. Agricultural production happens to be the most predominant form of economic activity and there is vast amount of underemployment. Economic development schemes and projects now underway aim at increasing the existing agricultural production as well as creating opportunities for non-agricultural employment by diversifying the country's economy. Bottlenecks appear in the execution of programmes of economic development, in the form of low savings, inadequate skilled personnel, immobility of factors of production and absence of credit facilities. It is credit facilities or banking that we shall deal with here.

The importance of credit facilities for proper exploitation and development of economic resources cannot be over-emphasised. The need for credit arises, among other things, from the length of production process such as the time-lag between sowing of seeds and disposal of crops, installation of plant and production and sale of goods on the market, or despatch of goods from one centre and their final consumption in another centre. Thus in almost all spheres of economic activity; agriculture, industry, commerce and distributive trades, the need for credit is important and, indeed, obvious. Absence or lack of adequate credit facilities creates bottlenecks in productive processes and by discouraging enterprise, arrest the development of the economy of a country.

One of the striking features of the credit system of Pakistan is an uneven distribution of credit facilities. In most of the under-developed countries the phenomenon of a scarcity of credit facilities in one sector co-existing with adequacy or abundance of credit facilities in another sector, is quite common. Invariably, there is an abundance of facilities in the spheres of commerce and a scarcity in the spheres of agriculture and industry. The organised commercial banking sector of Pakistan, comprising the Pakistani joint-stock banks, the Indian joint-stock banks and the foreign exchange banks, are interested mainly in the financing of trade, foreign and internal. They avoid financing of agricultural operations. Their share in the sphere of industrial finance is insignificant for development.[5] The bulk of funds go into the financing of trade. They do not generally lend for house-building, installment purchases or personal consumption. Following the British tradition in banking practice, they restrict themselves to short-term advances of a self-liquidating character and avoid long-term loans. It must be pointed out, however, that the emphasis on self-liquidating character of advances arises mainly from the weak financial position of the farmers and small-scale industrialists, the unsatisfactory nature of the security and the long periods for which loans are usually required. Nevertheless, the banks render assistance in the marketing of agricultural produce when they advance loans against such produce to approved commission agents, dealers or merchants. The most popular forms of lending are the cash credit system and the use of overdraft limit. Finance is also provided on a limited scale through the discounting of bills.

An important feature of the assets structure of the organised banking sector in Pakistan is their large holdings of Government securities. Investments appear to be the main outlet for their increasing deposit resources .The preference for Government securities is partly the result of a conservative

[5] Commercial banks in recent years have played a part in meeting the working capital requirements of domestic industries.

choice in favour of a stable, even though a small income, return as against an unsafe advance. It also reflects a desire to maintain an adequate level of liquidity to match the high proportion of demand deposit.[6] But the main reason for conservative lending policies must be sought in the limited range of marketable assets such as shares of joint-stock companies and other movable properties in Pakistan. This is due fundamentally to the low level of economic development of the country's economy. This fundamental difficulty gives rise to the oft-repeated vicious circle: lack of economic development causes lack of demand for finance and also lack of investment opportunities for banks.

Another striking feature of the organised banking sector is the absence of short-money and capital markets. Although there exist regional money markets in centres like Karachi and Lahore, anything approaching the integrated money markets of advanced countries is conspicuous by its absence in Pakistan. Money markets are splintered with transactions confined to a few large cities and the movement of funds in spite of the efficient remittance facilities is sluggish. Except for the call-loan market in Karachi where something approaching continuous activity exists, it is to quote interest rates in other sectors. The market in Karachi is restricted almost entirely to dealings between banks: certain banks are lenders while certain others, mostly exchange banks, are chief borrowers. This market is closely related to another feature of the banking system of Pakistan, namely, the seasonal pattern of their advances and deposits.

During the busy season (September-March), the major cash crops of the country are on the move and there is a sharp increase in the demand for credit. The monetary and banking statistics normally reflect the impact of the busy season. Bank advances and bills discounted register an increase, rising trends are observed in currency circulation and in the foreign exchange earnings of the country. The increasing demand for short-term funds generates conditions of stringency in the call-money market of Karachi and scheduled banks usually resort to the State Bank for temporary financial accommodation. With the onset of the slack season (April-June)

[6] A striking feature on the liabilities side is a very high proportion of demand deposits to total deposits which generally stands around 65%.

when the country's major cash crops have been moved, the credit needs of merchants and traders are reduced due to smaller turnover. These result most often in a net decline in bank credit, accumulation of idle funds in the hands of individuals and firms which tend to augment the deposit resources of the banks and enable them to repay their outstanding borrowings from the State Bank. There have been deviations from the norm but the pattern in bank lending is likely to remain seasonal so long as the country remains agricultural and crops are raised seasonally.

The seasonal demand for credit creates a problem of monetary management for the State Bank. The sharp increase in the demand credit during the busy season can create seriously unstabilizing monetary conditions. Interest rates tend to move upward in the absence of sufficiently flexible monetary resources. The State Bank has so far relieved seasonal stringency in the market by purchase of government securities. Funds are made available to the commercial banks in the form of "Demands Loans" and "overdrafts" against Government securities more recently under the Bill Discounting Scheme. This is not considered to be a suitable or normal method of making central bank credit available to the commercial banks. "Government securities are not a proper medium for the purpose as large and frequent purchases and sales by the banks, even were this practicable, lead to unhealthy conditions in the securities market. Unconditional guarantees by the State Bank to make advances against Government securities will be a severely inflationary factor."[7]

The ideal arrangement would be to have a properly functioning bills market. This would provide the State Bank with an excellent basis for extending credit to commercial banks. It would ensure automatic increase or decrease in the country according to requirements through re-discounting facilities. In pursuance of this objective, the State Bank decided to introduce a scheme in August, 1952 for giving advances under section 13(4)(c) of the State Bank of Pakistan Order and for re-discounting bills under section 13(2) (b) of the said Order. But the attempt is not likely to succeed as there is a general absence of re-discountable bills. The one way in which the banks

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[7] Mr. Zahid Hussain's speech on 28th September, 1951, on the occasion of the 3rd Annual General Meeting of the State Bank.

could avail of the facilities under the scheme was to replace the Demand Promissory Notes taken by them from their customers in respect of advances with Usance promissory notes for the desired period. This was done only by converting demand advances into time advances i.e. advances payable on a fixed date. Thus the success of the scheme depended entirely on the customers of the scheduled banks who may not be easily persuaded to convert cash credits into usance bills.[8] Cash credits are popular because they offer advantages to both borrowers and lenders. Interest is paid on credits actually utilized while banks withdraw credits in the event of deterioration of customers' finances .The anxiety of the State Bank to promote and facilitate the development for a short-term money market is understandable. It will broaden the role of the Bank as lender of last resort. But the banking system is not sufficiently developed to permit such a policy to succeed. The Bank is thus precluded from embarking on an ambitious policy of credit expansion.

The large holding of government securities by the banks pointed out above, may be further explained by the narrowness of the capital market in Pakistan. This also explains the limited amount of bank-lending against stock-exchange securities, including shares and debentures of joint stock companies. The narrowness and inflexibility of capital market in Pakistan is due to the low level of economic development and consequently limited supply of investment scrip. Investment paper is largely held by institutional investors for long periods and there is, therefore, a small volume of transactions. Treasury bills and securities are taken up not for re-sale before maturity but primarily to be held until maturity. These features of the capital market in Pakistan are responsible for the excess liquidity of the banking system.

The problem of excess liquidity has invited the criticism of those who favour the extension of commercial banking activity into the field of long-lending. The paucity of short-term investment outlets is not considered to be a justification for conservative lending policies but an added reason why banks should venture out into the field of long-term finance. The first Governor of the State Bank of Pakistan expressed similar views and urged the commercial banks to set up special departments for agriculture, house building and industries. The banks were exhorted to revise their practices

[8] The borrowings under the above arrangement have tended to grow in recent years.

and policies in the light of national requirements. They were advised to give up the English tradition of modern banking which bear "an unmistakable stamp of rigid conservatism concealing under covers of cautious procedures an attitude of indifference to production and internal distribution.[9] They must not regard the practices in which they have brought up to be immutable like the Laws of God.[10] Those are really pleas for mixed banking and may be a move in this direction would be necessary. But it must be pointed out that the problem of inadequate credit facilities in the spheres of agriculture and industry does not lend itself to quick and easy solution. The banks with their existing resources of capital and reserves, the high proportion of their demand liabilities, the inadequacy of trained and experienced staff are perhaps well-advised in hastening slowly. The provision of finance by credit institutions has certain pre-requisites viz., ability to deposit margins required, pay the rate of interest asked for and furnish suitable security against advances. The gap in the credit structure can be filled better by setting up specialised institutions than by converting existing commercial banks into long-term financing institutions. Only the prior economic development of the country will bring about a change and by opening up new lines of investment lead to a reduction in excess liquidity. In other words, the provision of institutional credit on a commercial scale will follow and not precede economic development and the consequent rise in credit-worthiness of borrowers.

In the setting depicted above, the State Bank's policy of credit control in direction, expansion or contraction, has a limited chance of success in the face of commercial banks' excessively liquid position and their policy of lending short and only against safe marketable securities. Thus we come to the obvious conclusion that it is not the wide and extensive power of control which will enable the State Bank of Pakistan to regulate credit and monetary conditions but it is the use of moral suasion which must provide the basis for central bank policies. The Bank will do well to take the commercial banks into its confidence and to provide them with leadership. Its aim should be to secure cooperation rather than to use coercion. Moral suasion should take the form of periodic consultation, suggestions, advice, warning and reminders. It must try to avoid mistakes and exercise its influence impartially. It's Department of Research and Statistics has an

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[9] Annual speech of the Governor of the State Bank (September, 1951), p.15.
[10] Ibid.,

important part to play in the collection and correlation of data on which policy-making has to be based. A correct appreciation of the current economic situation alone can help in minimising mistakes.

While the State Bank is handicapped in enforcing credit control on account of institutional inadequacies, its usefulness in other directions is not to be ignored. In the short financial history of Pakistan as an independent country, it has contributed towards restoring and maintaining orderly economic conditions. It has engaged in varied operations and the problems faced by it have been of a difficult nature. Besides setting up of an efficient organization, it has engaged from the very beginning in problem-solving activities. It has maintained the external and internal value of the monetary unit, restored banking services and assisted in the setting up of specialized finance corporations and the National Bank of Pakistan. Its open-market operations have helped in easing the seasonal stringency in the money market. As banker and adviser to Governments it has rendered valuable services. It floated a series of loans, developed a securities market and administered exchange control. It has supplemented its control of banking institutions through moral suasion by its powers of inspection and supervision, thus weeding out the weak and inefficient institutions and ensuring the safety of deposits.

# Allocation to the Education Sector in the Third Five-Year Plan*

We are spending too little on education. Education has received an inappropriate treatment from the planners in the First and Second Five-Year Plans. It has been treated as a residual claimant for resources. The first claim on resources has been that of the so-called productive sectors, namely, agriculture and industry.

This is not a correct strategy for allocating resources because it ignores the special characteristic of education as a productive investment. Education improves the quantity and quality of occupational skills and is a major source of productivity of labour. It has also a direct impact on the economy through increasing the stock of knowledge and ensuring its diffusion. It raises the level of initiative and promotes social and economic mobility. The educational system serves as an instrument by which society finds its leaders, entrepreneurs, administrators and technicians and improves their quality. Thus, it provides a basic service in the form of social infra-structure in addition to providing more specific skills needed for the performance of a number of occupations.

## Education in Third Five-Year Plan

The Third Five-Year Plan should be drawn up on the basis of a more rational approach to the sector of education. The level of investment in education should be related not merely to the manpower requirements which are needed to meet the targets in other sectors of the economy. We should also take into account the broad social objectives of planning. Socially, education is important because it increases knowledge, alters the outlook of the people, changes their perspective and, in general, leads to the acceptance of the scientific spirit in matters economic or otherwise. The

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* Prof M. Rashid presented this paper at the Twelfth All Pakistan Economic Conference organized by the Pakistan Economic Association in Peshawar during March 1-3, 1965 and published in the papers and proceedings printed as Anwar Iqbal Qureshi, ed. (1965), *The Third Five-Year Plan and Other Papers.* Lahore: Ferozsons, pp. 151-155. At that time he was Professor and Head, Department of Economics, Government College, Lahore.

difference, as regards economic potential, between a tribe of savages and a civilized community depends much more on education than on material equipment.

There is no standard theory of allocation of investment. The two central ideas which planners use in making sectoral allocations are efficiency and consistency. The concept of efficiency demands that returns on investment of scarce capital are maximum. The test of consistency is employed to ensure that requirements are matched by availabilities in the total investment programme. If inputs are available for the required output, bottlenecks do not appear in the implementation of the programme. These are simple but powerful ideas. However, planners run into difficulties when they try to put these ideas into practice. How to calculate the cost benefit ratios in the sector of education? Similar problems arise when funds have to be allocated for research, extension services, etc. These services are essential for development but it is difficult to impute marketable returns on investments made in them. They furnish a clear example of the importance in economic analysis of the difference between what economists call the 'private' and the 'social' net product of investment. It is a somewhat dubious exercise to try to measure by earnings differentials the return on educational investment, although some distinguished economists have tried to do so in the University of Chicago.[1] This is particularly true of countries like Pakistan where we have to think in terms of substantial increase of investment in education from the national point of view rather than from the point of view of the individual.

It is estimated that only 6 per cent of the total investment resources of the country were devoted to education in the First Plan. In the Second Plan, the proportion has been even lower than this i.e., 4 per cent. It is hardly surprising, therefore, that the country which started with a literacy rate of 18 per cent at the time of its inception, slipped back to 15 per cent according to 1961 census of population. Again, the manpower requirements of a developing economy could hardly be provided for through such meagre allocation to the education sector with the natural result that the country has become increasingly dependent on technical assistance which is currently

[1] T.W. Schultz, *The Economic Value of Education*, 1963, Columbia, New York.

running at a level of roughly 18 million dollars per annum. These are sad developments for a country which can boast of no other resource except its abundant manpower and where skill-formation is perhaps the best substitute for imported capital, technology and know-how. In fact, it is hard to visualize any dramatic break-through in the industrial or agricultural sectors without a major investment in human resources.

Not only the allocations made in the Plans have been small, the nation is spending a very insignificant proportion of its total income on education including both the recurring and non-recurring expenditures. As is shown in Appendix 'A', Pakistan's expenditure on education is one of the lowest in the world. It is instructive to see that Egypt is devoting as much as 5 percent of its national income to education through the public sector thereby building up the base of an enlightened, progressive and technological society. Pakistan must make up its mind as to the type and pattern of society that she wishes to evolve over the next few decades and then gear all her educational planning to the evolution of such a society.

## Education Sector Ignored

The education sector has been ignored in our economic planning because it is difficult, if not impossible, to measure the return on investment in education and to establish any precise relationship between such investment and economic growth. It is somewhat easier to demonstrate the need for technical education since it arises out of the targets that the Plan sets in various so-called economic sectors such as agriculture, industry, water and power, transport and communications etc. The need for producing good administrators, dynamic entrepreneurs and skilled organizers is no less urgent, although economic theory has not been able to evaluate their contribution to output in quantitative terms. Yet it is not difficult to give an idea of how necessary such training and education is in the context of Pakistan. The total development expenditure at present is running at an annual level of Rs.500 crores. Supposing that the provision of good administration and efficient enterprise were to improve the efficiency with which this programme is executed by 10 per cent (a conservative estimate as anybody familiar with the efficiency of execution of these projects would realize). What it means in terms of cold economic calculus is a saving of as much as Rs.50 crores to the nation. It will take only a small proportion of this investment in education to bring about this saving.

The allocation to Education and Training should be looked at in the long-term perspective. So far as primary education is concerned, it is inevitable the planners should make an act-of-faith type decision. The historical evidence is at least reassuring. There has been no case in economic history of an educated society having been left behind in the race of economic growth. And there has seldom been a case of an illiterate society forging ahead in economic development. The communities that have paid most attention to education and training have in general been the most progressive in respect of income and wealth. While the correlation between universal literacy and economic growth has not been established quantitatively, there is certainly no doubt that in recent history, the prelude to a spurt in growth rates in Russia and China has been provided by their mass education policies.

The allocation to be made to the education sector in the Third Five-Year Plan must be formulated within the perspective of the above considerations. In addition, it should also take note of some of the recent and future developments. First of all, it should recognize that the major emphasis of the Third Plan is going to be on the industrial sector. In fact, as much as 30 per cent of the total Plan allocation is being earmarked for industry. According to current thinking, the emphasis is likely to be even higher in future Plans whose demands the education sector has to anticipate and fulfill. Again, within the industrial sector, about 2/3 of the allocation is going to heavy industries which will require highly qualified technicians for their smooth execution and operation. Surely the allocation to the education sector cannot remain divorced from the kind of industrial society that we hope to evolve.

**Population Increase**

Secondly, population is increasing at a rate much faster than anticipated previously. It was expected in the Second Five-Year Plan that about 60 per cent of the children in the group of 5 to 9 years will be put in schools by the end of the Plan period. However, the fast rate of increase in population implies that actually only 40 per cent of the children will be receiving primary education even at the end of the Second Plan. The Commission on National Education had recommended the introduction of universal primary education by 1970 and universal education up to the 8th class by 1975. In order to implement the recommendations of the Commission on National Education fully, over 12 million additional children will have to be put in the primary schools by 1970 and about 7 million in lower secondary schools by 1975. Clearly these goals have already become unattainable because of higher population growth rate and poor allocation to the education sector in the past.

**Technical Hands**

Thirdly, it has to be remembered that there is a certain gestation period in producing qualified, technical hands. In fact, the investment in producing an engineer or a doctor or an architect may be as long as 15 to 20 years so that future requirements have to be carefully assessed and provided for in the current Plan. This is an important point. The allocation to the education sector in the Third Plan should be looked at not so much as a proportion of the total resources that will be available for the Third Plan, but the total resources available to society in the fourth, fifth and subsequent Plans. It is in that context that the current allocations may appear to be wholly inadequate when they are related to much higher investment rates of the next decade that the education sector is called upon to meet.

In the light of these general as well as specific considerations, it is suggested that as much as 10 per cent of the Third Five-Year Plan total resources should be devoted to the education sector. Since the total Plan size is being estimated at Rs.5,200 crores it implies that the allocation to the education sector should be Rs.520 crores as against the tentative allocation of Rs.322 crores being suggested by the Planning Commission.[2] The proposed allocation of Rs.520 crores will be more than four times the estimated actual expenditure of Rs.110.2 crores on Education and Training in the Second Plan period. Such a big acceleration is the only way to make up, at least partially, for the neglect of the last 15 years. In fact, if this allocation is compared with the projected size of the 4th Plan rather than the Third Plan, the total share of education in investment resources will come to no more than only 5 per cent, which is by no means excessive.

A searching re-examination of the priorities in the educational field will be called for to ensure effective spending. Both in the First and Second Plans

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[2] *Outline of the Tthird Five-Year Plan*, Government of Pakistan, August, 1964, p,160.

as much as 60 per cent of the total allocation to the education sector was devoted to universities, colleges and secondary schools while less than 40 per cent was set apart for primary and technical education including teacher's training. This type of inverted pyramid is hardly appropriate for meeting the manpower requirements of an industrializing economy. It results in producing a surplus of non-technical but formally qualified generalists whom the society cannot usefully accommodate or employ while it leads to a shortage of those very technicians so vital to the growth of economy. Not only is there national waste and misallocation of resources, but there is also discontent and frustration on the part of those whom the education system has not prepared for meeting rigorous demands of the society of tomorrow. These allocations as such are more ornamental than functional. A complete reorientation of thinking is needed in the Third Plan in order to evolve priorities in this field which are more in line with the requirements of the other sectors of the economy. It is inevitable that such a re-examination should lead to a much higher priority for technical and primary education in the Third Plan and a lower priority for higher and secondary education.

## Field of Primary Education

In the Field of primary education again, it must be mentioned that a lot needs to be done to avoid wasteful use of scarce resources. According to some preliminary surveys, as many as 80 per cent of the students who enroll in primary schools never reach the $5^{th}$ class. Whatever the causes for this high drop-out ratio and certainly these causes are deep rooted in the economic and social structure - it involves a waste of investment in children who never grow up as educated, responsible citizens. Similar waste of investment is there in the high failure rates at all levels of education and in the poor quality of education imparted to the students by ill-paid teachers.

The present education system is wasteful and is not designed to meet the requirements of a growing economy. It is responsible for creating the twin problems of unemployment of the educated and shortage of properly trained and technically qualified personnel badly needed for accelerating the pace of development in the country. There is a serious shortage of qualified and trained teachers at all levels which is perpetuating low standards. The system is wasteful because it is based on poorly qualified, ill-paid and untrained teachers, defective curriculum and antiquated methods of teaching. A considerable proportion of schools and colleges lacks the basic minimum requirements in respect of laboratories, equipment, suitable text books and handbooks. There is a limited range of elective courses and virtual absence of educational and vocational guidance. The system needs to be reformed so that waste is eliminated and output is produced which meets the requirements of skills badly needed for the developing sectors of the economy. A large proportion of development expenditure on education is being spent on bricks and mortar. While it enlarges and improves the physical capital in the form of school and university buildings, it should also improve the skills, knowledge and productivity of the people. What is needed is an improvement in educational services including salaries of teachers, the improvement of teaching methods and materials, and the provision of qualified and permanent teachers at each and every level.

Above all, we must build up administrative capability in the Departments of Education and the Universities to ensure efficiency with which available resources are used.

*APPENDIX 'A'*

## National Income and Public Expenditure on Education (1957-1960)

| *Country* | *Per capita national income in US $* | *Public expenditure on education per capita in US $* | *Public expenditure on education as per cent of national income* |
|---|---|---|---|
| U.S.A. | 2,132 | 97.0 | 4.6 |
| France | 960 | 32.5 | 3.0 |
| Turkey | 460 | 10.0 | 2.2 |
| Chile | 310 | 9.6 | 2.4 |
| Japan | 250 | 14.6 | 5.7 |
| Tunisia | 159 | 6.7 | 3.4 |
| Gautemala | 155 | 3.5 | 2.4 |
| Peru | 124 | 4.0 | 2.9 |
| Egypt | 114 | 4.9 | 5.0 |
| Thailand | 102 | 2.9 | 2.7 |
| Nigeria | 70 | 1.3 | 1.9 |
| India | 66 | 1.3 | 1.7 |
| Tanganyika | 56 | 1.7 | 3.0 |
| Pakistan | 51 | 0.6 | 1.2 |
| Burma | 42 | 11.6 | 3.6 |

Source: UNESCO-Basic Facts and Figures, 1962.

# Planning for Education*

Asian countries have achieved quantitative expansion of educational facilities at all levels of education - elementary, secondary, technical, vocational, higher education and teacher training during the last decade. The share of education in the Gross National Product has increased. Governments are committed to community education programmes designed to help young students to understand and develop their local environment by identifying and solving their social and economic problems. Programmes have been launched for converting ordinary secondary schools into comprehensive schools, revision of curriculum, stepping up adult and non-formal education, expansion of technical and vocational education and speeding the development of agricultural education. These improvements in education are desirable in themselves but they do not add up to an educational plan nor do they represent an integrated programme of social and economic development. It is expected that steps will be taken in the years to come to formulate comprehensive educational plans to achieve the desirable goal of integrated development.

The experience of countries in the ECAFE region in integrated development planning has shown that there are a number of difficulties involved in translating the concept into reality. The main difficulty is the absence of a general theory of development. Reference has already been made to the difficulty of quantifying benefits of educational investments. Inevitably, there is a vast amount of uncertainty and subjectivity involved in the whole process of planning. The relationship between education and the economy has been proved by studies and researches done by economists in advanced countries. The work done by Mr. Denison in the United States has demonstrated that the human factor -knowledge, skills organization - and in particular education- has been responsible to a large degree for economic growth in the United States. These studies and reaction to them led to a lively debate which is summed up in the book, "The Residual Factor and Economic Growth"[1]. It has been argued that "Growth rates derived from the experience of the United States cannot be used to calculate the returns on

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* Prof M. Rashid published this paper in the GC Economic Journal 6(1), 1-15, January-June 1973. At that time he was Secretary Education, Government of the Punjab, Lahore.

[1] O.E.C.D. *The Residual Factor and Economic Growth.* Study Group on the Economics of Education. Paris, 1964.

education in the entirely different setting of under-developed countries"[2]. Nevertheless, the impact of these studies has led to the growth of the new branch of knowledge called, 'Economics of Education'. There is a new vocabulary where education is referred to as "investment" rather than as a social service. Planning agencies in Asian countries have also been affected by the new discipline. They have now been converted to the point of view that education is a sector like other sectors such as agriculture, communications and power. This is a welcome change in thinking which augurs well for educational planning.[3]

It is time now to consider some practical problems which remain to be solved in the process of integration of educational planning with development planning. Firstly, developing countries of Asia are not yet equipped to mount big programmes in the sector of education. Quite apart from the scarcity of resources and the competing demands on them, the difficulty of preparing soundly-conceived programmes covering an entire field of activity cannot be easily surmounted. They do not have enough professional people who are needed for this purpose. Secondly, many Asian countries have formulated development programmes within the framework of short-term and medium term plans ranging between 3 to 5 years. The time horizon required for planning education is longer, say 10 to 15 years. Thirdly, the existing administrative structure for running the systems of education is simply not equipped to handle complex problems which must arise when a big development effort is launched to introduce radical changes which require innovation both in the structure of education as well as in the content and methods of education. The initiative in this direction must come from the administrators of education. They are helping to make the old system work but are not trained in the techniques of modern management. The existing system of education which they serve, with all its rules and procedures, its organization arrangements and staffing, is ill-adapted to the requirements of a modernizing society. It is imperative to reform the administrative organization and bring some order into its activities to ensure that suitable personnel are placed in charge of

[2] T. Balogh and P.P. Streeten, "The Coefficient of Ignorance," *Bulletin of the Oxford University Institute of Economics and Statistics.* 25 ( 2), 99—107, 1963.

[3] See Annex I.

educational development. All these problems remain to be solved before educational planning is integrated with development planning.

The problems facing the developing nations in the sector of education are many and complex. The state of educational administration is generally unsatisfactory, little coordinated planning takes place, rates of wastage and drop-outs are high and many imbalances exist in the educational structure. These problems are compounded by rising costs, poor quality of teaching, student unrest, irrelevant content of education and lack of innovation and adaptation in the curriculum. The existing systems of education need to be reformed and future expansion needs to be planned so that waste is eliminated and output is produced which meets the requirements of their economies and societies. Governments in developing countries are busy doing an agonizing reappraisal of their development experience and are expected to devote more attention to this politically sensitive sector in the decade 1970-1980. It would be wrong to expect miracles. All that one can ask for is a steady improvement in the internal efficiency of the educational systems by introducing educational planning. There is a long way to go and each country has to decide its particular strategy for meeting the challenge of the future. The obstacles are many. The factors which impede progress are

(a) Basic intertia and conservatism of the educational systems;

(b) Weak educational administration;

(c) Scarcity of resources and uncertainty about their availability;

(d) Lack of reliable and up-to-date statistics.[4]

**Formulation of an educational plan**

An educational plan is a statement about the future. It is not merely a technical document containing facts, trend estimates or a statement of future policies. It is an instrument of action which is designed to influence what will actually happen, what schools will be opened or expanded, at what location and at what time. A plan is usually a formal document approved by

[4] See Annex II.

government at the highest level which lays down a set of goals and policies for the future development of the educational system. It is subject to constant revision so that the content of plan keeps changing as information about previous planning efforts are received and evaluated. It provides guidelines for all those who are involved in the process of educational planning.

The preparation of an educational plan requires a great deal of participation by a variety of professionals: economists, statisticians, demographers, curriculum experts, engineers, educational admiñistrators, teachers, sociologists, psychologists and others. They look at the system of education from the economic, demographic, sociological and manpower points of view. They are not merely looking at the cultural value of education or education for education's sake.

We shall sketch briefly the steps in the formulation of an educational plan. The preliminary stages of planning include:

(i) The identification of constraints

(ii) The preparation of overall national econontic and social targets

(iii) The preparation of budgetary and manpower targets

Alter this preliminary work has been done, the active preparation of the plan is taken in hand. At this stage, the planning organizations get down to the formation of committees whose role is defined by giving them their terms of reference. This is followed by an in-depth study of alternatives and basic policy decisions. All this hard work is then translated into programmes for all levels of education: elementary, secondary, higher, professional and technical education. The programmes are usually formulated in macro-terms by setting global targets. These macro targets are then broken down into school by school targets of enrolments, teachers, operational costs and capital costs. From this, the planners go on to the preparation of projects. A draft educational plan is born after all this elaborate exercise which identifies objectives, sets out priorities, lays down specific targets to be met within specific time limits. It is discussed at all levels and, if formally approved by government, becomes a programme of action which is to be implemented by appropriate agencies. The story does not end here. In fact, the stage is now set for the preparation of school operational plans. It involves fixing school enrolment targets for each school, calculating the number of teaches needed by qualifications, and from this estimating operational cost for each school. As far as capital costs are concerned, it is first necessary to study the existing facilities, their need for maintenance or replacement and their level of utilization. The capital expenditures needed for maintenance or replacement can then be calculated. This makes it easy to work out the capital requirements for new buildings and equipment.

Educational planning is a new field of activity in Asian countries. Governments are devoting a great deal of attention to education and efforts are being made to plan the development of education in a systematic manner. Educational planners are busy working on alternatives and possibilities open to governments and the range of consequences arising from their adoption. They are working out guidelines for the policy-makers to enable them to adapt the organization of content of their educational systems to their economic needs and social conditions.

We shall now take up some of the key policy issues for discussion.

**A. Multiple objectives**

The process of preparing an educational plan is bedeviled by multiple objectives. These objectives are both cultural and economic and include:

(1) Preservation of national culture;

(2) Equality of opportunity;

(3) Forging of national unity; and

(4) Economic development.

Conflicts arise because the modernizing elements want a radical break with the traditional system of education. To them, the modernization of the curriculum, methods and content of teaching is an essential pre-requisite for improving the efficiency of the educational systems. They are critical of the over-academic curriculum and irrelevance of courses at all levels of education. Economists are usually the allies of these elements and insist that scarce resources available for education be used efficiently. They like to ensure that education for development takes precedence over other goals of education On the other hand, conservative educationists accuse the economists of a narrow vision and emphasize the broader aims of education which include the development of total human personality. They regard themselves as 'keepers of tradition and tutors of the elite'.

The conflict between cultural and economic goals can be resolved by adjusting the scale and structure of the desirable educational pyramid or by surrendering the achievement of one or more of the objectives. The need to introduce education for development, therefore, involves a delicate marriage of the old and the new, not necessarily replacing the one with the other. The modernization ideal demands that something must be given up to accommodate the demands of new culture based on science and technology. In any case, the formulation of an educational plan requires team work and cannot be entrusted to economists alone who merely point out the economic costs of choosing one alternative rather than the other. The cooperation of a variety of experts, viz. engineers, statisticians, administrators, sociologists, psychologists, curriculum experts, and others has to be enlisted to ensure that an educational plan is drawn up which meets the requirements of the society and the economy.

**B. Determination of the share of investment in the total investment**

We have already referred to the problem of inadequate allocation to the education sector in a preceding seminar. How much should a country spend on education? UNESCO recommends to governments in developing countries the figure of 5 per cent of GNP for achieving minimum targets of expansion as well as for improving quality. The share of education in national budgets has been growing. The annual rate of growth of educational expenditures between 1960-1965 has been 13 per cent in Asia, 16 per cent in Africa and over 20 per cent in Latin America. This expansion has helped these countries to register quantitative improvements on an unplanned basis and created problems of dilution of quality, indiscriminate expansion of inappropriate institutions and construction of expensive buildings. In most cases, the linear expansion of the existing system of education has aggravated the imbalances in the educational systems and accentuated the problem of educated unemployment. What these countries need is planned expansion of educational facilities in the light of projected economic and social requirements ten or fifteen years from now. Only a firm commitment to invest a definite percentage of Gross National Product in the development of education and training can provide a basis for sound educational planning. Educational programmes covering an entire field of activity can then be drawn up. Heretofore, this commitment has been lacking in most of the plans of developing countries with the result that educational programmes are drawn up which lack coherence and substance. These programmes are neither properly coordinated with the economic development of the country nor can be justified in terms of certain widely accepted social goals.

### C. Setting educational priorities

A strict order of priorities among different branches of education is necessary because developing countries lack resources to support the cost of simultaneous and equalized development at all levels. Decisions have to be taken on the distribution of total investment among the different levels and tiers of the educational system. Further, at any particular level, how should the total be divided among vocational and academic education, among expansion of numbers and improvement of quality, among formal education and informal training, and so on? Questions which arise are: Should universal primary education be given priority? Should technical education get precedence? How should quantitative expansion at various levels be reconciled with qualitative improvements? What can be done to strike a balance between general education and specialized training? These and many more issues need to be resolved before an educational plan can be formulated to satisfy the tests of efficiency and consistency. Poor countries faced with these compelling alternatives and with ill-equipped analytical and statistical bases need pragmatic guidelines for choosing between these alternatives.

### D. Reform of the educational systems

We have already referred to the serious imbalances in the system of education in developing countries which have created the twin problems of unemployment of the educated and the shortage of persons with intermediate skills that correspond to the needs of industry, agriculture and other developing sectors of economies. We shall examine some of the features of the system of education in Asian countries which have contributed to the structural maladjustment in the supply and demand for the educated.

There has been a rapid expansion in the number of schools and colleges, particularly for non-professional studies, without a corresponding expansion of physical and other teaching facilities. Indiscriminate admission to colleges and universities without using suitable criteria for selection has led to low standards and mass failures in examinations. An element of waste is inherent in a system based on poorly qualified and untrained teachers. A considerable proportion of schools and colleges lack the basic minimum requirements in respect of laboratories, equipment, suitable textbooks and handbooks. There is a limited range of elective courses and virtual absence of educational and vocational guidance. Overcrowding in non-professional courses is threatening to convert these institutions into glorified coaching establishments.

In colleges and universities, teaching is geared to the sole purpose of passing the examination and securing a diploma or a degree. There is a deep-seated conviction in everybody's mind that the whole purpose of teaching is to go through a prescribed course and finish it. The course is specified by a list of items set down in the syllabus which is to be expounded by the lecturer to the students. No time must be wasted on items which are not in the course. Presently the student will be faced with an examination in which he will be asked stock questions on the stock material; it is, therefore, necessary that he be primed with the required information. In this process, the student is neither required nor expected to display any initiative. Complete passivity in the classroom is considered a virtue. The information offered to him must not be questioned; it is simply to be memorized. Every device that helps to eliminate the necessity of thinking is used to the full - notes to be copied and memorized, ready-made answers, bazaar notes and 'made-easies' are the stock-in-trade of the professional crammer. Memory is at a premium and intelligence at a discount. The system is designed to iron out independence of mind, originality and native curiosity; to turn young men and women into automata. It is almost a Pavlovian process of conditioned reflexes; the perfect examinee is one for whom the stock question evokes the conditioned, the memorized answer. The examination is the measure and mould of everything else. It dominates the educational process and is highly inefficient as a method of producing properly educated graduates. A radically new approach is needed if we are to improve the quality of the end product of the educational system.

The system is not designed to produce the types of persons for whom the demand has grown during the last 20 years. It produces a large number of school and university graduates who cannot be absorbed in the type of jobs and at the rates of pay which they expect. The system lacks balance. It is heavily weighted in favour of general studies and humanities. This pattern attaches less importance to science education at all levels; primary, secondary and higher education. Finding few alternative outlets, products of secondary school gravitate to colleges and universities and aggravate unemployment. There is no point in clinging to the so-called liberal concept of education which suggests that everyone is entitled to higher education of any sort. Such a concept is an intellectual luxury which low-income countries simply cannot afford. What is needed is to adopt a radically new approach and plan the output of educational institutions in the light of national requirements. The preferences of the individual may have to be made to conform to the needs of society.

This is not to deny the importance of general education. Education is important because it increases knowledge; it alters the outlook of the population, changes their perspective and in general leads to a widespread acceptance of the scientific spirit in matters economic or otherwise. But these are mere tautologies about the significance of education in the modern world of science and technology. These have been substituted for vague generalizations of an earlier age about the aims of education. To say that education is a social force integrating the individual into society or that it is a means for adapting the human personality to meet the challenge of environment tells us precious little about the practical issues in education. The planner is interested in examining the systems of education with a view to finding out if investment in education is related to the social and economic needs of the country and to determine the priorities of such investment. Indiscriminate investments in education lead to human and material waste; optimum returns are obtained through a careful analysis of trends in the economy and the allocation of resources to key educational sectors so that education fits harmoniously into the pattern of economic and social change.

## Conclusions

a) Theoretical models of educational planning have limited value for practical programming in the sector of education.

b) The formulation of educational plans and programme is a laborious and time-consuming process. It requires participation by a large number of specialists.

c) Planning and implementation cannot be separated. A plan that is not implemented is not even worth the paper it is written on.

d) It is necessary to convince people who run educational institutions that planning is good for them.

ANNEX I

Some definitions

1. A plan is a rational method of attaining a goal. A national educational plan is a sketch which identifies objectives, sets out priorities, lays down specific targets to be met within specific time limits. It provides basis for action but it does not, in itself, produce action.

2. An Educational Programme is an entire field of activity that is either justified in terms of economic development plan of the country and/or in terms of certain widely accepted social goals, say, expansion of the secondary school system.

3. An Educational Project is a separable activity fitting into a larger programme; say the construction of teacher training colleges whose graduates are designed to take up teaching in secondary schools.

4. Internal efficiency of an educational system refers to the relationship between the resources it is using and the educational results it is getting, looked at from the inside.

5. Productivity of an educational system refers to the relationship between the resources invested in education and all the resulting benefit accruing later on to the students and to society as a whole.

ANNEX II

## Statistics Needed For Educational Planning[5]

**A. Demography statistics**

**a.** Basic Data

A:I Total population, by sex and age

A:2 Population projections

**b.** Supplementary Data

A:3 Population 15 year& old and over, by sex, age and educational attainment (or literacy)

A: 4 Natality, mortality and migration

**B. Labour force statistics**

**a.** Basic Data

B:1 Economically Active population, by industry and educational attainment

B:2 Projections of the labour force

**b.** Supplementary Data

B:3 Economically Active population, by occupation, sex and age

**C. Economic and financial statistics**

**a.** Basic Data

C:1 Gross national product, indicies of economic growth

C:2 Total public expenditure, by authority and purpose

**D. Statistics on educational institutions**

**a.** Basic Data

D:1 Institutions by level and type of education

**b.** Supplementary Data

D:2 Institutions by regions

D:3 Number of schools of the first and second levels of education by number of grades, number of teachers and number of pupils enrolled.

[5] Extracted from document of same title by K.G. Brolin, Director, Office of Statistics, UNESCO Regional Office for Education in Asia, as No. A-6 Reproduction Series (Bangkok 1970)

**E. Teachers and other educational personnel**

**a.** Basic Data

E:1 Number of teachers by sex and age

E:2 Teachers by qualification and length of service

E: 3 Number of teachers lost to educational system each year, for various reasons

**b.** Supplementary Data

E:4 Teachers by subjects (or group of subjects)

E:5 Full-time and part-time teachers hours of teaching

E:6 Number of non—teaching staff, inspectors, administrative, health and other auxiliary personnel

**F. Classes**

**a.** Basic Data

F:1 Number of classes by grade

**b.** Supplementary Data

F:2 Number of classes by size

**G. Pupils**

**a.** Basic Data

G:1 Number of pupils by sex, age and grade

G:2 Pupils at the first and second levels of education leaving school each year

G:3 Pupils entering school each year

G:4 Pupils repeating grades each year

G:5 Pupils at second level of education by branch of study

G:6 Students at the third level of education by field of study, level and type of degree and diploma

G:7 First time students at the third level of education, by field of study.

**b.** Supplementary data

G:8 Number of pupils by regions

G:9 Pupils in non- co-educational schools

G:10 Full time and part- time pupils

G:11 Pupils by socio economic origin

G:12 Pupils by domicile

G:13 Future occupations of pupils

G:14 Average daily attendance of pupils at first and second level of education

G:15 Students abroad, by country, field and duration of study

**H. School building and equipment**

**a.** Basic Data

H:1 School buildings by type of construction, qualitative standards, and size

H:2 Classrooms and special rooms

H:3 School buildings, classrooms and special rooms completed each year, and their capital costs

**I. Educational testing and vocational guidance**

**a.** Basic Data

I:1 Evaluation of pupils achievement

**b.** Supplementary Data

I:2 Mental measurement of pupils

I:3 Measurement of pupils' aptitude and interests

**J. Health, feeding, transportation and lodging of pupils**

**a.** Basic Data

J:1 School health services

J:2 School feeding programmes

**b.** Supplementary Data

J:3 School transportation service

J:4 School lodging facilities

**K. Scholarships and fellowships, school fees**

**a.** Basic Data

K:1 Scholarships, fellowships, etc.

**b.** Supplementary Data

K:2 School fees

**L. Out-of-school education**

**a.** Basic Data

L:1 Facilities for out-of-school education, by type of organization

L:2 Staff engaged in out-of-school education, by sex and qualification

L:3 Persons availing themselves of facilities for out-of-school education, by sex, age and level of educational attainment

**M. Costs of education**

**a.** Basic Data

M:1 Recurring expenditure on education by public authorities

M:2 Capital expenditure on education

M:3 Loan repayment and interest charges, related to educational expenditure

**b.** Supplementary Data

M:4 Private expenditure for education

# Some Controversial Strands in the History of Monetary Theory: An Essay in Honour of Prof. M. Rashid

Pervez Tahir*

## 1. Introduction

Does money regulate economic activity or it merely and truly reflects economic activity? Attempts to answer this question have provided the main body of monetary theory since David Hume's exploration of the subject in 1752. This paper picks up some important stands of monetary theory to highlight controversies that have influenced the monetary dicourse till today. Section II focuses on the "Keynesian" theory. What comes out starkly from an historical view of the continuum of Keynes' works is that he was a monetary theorist, lock, stock and barrel. This Section attempts to do just that, on the basis of what Keynes himself had to say, and without any extra exegetical assistance. In Section III of the paper, the focus shifts to those who went the way of Keynes and refused, as Joan Robinson would say, to be bastardized – the so-called "Post-.Keynesian" monetary theory. Section IV discusses the "neo-classical" monetary theory and the neo-classical-Keynesian synthesis. At the end are presented some concluding observations.

## 2. "Keynesian" Theory

The problem that Keynes was trying to deal with "is closely analogous with the proposition which harmonizes the liberty, which every individual possesses, to change, whenever he chooses, the amount of money he holds, with the necessity for the total amount of money, which individual balances add upto, to be exactly equal to the amount of cash which the banking system has created. In this latter case the equality is brought about by the fact that the amount of money which people choose to hold is not independent of their incomes or the prices of the things (primarily securities), the purchase of which is the natural alternative to holding

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money. Thus incomes and such prices necessarily change until the aggregate of the amounts of money which individuals choose to hold at the new level of incomes and prices thus brought about has come to equality with the amount of money created by the banking system. *This, indeed is the fundamental proposition of monetary theory*" (Keynes, 1936, pp.84-5).

The above-quoted "fundamental proposition" of the *General Theory* was the culmination of Keynes' "long struggle of escape" (p. viii) which began with his first major book, *Indian Currency and Finance.* Essentially he was concerned with the problem Mill had dismissed casually, that money "only exerts a distinct and independent influence of its own when it gets out of order" (Mill 1923, Book III, pp.22-4). His worry had been that the out-of-order characteristic of money becomes the rule rather than the exception when it coexisted with *laissez-faire* and uncertainty. It is important to understand the underlying linkages here before we proceed any further. *Laissez-faire* choices are undertaken in the face of uncertainty, and uncertainty is caused by the existence of money. The result would be the failure of the system to coordinate, and the compulsive need for some sort of intervention. This is the recurrent theme in all of Keynes' works, though he could not get his act together until he wrote the *General Theory.* He shared the Freudian concern that the discontents generated by a system are incapable of resolution within that system. While Freud did not suggest any alternative experiments, Keynes was intent on precisely that. The question from the beginning to the fag end was the same: "Why should anyone outside a lunatic asylum wish to use money as a store of wealth?" (Keynes, 1937).

In *Indian currency and Finance,* he asserted that "the line between gold in hoards and in circulation is an indefinable one. . . . . There is, however, a clear line between meeting a definite demand for gold coins, which it would be unfair and impolitic to refuse, and encouraging a further demand for gold beyond what would exist otherwise". (Collected Writings, Vol. IX 1985, p.232). This barrenness of gold ultimately led him to the barrenness of money: "it is a recognized characteristic of money as a store of wealth that it is barren"( Keynes, 1937).

In *The End of Laissez-faire,* he described *laissez-faire* ideology as "vulgar economics", designed to "solve the contradiction between egoism and socialism which emerged out of the philosophising of the eighteenth century and the decay of revealed religion". The cure of the disease was "to be sought in the deliberate control of the currency and of credit by a central institution . . . . These measures would involve society in exercising directive intelligence through some appropriate organ of action over many of the inner intricacies of private business" (Collected Writings, Vol. IX, pp. 272. 277). These measures were needed because "the economic organisation by which Western Europe has lived for the last half century has sandy and false foundations". The system "depended for its growth on a double bluff or deception. On the one hand the labouring classes accepted from ignorance or powerlessness, or were compelled, persuaded, or cajoled by custom, convention, authority, and the well-established order of the society into accepting, a situation in which they called their own very little of the cake that they and nature and the capitalists were cooperating to produce. And on the other hand the capitalist classes were allowed to call the best part of the cake theirs and were theoretically free to consume it, on the tacit underlying condition that they consumed very little of it in practice".[1] However, the bluff was called by the World War I: "The war has disclosed the possibility of consumption to all and the vanity of abstinence to many. Thus the bluff is discovered; the labour classes may be no longer willing to forgo so largely, and the capitalist classes, no longer confident of the future, may seek to enjoy more fully their liberties of consumption so long as they last, and thus precipitate the hour of their confiscation".[2] For, as he put dialectically, "No order of society ever perishes save by its own hand."[3]

This was the time when Keynes was not only himself thinking about, but also looking around, for alternatives. He looked with appreciation at what was happening in Soviet Union: "Leninism is absolutely, defiantly non-supernatural, and its emotional and ethical essence centres about the individual's and community's attitude towards money . . . . (It) tries to construct a framework of society in which pecuniary motives as influencing action shall have a changed relative importance, in which social approbation will be differently distributed."[4] Not only that "Something – there is just a chance – might come out. And even a chance

[1] Collected Writings, Vol. II, Introduction to the 'Economic Consequences of the Peace.'
[2] Ibid., Vol. X, p.13
[3] Ibid., p.150
[4] Ibid., Vol. IX, p.259

gives to what is happening in Russia more importance than what is happening (let us say) in the United States of America."[5]

As early as in 1924, Keynes emphasized, in his obituary to Marshall, the attention he [Marshall] devoted to the "exposition of the Quantity Theory of Money as a part of the General Theory of Value".[6] This was the most important element in the "natural evolution in a line of thought "which would later dedichotomize the monetary and the real (Keynes, 1936).

Although a polemic, the *Tract* advanced Keynes further to the *General Theory.* His rewriting of the Marshallian quantity equation was his first theoretical attempt to integrate monetary theory and value theory. The substitution of "K" for the mechanical "V" brings into the picture demand as well, with the critical difference that "K" is not necessarily constant and the elasticity of demand of money with respect to income in real terms does not have to be unity. Another departure was from the old quantity theory belief that deflation was preferable to inflation. He wrote: "Thus inflation is unjust and deflation is inexpedient. Of the two perhaps deflation is, if we rule out exaggerated inflations such as that of Germany, the worse: because it is worse, in an impoverished world to provoke unemployment than to disappoint the *rentier.*"[7] Over the business cycle, changes in "K" are sufficient to get these effects without changes in the quantity of money – Here lies the embryo of liquidity preference. In policy terms, Keynes was significantly more interventionist than the traditional quantity theorist in advocating lower bank rate during depression and higher bank rate during inflation. In the long run he would concede money influenced only price level. But, "in the long-run we are all dead. Economists set themselves too easy a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again."[8] Once again we see Keynes concerned with the inability of the system to coordinate in the uncertain, short run of a monetary economy, save by policy intervention.

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[5] Ibid., p.270
[6] Ibid., Vol.X, p.191
[7] Ibid., Vol. IV, p.36
[8] Ibid., p.80

The *Treatise* has seen its oblivion and rehabilitation. Doubtless, it remains essential to the understanding of the evolution of Keynes' monetary thought. Indeed, it provides the "technical monetary detail [that] falls into the background" when, in the *General Theory,* "money enters into the economic scheme in an essential and peculiar manner".[9] There was a move away from, though not a total abandonment of the framework of, quantity theory to his peculiar income-expenditure construct. In the "fundamental equations", what is conspicuous by its absence is money supply as a direct determinant of price level. Money continues to matter, but the operation is indirect. The joint determinants of price level are the rate of increase in wages to increase in productivity -- cost inflation, and the inequality of saving and investment – demand inflation. The latter would become aggregate demand in the *General Theory.* Investment- saving inequality results from the definition of profits as normal remuneration leaving no motive for scale changes. Here Keynes remains in the Wicksellian and loanable-funds traditions, though the elements of a break are not indiscernible either. Price level changes, not because quantity of money changes, but because there may be a cost-push or demand-pull, requiring accommodating velocity adjustments -- an anathema to a quantity theorist. Saving moves the price level down. A decision to spend profits leads to more profits. The price level of new investment goods is determined by the state of excess bearishness of the public. This is yet another indication of the transition towards liquidity preference. The bank rate, which in The *Treatise* mainly controls rate of investment by affecting the cost of doing business, has the secondary effect of increasing saving in the loanable-funds framework, and the tertiary effect of removing monetary stringency for business investors. The resulting fall in interest rate might stop decline, but Keynes was skeptical about a pure monetary bail-out. In his own words: "We have not claimed that the banking system can produce any of these effects [i.e. investment] instantaneously; or that it can be expected always to foresee the operation of non- monetary factors in time."[10]

By the time the *Treatise* was published, Keynes, as is evident from the preface, had already moved ahead in terms of ideas. His rather suggestive talk on BBC in 1934, "Is the Economic System Self-Adjusting"? focused on "failure of the classical doctrine to develop a satisfactory theory of the

[9] Keynes 1936. p.vii
[10] Keynes 1930. Vol.II, p.346

rate of interest".[11] And the route towards the *General Theory* was by escaping what he described in the French edition's preface as the "confusions of the Quantity Theory, which once entangled me."[12]

In the *General Theory,* money matters because it is the most liquid of assets, due to zero elasticities of production and substitution. Also, it is a link between present and future enabling agents, faced with uncertainty, to postpone decisions to consume or invest. This results in higher liquidity preference and thus higher money interest rates relative to marginal efficiency of capital, a real concept. As opposed to the "classical" system, higher interest rates do not encourage saving and hence investment, but depress investment by creating a problem of finance. "Saving and investment are the determinates of the system, not determinants . . . . . income depends on investment, in such fashion that, when investment changes, income must necessarily change in just that degree which is necessary to make the change in saving equal to the change in investment".[13] Meade put the problem in these comprehensible terms: "Keynes' intellectual revolution was to shift economists from thinking normally in terms of a model of reality in which a dog called *savings* wagged his tail labeled *investment* to thinking in terms of a model in which a dog called *investment* wagged his tail *labelled* savings".[14]

The quantity of money is important as it impacts interest rate, not prices. In turn, interest rate affects the demand for finance for investment. In the case of unemployment, increased quantity of money, given the multiplier, will encourage activity and not price rises. As the full employment approaches, the effect of increased quantity of money will be reflected in increasing prices, though not proportionally. "Unemployment develops, that is to say, because people want the moon; - men cannot be employed when the object of desire (i.e. money) is something which cannot be produced and the demand for which cannot be readily choked off. There is no remedy but to persuade the public that green cheese is practically the same thing and to have a green cheese factory (*i.e.* a central bank) under public control."[15]

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[11] Collected Writings, Vol. XIII, p.489
[12] Ibid., Vol.VII, p.34
[13] Keynes 1936. pp.183-4
[14] Meade 1975. p.82
[15] Keynes 1936. p.235

In reality, the government would have to step in as Keynes had concluded from experience that the old Lady of Threadneedle Street invariably failed to oblige.[16] There is, at any rate, nothing in Keynes to suggest the theoretical irrelevance of monetary policy.

Could the system supply proper amount of money by wage-price deflation? Keynes agreed that flexible money and flexible wage policy were analytically the same thing, but he insisted that "the economic system cannot be made self-adjusting along these lines". He remarked that if labour could "reduce its money demands by concerted action to whatever point was required to make money so abundant relatively to the wage unit that the rate of interest would fall to a level compatible with full employment we should, in effect, have monetary management by the Trade Unions, aimed at full employment, instead of by the banking system".[17] However, "if the quantity of money is itself a function of the wage and price-level, there is, indeed, nothing to hope in this direction".[18] Indeed, the effect of fixing wages in terms of real wage goods will "only be to cause a violent oscillation of money-prices".[19] Leijonhufud, who incidently accused Kalecki of a lack of interest in monetary theory,[20] points out that "Keynes' implied conclusion is much the same as Kalecki's".[21] Kalecki (1944) had argued that the operation of Pigou effect was limited to assets without a debtor-creditor relationship.

The above is by no means to suggest that Keynes' conclusions depended on wage rigidity. As he maintained in no uncertain terms, it was a "simplification . . . . introduced solely to facilitate the exposition. The essential character of the argument is precisely the same whether or not money-wages, etc., are liable to change".[22] The chief import of his argument was that "if a sagging rate of interest has to be brought about by a sagging wage-level, there is . . . . a double drag on the marginal

[16] Harrod 1951. pp.467-73. Collected Works. Vol.II, pp.369-74
[17] Keynes 1936. p.267
[18] Ibid., p.266
[19] Ibid., p.239
[20] Leijonhufvud 1981. p.177
[21] Leijonhufvud 1968. p.320
[22] Keynes 1936. p.27

efficiency of capital and a double reason for putting off investment and thus postponing recovery".[23]

Nor did Keynes' conclusions depend on liquidity trap. It was merely a "limiting case", and he knew "of no example of it hitherto. Indeed, owing to the unwillingness of most monetary authorities to deal boldly in debts of long term, there has not been much opportunity for a test. Moreover, if such a situation were to arise, it would mean that the public authority itself could borrow through the banking system on an unlimited scale at a nominal rate of interest".[24]

To sum up: it is crystal-clear from Keynes' writings that his chief concern from the very beginning had been the self-maladjusting capability of the capitalist system, flowing mainly from the uncertainties occasioned by the existence of money. He agreed with Lenin that "there is no subtler, no surer means of overturning the existing basis of society than to debauch the currency".[25] His sympathy for "monetary cranks" like Gesell and others with labour-theory orientation is well-known. Little known is his consideration of the possibility of abolishing money altogether.[26] Finally, he was convinced that "we cannot get rid of money even by abolishing gold and silver and legal tender instruments. So long as there exists any durable asset, it is capable of possessing monetary attributes and, therefore, of giving rise to the characteristic problems of a monetary economy".[27] What are these characteristic problems? His statement ran like this: "If individual purchases of investments were rendered illiquid, this might seriously impede new investment, so long as *alternative ways* in which to hold his savings are available to the individual. This is the dilemma. So long as it is open to the individual to employ his wealth in hoarding or lending *money,* the alternative of purchasing actual capital assets cannot be rendered sufficiently attractive".[28] The decisions resulting from "animal spirits . . . . , and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities"[29] cause "fluctuations in

[23] Ibid., p.269
[24] Ibid., p.207
[25] Collected Writings. Vol.II, p.149
[26] Festschrift fur Arthur Spiethoff, 1933
[27] Keynes 1936. p.294
[28] Ibid., p.160
[29] Ibid., p.161

the market estimation of the marginal efficiency of various types of capital . . . . too great to be offset by any practicable changes in the rate of interest".[30] Keynes expected only state to be "in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of general social advantage".[31]

Keynes' emphasis on uncertainty and psychological money motives earned him the castigation of Karl Popper's bucket theory of science or mind – the decisiveness of perceptions as opposed to making an observation.[32] Keynes seems to have foreseen the objection when he asserted: "Economics is essentially a moral science and not a natural science . . . . it deals with introspection and with values. I might have added that it deals with motives, expectations, psychological uncertainties. One has to be constantly on guard against treating the material as constant and homogeneous. It is as though the fall of the apple to the ground depends on apple's motives on whether ground wanted the apple to fall, and on mistaken calculations on the part of the apple as to how far it was from the centre of the earth".[33]

A major problem with Keynes' theory is the failure to see that the state is not something apart from the other capitalist actors.[34] More important, despite the fact that his speculators pursue exchange-value rather than the neoclassical use-value, he could not see that the speculators are the product of the way surplus value is appropriated and distributed. No wonder he runs into theoretically awkward psychologisation and expectationism to explain speculative behaviour, rather than addressing first the motions of capitalist production.[35]

The above criticism need not detract from Keynes' contribution in restoring the centrality of money in the capitalist system, and thus bringing into sharp focus its crisis-prone nature.

[30] Ibid., p.164
[31] Ibid., p.167
[32] Frankel 1977. p.62
[33] Collected Writings, Vol. XIV, pp.297-300
[34] Sweezy 1960. p.108
[35] Foley 1978

## 3. "Post-Keynesian" Monetary Theory

There is no such thing as a "Post-Keynesian" monetary theory. And not for no reason. It is a theory about the way capitalism works – or fails to work, to be apt. Its grandparents are Ricardo, Marx and Keynes. These are strange bed-fellows at first sight. But not quite so, thanks to the parents – Sraffa, Kalecki and Joan Robinson, in that order.

Ricardo's concern with value and distribution is an overriding consideration with "Post-Keynesians". The Ricardian–"Post-Keynesian" link was established by Sraffa, who worked out a non-marginalist basis for value-distributive analysis. He showed how a predetermined wage or profit rate, and not demand, was necessary to determine relative prices.[36]

Marx enters the picture courtesy Kalecki. Marx employed Ricardian analysis for diametrically opposed conclusions. The conclusions would have surprised the rather unemotive Ricardo, who failed to understand how Malthus could accuse him of opposing landlords. The Ricardian story was interestingly naïve, allowing no possibility of crisis: "Each year the capitalist begins his operations, by having food and necessaries in his possession of the value of 13,000L., all of which he sells in the course of the year to his own workmen for that sum of money, and, during the same period, he pays them the like amount of money for wages; at the end of the year they replace in his possession food and necessaries of the value of 15,000L., 2000L. of which he consumes himself, or disposes of as may best suit his pleasure and gratification".[37] "This is", says Marx, "the childish babble of a Say, but it is not worthy of Ricardo". To Ricardo, money is just a means of circulation and exchange value a transient form in capitalist production, "which is consequently for him not a specific definite mode of production, but simply the mode of production".[38]

What is important from a monetary-theoretical standpoint, Ricardo failed to appreciate the fixity of capital, the existence of which can cause the Keynesian type crisis. Marx himself held somewhat contradictory views about crisis. The Keynesian-type crisis could arise due to the failure of

[36] Sraffa 1962
[37] Ricardo 1951. Sraffa edition, Vol.I, p.388
[38] Tucker 1978. p.447

surplus value to be realized, when the workers' desire to consume and the capitalists' desire to accumulate are eclipsed. Joan Robinson likens the situation to the failure of warranted growth in the sense of Harrod. A supply-side crisis may result in Marx's system from the checks on continued accumulation due to the depletion of reserve army of labour. But the crisis may be prevented by labour-saving devices or immigration. For our purposes, Marx's important contribution is the view that *money is capital:* "The capitalist's immediate object in selling, is to turn his commodity, or rather his commodity capital, back into *money capital*, and thereby to *realise* his profit. Consumption – revenue – is by no means the guiding motive in this process . . . . (in) capitalist production, in which revenue appears as the result and not as the determining purpose. Everyone *sells* first of all in order to sell, that is to say, in order to transform commodities into money".[39]

Kalecki's inspiration flowed directly from Marx. Unlike Keynes, he did not have a long struggle of escape from Marshall. Keynes recognized mass unemployment and "arbitrary and inequitable distribution of wealth and income as the two basic problems of capitalism. But he never dealt with the latter. Nor was growth his problem. Kalecki's contribution lies in these untrodden paths. He integrated the separation in Marx of the realization of surplus and accumulation to show that profits furnish not only the motive for investment but also the supportive finance and that growth depends on investment as well as the production of wage goods: "Workers spend what they get and capitalists get what they spend".[40]

Here was the opportunity to build a "Post-Keynesian" monetary theory. Tracy Mott exploited it to the fullest.[41] Based on the Kalecki's emphasis on the need to finance investment, the principle of increasing risk, the degree of monopoly, Kaldor's "Keynesian" distribution theory, reinterpretation of Keynes' liquidity preference theory and Harris' micro foundations, he constructed the following story: As fixed capacity is piled up, marginal risk increases due to increasing illiquidity and the danger of bankruptcy in an uncertain world. More so in case of borrowed funds as the variance of return on equity rises. More than the shortage of greencheese in general,

[39] Ibid., p. 446
[40] Kalecki 1968.
[41] Mott 1981.

investment is constrained by debt-equity ratios. Liquidity premia in short-term and long-term interest rates thus reflect current and expected profitability of investment, and liquidity preference is critically related to sunk capital. Since capital is nonmalleable, wearing out only in calendar time and embodying past errors, a sudden deficiency in demand only means one is stuck with it, financial capital being a distinctly different category. But the financial capital does represent claims against real capital. In the wake of falling demand for output, these claims fall in value, too. Long-term finance will become costlier than short-term finance, leading to a cyclical reinforcement by liquidity preference and interest rates of the already declining profits. Higher wages cause, not unemployment, but increased national income, as workers spend what they get. And rising income implies rising profits, ploughed back into achieving the desired level of real capital, for the capitalists get what they spend. The moral of the story is that external finance is also governed by the internal finance parameters and focusing interest rate policy on former will only display the oft-repeated ability of the Fed to misunderstand the underlying causation

We have not yet talked about the third grandparent of "Post-Keynesian" theory as such, although his name appears in practically every paragraph heretofore. The reason is that the first part of the paper is devoted exclusively to him. A few observations, however, will be in order here before we go over to the parent claiming his direct descendence – Joan Robinson. Keynes is an ideological odd-ball here. So is Ricardo. "Post-Keynesians" have made the best use of what Ricardo failed to understand and what Keynes fully understood, and in a Marxian perspective, although some are careful to point out that "Post-Keynesian economists generally avoid those aspects of Marxist theory which are either mataphysical or ideological".[42] Keynes would describe younger economists taking the Marxian road as "not properly brought up". He was also critical of Ricardo quite like Marx – full employment assumption, Says law and so on. But he found Ricardo offering "us the supreme intellectual achievement, unattainable by weaker spirits, of adopting a hypothetical world remote from experience as though it were the world of experience and then living in it consistently".[43] Pasinetti, it is interesting to note, discovers Ricardian

[42] Moore 1979.
[43] Keynes 1936. p.192

features in Keynes: the conception of economic system, broad categorisation of agents, search for determination of interest rate with distributional implication and ranking of capital assets like ranking of land.[44]

Keynes sharply distinguished between rate of profit and rate of interest. However, "where he allowed his mind to play upon long-term problems, his conceptions are . . . . obscure".[45] Similarly, Kalecki "shows the determination only of the flow of profit in national income; [he] does not discuss the formation of the rate of profit on capital. To define the rate of profit it is necessary to define the value of the stock of capital, and that no one seemed able to do".[46] So Joan Robinson set out to resolve the issue. She showed the illogicality of neoclassical capital theory by demonstrrating the possibility of same technique being most profitable at two different rates of profit.[47] The neoclassical theory was thrown into the dustbin, clearing the way for more meaningful theorising in the form of growth models, based on animal-spirited investment function, and concerned with the question of how the system reproduces itself, from here to eternity. Profits and wages are determined simultaneously with the rate of profit, rate of growth and capital-output ratio. The conclusion is the improbability of steady growth and high employment under capitalism, as it existed.[48]

The Cambridge growth models are summed up in the Pasinetti theorem: the equilibrium rate of profit in steady-state growth is unequally determined by the growth rate of the economy and the saving propensity of the capitalists, completely independent of the saving behaviour of workers and the underlying technology.[49]

What has all this got to do with monetary theory? Well, an early warning was given that we would be talking about the system, not money *per se.* It is not, however, impossible to make a monetary story. If expectations are not realised and more likely they are not in the "Post-Keynesian" world

[44] Pasinetti 1974. pp.42-3
[45] Robinson 1973. p.32
[46] Robinson 1978. p.16
[47] Harcourt 1972.
[48] Robinson 1969.
[49] Pasinetti 1974. pp. 121-44

where uncertainty is the rule rather than the exception, while Keynesian competitive producer will adjust output, the Post-Keynesian producer will combine mark-up pricing with output adjustment. In the process, quantity of money adjusts too, according to changing needs.

If that does not satisfy those looking for a tall, tellable tale of money, we still have in reserve the "Chapter 12 Post-Keynesians", found mostly on other side of the Atlantic. Money is their chief obsession. Keynes of Chapter 12 is *the* master, Marx is quoted rarely, if at all, and Ricardo is ignored due to competing claims on him by the monetarists. The first tenet is the jest that time was invented to prevent everything from happening at once.[50] It is historical and in-calender. Secondly, expectations are formed in an uncertain world. There is no such thing as certainty-equivalents of risk. Thirdly, institutions like money contracts, wage contracts, banks, markets exist and actively influence the course of economic events. Fourthly, the distribution of income and power is relevant. Finally, capital exists in financial and real forms, the latter not being malleable.

Under these Davidsonian[51] conditions, Minsky[52] tells the story. Capitalism has capitalist assets, privately owned. They, and their output, need to be priced and control over them has to be financed. Capital-asset owner earns profit not because it is productive, but because it is scarce. Output prices predominantly reflect wage cost and profit margins. Prices of capital assets reflect the capitalized value of current and future income from it. The comparison between the two furnishes the rationale for investment. Money is created in the process of financing this investment. Enters uncertainty. As debt exists, provision has to be made for meeting obligations. Demand for money results. Debts are used for financing capital assets or bonds. Higher quantity of money implies higher prices for these assets. The liquidity premium relevant here is on capital assets. Enter speculators. Financing of long-term assets is now possible through a process of short-term refinancing. Change in market interest rate can lead to the present value of cash flow from asset falling short of the present value of debt. Any attempt to sell now will cause a collapse of asset values. Investment falls and economy is in crisis.

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[50] Weintraub and Davidson 1978. p.151

[51] Davidson 1978. pp. 101-112

[52] Minsky 1975.

We have seen more stories than one. That is exactly how it is: there are as many stories as there are "Post-Keynesians". We selected only a few important ones. There are, however, a number of common undercurrents, namely, the endogneity of money – the quantity equation has to be read from the right side; wages and prices are not a monetary phenomena, but the outcome of bargaining and mark-ups; uncertainty; importance of finance and a real view of the real world.

"Post-Keynesians" claimed to have a solution for stagflation. But the stories outlined here don't even say how inflation starts. There is theoretical justification for an incomes policy, but how to work out a mix with fiscal policy is a question awaiting answer, considering that monetary policy effect on liquidity preference is unstable due to expectations. Finally, the empirical relevance of reswitching and Pasinetti theorem is questioned. The so-called models of real world contain, at best, "stylized facts", to use a Kaldor aphorism.

## 4. "Neoclassical" and "Neoclassical-Keynesian" Monetary Theory

To lay the blame where it belongs, this section of the essay could appropriately have been retitled as "The Monetary-Theoretical Obfuscations of a Nobel Laureate". For, these were John Hicks' two infamous "suggestions" that ultimately developed into what passes as monetary theory – neoclassical (N-theory) or neoclassical–Keynesian (NK-theory). His pre-*General Theory* suggestion to incorproate money into the utility function,[53] together with his general equilibrium infatuation, grew up in time to be the N-theory in the analytical hands of Patinkin. The post-*General Theory* suggestion[54] was ignored by his compatriots, but the American Keynesians seized upon it to perfect it into the NK-theory. True to his tradition, he first recanted and then relented in both cases when confronted with holes in his holiness. Patinkin's first edition was rebuffed as an attempt not "to elucidate the 'Keynesian Revolution', but to deny that it is a revolution at all"[55] Lator on, he admitted not having read Patinkin's

[53] Hicks 1935.
[54] Hicks 1937.
[55] Hicks 1957.

chapter XIII[56] About the IS-LM framework he claimed that Keynes had accepted his formulation, although Joan Robinson maintains the contrary.[57] Hicks, however, persisted in saying that his was "not a bad representation of Keynes".[58] Before long, Leijonhufvud and others "forcibly reminded that there is much more in Keynes that there is in formal theory; I fully agree".[59]

No wonder, the "Keynesian" view is unstable: money matters because it is demanded. Why that be so is an open-ended question, causing it to dissolve into the N-theory - a view that is embarrassing in its requirement to impose socially undesirable conditions to show long-run neutrality of money.

### 4.1 The N-Theory

Defining an N-theorist will be a waste of time, as time is the last thing he or she cares about. However, just as we can't define a camel, but we know one when we see one, an N-theorist rarely fails to be identified. For the purpose of the present paper, we can categorize as N-theorists all those owing allegiance to the quantity theory (paradigm?) – crude, Fisherine, Cambridge or even restated, grafting it to Walrasian general equilibrium, with the spectrum ranging from money-does-not-matter Walrasianism to money- matters-does-not- matter Patinkinism down to only-money-matters Friedmanism. The common thread, according to Joan Robinson is that all of them "apply the supply-and-demand tool to the analysis of purchasing power of money".[60]

The master, Walras, identified the problem to be dealt with, but was never able to solve it. Setting up his model basically for an exchange economy and then extending it to production and fixed capital, he maintained somewhat cavalierly: "There remains, then, only to find the price of circulating capital and to see what becomes of all the prices when the *numeraire* is also money. This is the object of the problem of circulation

[56] This is on the authority of late Prof. Nick Shrock. I have failed to find the appropriate reference.
[57] Robinson 1973. p.82
[58] Hicks 1967. p.7
[59] Hicks 1979. p.72
[60] Robinson 1933.

and money".[61] Assuming a static framework, given distribution and employing a concept of "desired cash balances", he hypothesizes that "circulating capital" renders a "service of availability" in money, supplied by capitalists and demanded partly by landowners, workers and capitalists as utility maximisers and partly by capitalists as producers. The current prices of these services are determined like all other prices – visa *tatonnement.* The price of money is the ratio of the price of service of availability to rate of income and thus an inverse function of quantity of money.[62] The equation of supply of and demand for money is derived from exchange equations, utility–max equations and from the equality between demand and supply of circulating capital goods.[63] His quantity theory was crude, but nearer to Cambridge cash balance approach than to Fisher's transactions approach.[64] Walras recognized the problem that with the price of *numeraire* being unity, a change in the price of a commodity which is money as well as *numeraire* will reflect, not the change in price of money, but of all prices. He attempts to solve the problem by assuming that money commodity is not *numeraire* and by examining the effects of the "cumulation of its two roles" in terms of some other commodity. This is where he runs into rectangular utilities.[65] *Numeraire* measures value, but the standard measure of value is a certain quantity of a given commodity and not the values of this quantity of the given commodity in real world, the *numeraire* is also medium of exchange. But the two roles are distinct even if embodied in the same commodity. Again, the use of a commodity as money affects its values as traders keep stocks of it for eventual exchange.[66]

Walras disagreed with Bohm Bawerk's interest theory, but offered a peanut theory as a replacement. To him interest is not the price of circulating capital in general, but the price of the service of those cash balances held in lieu of fixed capital. His long rate is not the rate equilibrating aggregate demand for cash balances with quantity of money, but one of the many rates used for adjustment purposes.

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[61] Walras 1954. p.42
[62] Ibid., pp. 42-3
[63] Ibid., p.38
[64] Marget 1931.
[65] Walras op.cit. pp.327-8, 333-7.
[66] Ibid., pp.188-91

Thus, the long-run Ricardian dichotomy and a short-run Throntonian monetary equilibrium existed side by side. Indeed, the dichotomy was more transparent in the case of interest theory. A short-run implication of quantity theory was that an increase in quantity of money will decrease interest rate and increase prices. But the evidence accumulated by Tooke showed that they varied in the same direction. This is what led Wicksell to remark: "If the Quantity Theory is false – or to the extent it is false – there is so far available only one false theory of money and no true theory".[67] To resolve the puzzle, Wicksell took the road leading to Keynes. He begins by looking at the consequences of a shift in investment, with banks altering loan operations at a time when market rate of interest falls behind natural rate of interest. In this situation, prices and interest rate rise and fall together, the very thing disallowed by the quantity theory by integrating the real and the monetary in interest rate, in which case the neutrality of money is in doubt. In his cumulative process, the failure of the market rate to adjust to natural rate would lead to inflation infinitely.

In contrast to the currency-school orientation of Wicksell was Fisher, who laid the blame at the door of rate of interest for its failure to adjust fast enough, but with the essential differences that the casual role was played by the monetary factors. and the villain in the piece was "transition". The question is: where on earth has ever existed a non-transition?

It was left to Patinkin[68] to pick up the pieces and to put them together in a coherent N-theory. According to Walras' equation of exchange, a rise in money supply leads to excess supply of cash balances and thus excess demand for goods which, in turn, forces equiproportionate rise in price level. The demand for money implied here is a rectangular hyperbola with constant real balances. At the same time, the homegneity postulate requires a neutral effect of doubling real balances. If Walras law holds; equilibrium in markets should ensure equilibrium in the n+1-th money market as well. But a quantity-theory story in money market generates no forces to restore equilibrium real balances through absolute price changes. The contradiction is the inevitable outcome of the invalid dichotomy, with absolute prices determined in the monetary sector and relative prices in the real sector. Says identity excludes disequilibrium in the real sector, and

[67] Wicksell 1936. p. 23
[68] Patinkin 1965. chap. VIII.

together with Walras law, also in money market. What it leads to is the contradiction resulting from the homogeneity postulate – the indeterminacy of absolute price level.

These contradictions are resolved once the real balance effect is introduced to furnish the equilibrating mechanism behind the quantity theory operation in the money market. The real balance effect is positive when nominal money stock changes, given the price level, and negative when price level changes, given the nominal money. For one thing, price level changes affect monetary as well as real factors and the classical dichotomy disappears. For another, money is neutral but not a veil. Given full employment, an increase in nominal money causes excess demand for goods through a positive real balance effect; prices rise; negative real balance effect comes into operation to ultimately restore original real balances. Also, Patinkin arrives at a less than unitary elasticity of demand for money by making demand for goods a function of real prices, real goods and real balances and the demand for real balances a function of price level. So the homogeneity postulate is done away with, if money stock does not change. Patinkin's achievement, in his own words, is that his approach "actually rigorizes and completes" the N-theory.[69]
Patinkin came under fire from Archibald and Lipsey for ignoring long-run. They also maintained that real balance effect did not exist in equilibrium.[70] The latter criticism was trivial as real balance effect has zero quantitative effect in equilibrium. Patinkin, however, recognized his long-run slip and went on to show that the real balance effect was relevant to the dynamic stability of both short-run and long-run equilibrium.

An unresolved issue is the nature of monetary assets through which real balance effect operates. The common argument is that its effect is restricted to Gurley–Shaw outside money. In case of inside money, demand deposits for instance, a fall in price level increases both real deposit holdings and real outstanding debt, leaving the real aggregate demand unchanged. Pesek and Saving[71] argue against, and in the opinion of Johnson[72] successfully if his refinements are accepted, the distinction

[69] Ibid., p.188
[70] Archibald and Lipsey 1958.
[71] Pesek and Saving 1967.
[72] Johnson 1969.

between inside and outside money. According to them, demand deposits increase net worth and, therefore, cause real balance effect. The medium of exchange function is crucial, being non interest-bearing, though Yeager[73] would view it as interest-neutral, making Friendman to suggest that the question remains empirically open. But the question is also theoretically open if we note Clower's objections to Patinkin's money buys goods and goods do not buy money approach.[74] In the real world, changing price expectations may also offset real balance effect. On the whole, a change in quantity of money has interest rate (Keynes effect), real balance and price expectations effects, impacting output and employment in the short run, but prices alone in the long run.

In sum, N-theory is an amalgam of a good many economic subcultures, the common thread being the explanation of the coordinating features of market processes in terms of plans and subjective evaluations carried out by individuals subject to constraints of technology, endowments and tastes. It is essentially a long-run theory, but recognizes short-run disequilibrium states. Money supply is exogenous and neutral in the long run, though not wholly in the short run: it is a passive technical device to carry out transactions efficiently. In this economic story, real balance effect becomes the *sine qua non* of monetary theory and Patinkin carries the day. It is a story of the believers, by the believers and for the believers.

### 4.2 The NK-Theory

As mentioned above, this story was also suggested by Hicks, taught by Hansen and Samuelson and practised by Heller *et al.* in the "We are all Keynesians" days. And when Leijonhufvud asked "Where are all the Keynesians now"?[75] there was none! Not even the bastardized. Such is, and will be, the inevitable fate of any synthesis, treating political economy "on the edge of history",[76] yet pretending to analyse capitalism – a stage in history, with tastes, preferences, social reality, of which money is a part, always conspiring to be pervasive rather than obliging to coordinate. Said the silver-haired woman from Cambridge: "It is only by interpreting

[73] Yeager 1968.
[74] Clower 1967.
[75] Leijonhufvud 1981. p.177
[76] Hicks 1979.

history, including the present in history, that economics can aspire to be a serious subject".[77]

The problem this theory was trying to deal with was to do away with "and" in the "Keynes and the Classics" debate. And how does it work outside the class room, where it was a tremendous success? Well, it doesn't unless there is a military-industrial complex to backup. Inside the class room, it is a hyphenated, four-letter world – IS-LM. The model is so general that any result is for the asking; all one needs is a super-ability to draw the relevant curves in a never, never equilibrium.

In the "normal" case, monetary disturbance affects the real variables and a real disturbance has monetary consequences. With moderate unemployment, an increase in money supply shifts LM to the right, with the shift indicating a loanable fund effect to lower interest rate and the movement along the IS an income effect. An increase in investment will shift IS to the right, raising income but at a higher interest rate. So everything matters, money not excepted. Now we can play many games depending on the interest elasticities of the two curves. If we travel horizontally on the lower left portion of LM, we are trapped in the extreme Keynesian case. Money does not matter. Zero interest elasticity of LM gives the neoclassical special case. Money matters, and if one is a monetarist and the economy is at full employment, only money matters.

The main theoretical thrust of the neoclassical part of the synthesis is the Pigou effect. The original Hicksian analysis had left out labour market and by assuming price rigidity, nominal income was used for liquidity preference analysis and real income for goods market. With the introduction of Pigou effect, it was maintained that unemployment equilibrium could not coexist with price and wage flexibility. A cut in money wages will reduce prices, increase real value of money, decrease the desire to save and the shift is to the full employment level. This suggests that the system is self- coordinating and the Keynes' conclusion depended on downward wage and price rigidity. Hicks, in the second edition[78] of his synthesis suggested that wages are flexible upward at full

[77] Robinson 1980.
[78] Hicks 1967, chapter 8.

employment level and downward at "full unemployment" level, making IS horizontal at both these levels. Within these limits, IS slopes negatively and wages are rigid in the short-run, with long-run full flexibility making the whole IS horizontal. Back, therefore, to the dichotomy story as interest rate is determined in the real sector. To complete the system, all one has to do is to introduce the Keynesian limit of liquidity trap and the neoclassical limit of perfectly interest-inelastic investment. Note that the warning this time is not that it is "a terribly rough and ready sort of-affair", but that when Keynes and the classics fail to synthesize, "the Keynes theory has the wider coverage".[79]

Of course Keynes theory has wider coverage, though not in the bastardized versions baptized by Hicks. What the N-K synthesis suggests is that Keynes theory was theoretic nonsense as unemployment and downward wage flexibility cannot coexist. As a matter of practical policy, however, Keynes' prescriptions could be used to speed up the otherwise slow, automatic coordination.[80] This is distortion par excellence. What Keynes argued was not that wages are rigid downwards for some institutional reasons, but that wage cuts would deteriorate a slump. The trouble lies with Hicksian investment rate of interest, ignoring the significance of irrational expectations. Investment is encouraged or discouraged relative to the state of these expectations. Falling wages induce falling prices and falling money values of assets shrink credit. Expectations are depressed and investment falls.[81] Interestingly, as Moggridge's note on Keynes letter to Hicks indicates, Keynes himself had objected to the treatment of expectations given by current income, ignoring uncertainty.[82] The money rate of interest indicated by LM is as un-Keynesian as the investment rate of interest. It preposterously suggests that finance is harder to get when activity is high than when it is low. The lesson of monetary history is that a fall in activity depresses expectations and causes high interest rates.[83] The Reagonomic period is a case in point.

[79] Ibid.
[80] Minsky 1975. pp.52-3
[81] Robinson 1973. pp.90-91
[82] Moggridge 1976. Appendix: Keynes' letter is reproduced in Hicks 1967.
[83] Robinson, op. cit., pp.83-85

Liquidity preference – the only non-Kaleckian component of Keynes system, has provided much food for thoughtlessness to many a Keynesian. In the IS-LM framework, liquidity preference is restricted to the choice between money and nonmoney assets. Hence the trap argument. Building on the endogeneity of Gurley-Shaw financial intermediation[84] and contending that the linkage between monetary and financial institutions as well as with real sector is not through money supply but through interest rate and yield structure and credit availability, Tobin rejects the perfect substitutability between money and nonmoney assets in favour of a broader portfolio of money, bonds and physical assets, governed essentially by a risk-return trade-off. Portfolio equilibrium is achieved by equating actual yield and supply price of capital.[85]

The portfolio view retains the anti-Keynes equilibrium flavour of IS-LM. At the root lies the so-called separation theorem, isolating productive optimum from utility preferences. The casualty is "movement and change and flux of real economic affairs".[86] Paul Davidson goes to the extent of saying that "Keynes would reject the implications of the portfolio-balance effect, namely, the notion that resource-using reproducible durables are good substitute for money as a component of ones' portfolio – for this violates one of the essential properties of money".[87] In an essential way, what liquidity preference explains is the term structure of interest rates. Depressed profit expectations and high risk, move investment from long end of the market to the short end. Underlying it is the unwillingness to lend long, not a desire to hoard. A long enough downturn leads to fall in long rates, too – where the recovery also begins. But to wait for this long run, and not to inject proper supply of money to ease debt burdens, is where the NK-theory missed the bus of *General Theory*.

What do we make of the unsinkable Friedman and his latter day currency school? The chief distinction between the N-school and the NK-school is that the former believe that the system coordinates and the latter fear it may not. In this sense Friedman is a neoclassic, but his precursor is not Wicksell, who had his doubts about short-run and was closer to Keynes,

[84] Gurley and Shaw 1956.
[85] Tobin 1958; 1963; 1969.
[86] Vickers 1978. p. 76
[87] Davidson 1977. p.292

but Fisher with the difference that transitions are transitions after all and, therefore, not important. He is not a Keynesian but, according to his own admission, is "more Keynesian than the *General Theory*".[88] Money wage is a by-product of Walrasian system, which yields a natural rate of unemployment. But the "natural" here is different from Wicksell's who failed "to distinguish between *nominal* interest rates and *real* interest rates". However, he is also a crypto-Keynesian in that his demand for money, the stability of which he replaces for the stability of velocity, is a plagiarisation of liquidity preference theory. With portfolio development of the Neoclassical-Keynesianism, Friedman turns out to be a special case with different magnitudes of interest elasticities. But these are short run aberrations, unfailingly aggravated by Keynesian policies. In the long run, he lives to see money supply assert itself distinctively. The quantity theory comes into its own, though Patinkin would dispute his claim to be the carrier of the oral tradition of Chicago.[89] All said and done, Friedman is a special case of Neoclassical-Keynesianism with some neoclassic "extras".

## 5. Concluding Remarks

The capitalist theory had been in trouble ever since it abandoned the great classical questions of value and distribution as a reaction to Marx. In Walras' words, "economists have been less concerned with establishing proofs for their arguments in favour of *laissez-faire, laissez-passer* than they have been with using them as weapons against socialists, new and old".[90] The neoclassical economists, Walras included, concerned themselves mainly with the long-run allocation of use-value, with money merely a *numeraire*. Thus, the social reality of exchange value was ignored. The later-day neoclassicists, such as Patinkin, attempted to de-basterdize the Walrasian system. What they forgot was that "these barter economies are in fact money economies, studied from a point of view which abstracts from the existence of money. It is not surprising that the project of reintroducing money into these models as a medium of exchange creates paradoxes".[91] One paradox is to assume velocity to adapt constantly without showing that pricing decisions are influenced by

[88] Gordon 1980. p.150
[89] Patinkin 1969.
[90] Walras 1954 p.254
[91] Foley 1978. p.52

existing quantity of money rather than costs.[92] The paradox afflicts monetarists more severely to require them to have money prices adjust to given quantity of money.[93]

Keynes' message about the centrality of money in the capitalistic system was lost in the jungle of Neoclassical-Keynesian exercises. Marx lived long enough to denounce Marxists. But Keynes died long before he could reject Keynesians, his polite protestations to Hicks notwithstanding. The reason again was the attempt to furnish a policy-mix, in the cold war era, for the triumph of capitalism over communism. By 1970s the US was facing the Marx's contradiction of purchasing power lagging behind capacity.[94] As the anti-Keynes role of money in the Neoclassical-Keynesian system disallowed the possibility of crisis, the whole theory came a cropper when the crisis did occur. The theory did "work" for sometime in the post-war era, but the reason was the military-industrial complex rather than any stability of the theoretical system. The theory was in quandry, but Fusfeld was expectant. "This is a great time to be studying economics, for the subject is in ferment at all levels".[95]

[92] Ibid., p.54
[93] Ibid., p.55
[94] Fusfeld 1982. pp.128.40
[95] Ibid., p.140

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## BOOK REVIEW

**Nina Gera** *Structural adjustment Programmes in Pakistan: A boon or a bane*? Lahore: Lahore School of Economics Press, 2007. Pages 169. Price not given.

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This book focuses on the influence of structural adjustment programmes on overall social welfare in Pakistan. It highlights the programmes of the IMF for Pakistan which called for a reduction in fiscal deficit, rationalization of tax structure, removal of subsidies on consumption and production. The author evaluates the adequacy of these programmes and their impact on employment, income distribution and poverty.

Divided into nine chapters, Chapter1 of the book establishes the hypotheses which are to be tested using Pakistan's time series data. The hypotheses are:

- Growth is enhanced by macro-economic stability under structural adjustment programmes.
- Enhanced growth has led to poverty reduction.

The international and Pakistan specific literature on structural adjustment is reviewed in Chapter 2 of the book. Controversial arguments are found here regarding the question of boon or a bane by different schools of thought.

Chapter 3 analyzes why the government of Pakistan had to seek IMF assistance. It raises important questions about structural adjustment programmes: Adjustment for what? By whom and how? etc. Then it presents the historical overview of structural programmes in Pakistan. The economic performance in different democratic and military regimes is discussed here. In the earlier phases of structural adjustment programmes, the economy's performance was fairly good for a while but with the passage of time the conditionalities increased and became harsher so the economy started presenting a gloomy picture gradually. Underlying causes of increase in poverty have been discussed which include elimination of subsidies under structural adjustment programme, slowdown of growth in GDP, fall in remittances and weak growth of human and physical capital. The flaw which is discussed here is that our successive governments have focused merely on macro-economic stability, ignoring that trickle down theory is not working to address acute poverty. In fact, Pakistan is referred to as a "development puzzle". Failures of adjustment programmes are also attributed to the persistent political instability prevailing in the country which may be the major hindrance in proper implementation of programmes.

Chapter 4 aims to provide the reader an overview of the impact of structural adjustment programme on overall social welfare in Pakistan. This chapter mainly focuses on the impact of such programmes on poverty and inequality in Pakistan over adjustment decade (1988-1999) through empirical analysis. It is argued that donors present conditions which are consistent with their ideological stance. The motive behind such programmes is also to restructure and minimize the role of government. The purpose described is that improvement in economic growth leads to enhance the income of the people and increase their ability to invest in health, education and other social sector activities. Moreover, government expenditures are affected by inefficiency and corruption. Pakistan is a signatory of the Millennium Development Goals (MDGs) and halving the poverty level is one of the major goals. But by taking an overview of the book it looks like a daunting task.

Chapter 5 presents the impacts of removal of subsidies on wheat and agricultural inputs under structural adjustment programmes. As a result the role of the government to provide food security for its citizens is restricted. The twin problem of food insecurity and poverty emerged since the early 1990's, but why the situation has worsened is discussed here. An attempt is made to find out the in-depth reality by focusing on prices, production and wheat polices, etc.

A case study of Punjab to analyze the outcomes of social sector expenditure on poverty levels and economic indicators is discussed in Chapter 6. Province-wise poverty trends have been presented. Comparison of poverty in Punjab with overall poverty in Pakistan has been undertaken here. The Punjab is divided into three regions, Northern Punjab, Central Punjab, Southern Punjab and incidence of poverty is compared among them. Then the extent to which 'social gap' has contributed to low growth is examined. Non-income measures like education, literacy level, access to safe water are discussed. Different suggestions are presented to improve the social indicators as without it all the claims about high growth rates will prove meaningless.

In chapter 7, Nina Gera explores the reasons of increase in poverty by structural adjustment programmes. Social and economic determinants of poverty are discussed. Political stability is needed for the creation of a favourable environment where prosperity will flourish and poverty will diminish. Lack of transparency in public sector planning, allocation of resources, and pattern of institutions etc create hindrances in the uplift of the individuals who do not have elite backgrounds. So poor remain poor. This chapter provides an account of the large social cost of adjustment and the author comments that such costs are due to improper planning and market oriented ideology of the policy makers.

Chapter 8 is divided into four parts. Poverty trends related to structural adjustment programmes regimes are evaluated in the first part. In the second part, available analysis of causality is assessed. The third part uses the PIHS (Pakistan Integrated Household Survey) of 2001-02 to analyze the determinants of poverty, and summary and recommendations are given at the end. Different variables, like age of the head of the household, levels of education, levels of skills, employment standards and in-house basic facilities are used; their impact on poverty is tested. Positive recommendations to overcome the problems are given, but in Pakistan's perspective, it is a Herculean task and requires persistent efforts.

The last chapter evaluates the structural adjustments programmes in the light of the facts discussed in the book and the impact of these programmes on changing the lives of the people of the developing countries especially Pakistan. The author recommends a number of policy measures to be adopted for improving the situation. Conceptually, the IMF and the World Bank are trying to contribute in reducing poverty but operationally their assistance marginalizes. So the Government needs to intervene more effectively. This will be far more effective in improving the dismal situation than all structural adjustment programmes put together. The author has suggested that a set of carefully designed targeted safety nets and programmes are needed to protect the vulnerable segments of the society against unforeseen circumstances. These enable the poor to better manage the risk and protect them against short term stress to take them out from long term disability by providing employment opportunities and better incomes.

The author's main finding is that macro stability, no doubt, is correlated with growth but poverty reduction and favourable social sector outcomes cannot be guaranteed. The book analyses the issues in the context of political scenario prevailing in Pakistan since 1980 and also presents a detailed examination of poverty trends in the country. The author highlights that structural adjustment regime based on IMF conditionality was initially triggered by the debt crises of the 1980's. Fiscal and payments deficits and inflation were also responsible for the introduction of structural adjustment programmes. Although our government has claimed the trickle down effect of growth to the poor but the reality is that stabilization programmes turned a blind eye to the poverty issue.

The endeavours of the writer are commendable which suggest that dancing around the fire is not the solution to any problem, rather one needs deep insight of the picture in order to grasp the facts. Adjustment lending by external donors has had little causal effect on Pakistan's macro-economic performance. The author pinpoints the fact that the enforcement of such programmes by the industrialized countries in the developing nations is, in fact, in the interest of their own countries and related to their ideological stance.

This book is a valuable addition in filling some gaps in research. It would be beneficial for the policy makers who are setting targets to achieve the Millennium Development Goals. It offers fresh insights into the programmes being followed by developing countries and their impact on overall welfare. It tries to explain why Government has succeeded in performing some ambitious goals like macroeconomic stability while at the same time failing to implement policies in favour of the poor. It is successful in its endeavour of giving the reader a comprehensive picture of the state of structural adjustment programmes which are being followed in Pakistan. The book contains both theoretical material and detailed empirical analysis in order to observe the impact of structural adjustment Programmes and hence an interesting reading for wider public, students and researchers.

At places, however, the author seems to be countering ideological arguments with her own ideological predisposition. The strength of the overall message of the book, however, remains unaffected.

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