Aid and Governance in Vulnerable States: Bangladesh and Pakistan since 1971

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Abstract

Bangladesh and Pakistan had very different experiences with aid after 1971. Politics in Pakistan was less inclusive in terms of opportunities for intermediate (middle- and lower-middle-) class political entrepreneurs, and the dominance of military aid to Pakistan exacerbated the problem by allowing the top leadership to continue to rule without sharing much power with these classes. This not only had negative effects on the evolution of Pakistan's politics but also slowed down the growth of a broad-based manufacturing sector. In contrast, in Bangladesh the less centralized organization of political power and less concentrated forms of aid allowed intermediate class political entrepreneurs to improve their access to resources and created opportunities for many of them to enter productive manufacturing activities like the garments industry. Neither country has moved toward good governance, nevertheless differences in patterns of aid can help explain significant differences in economic and political outcomes in the two countries. These experiences challenge conventional ideas about the relationship between aid, good governance, and security. Designing aid policies better so that aid can assist developing countries to improve their economic and political viability therefore requires a better understanding of the complex relationships between aid and the political economies of recipient countries.

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

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The different experiences of Bangladesh and Pakistan since 1971 are relevant for understanding how aid can affect governance in vulnerable recipient countries where states face serious economic and political challenges. Aid does affect the development prospects of such countries but in more complex ways than is often assumed. The cases of Bangladesh and Pakistan challenge the idea that aid can be used to achieve what is described as "good governance." However, the interaction between types of aid and preexisting political and governance structures can result in positive or negative outcomes for economic development and political stability. It is interesting to compare Bangladesh and Pakistan because they were the same country until 1971 when a civil war, followed by a war of independence, led to the emergence of Bangladesh. Bangladesh was poorer and less developed, and was famously written off by Henry Kissinger as a "basket case" dependent on aid. Both countries had vulnerable democracies after 1971, with interludes of military governments. Both received roughly 50 billion dollars of foreign aid in nominal terms in the 40 years following 1971. While both remain poor and vulnerable to internal conflicts, Bangladesh has arguably made greater progress given its starting point, while Pakistan has become more fragile. Pakistan's per capita GDP was higher in 1971 and remained so in 2011, but economic growth has been faster in Bangladesh since the 1990s and the gap in per capita GDP between the two countries has narrowed significantly. Bangladesh has also done better in terms of a number of social indicators with more rapid progress in areas such as infant mortality. Its manufacturing sector has grown more rapidly, creating jobs for millions in the garments industry, while industrial growth in Pakistan has languished. The most striking difference is that despite intense internal conflicts in its early years, Bangladesh has moved toward somewhat lower levels of internal violence and greater political stability (though progress remains vulnerable to reverses) while Pakistan appears to have moved in the opposite direction.

Aid is clearly just one factor among many that may explain the divergent trajectories of the two countries. Despite the common elements in their histories, there are important differences. Bangladesh is a more homogenous country and the war of independence mobilized many people, particularly in the "intermediate" (middle- and lower-middle-) classes, to expect greater participation and progress. Many of these expectations were not realized and indeed created much turbulence in the years after independence. But the less centralized organization of political power in Bangladesh allowed many more individuals from the intermediate classes to enter politics and capture legal and illegal income flows or "rents." This process involved ambitious individuals acting as 'political entrepreneurs' and organizing their supporters to put pressure on higher level politicians to allow or enable their group to capture rents. This type of patron-client politics has social costs in terms of resource diversion and political corruption but it can in some contexts also have a social benefit in stabilizing the polity by creating opportunities for ambitious and potentially disruptive groups to incrementally acquire political power and resources (Khan 2010, 2012a). In Pakistan too there was a political opening under Zulfiqar Ali Bhutto in the early 1970s, but this was largely driven from above and many of the old elites continued to dominate the political process. In Pakistan, intermediate class political organizers did not have the organizational power to challenge the resource allocation decisions of higher elites to anything like the same extent. But emerging patterns of aid to Pakistan also helped higher elites to further consolidate their position. The failure of the Pakistani political system to rapidly absorb intermediate class political organizers was further exacerbated by the eventual loss of legitimacy suffered by Pakistan's ruling elites as a result of their later support for U.S. interventions in the region. This combination of factors was to have dire consequences for the internal stability of Pakistan. Aid played a role in this because Pakistan's position as a frontline state for the U.S. meant that security and military aid were much more important here than in Bangladesh. An important characteristic of security-related aid is that it is controlled by a limited number of state and political leaders. Leaders can gain control of enough resources to try and stay in power by buying support from poorer social groups while repressing the ambitions of other intermediate class political entrepreneurs. As a political strategy this may work for a while but is unlikely to be viable in the long run as resentment is likely to grow within the excluded intermediate classes. Finally, security-related aid is volatile and flows can also change dramatically with changes in the strategic perceptions of donors.

Particularly unfortunate for Pakistan was the fact that two periods of military rule in the 1980s and 2000s coincided with periods when the United States pumped military and security aid into Pakistan to buy its support in regional conflicts. The combination of military governments with large flows of security-related aid to the top leadership blocked the evolution and incorporation of political organizations led by the intermediate classes, with significantly adverse effects on the economic and political dynamics of the country. In contrast, in Bangladesh, the allocation of mainly civilian aid could not be tightly controlled by a few individuals. To stay in power, the political leadership had to continuously incorporate new political entrepreneurs from the intermediate classes, allowing them to progressively enter the ranks of the political elites. In addition, because they did not control much aid on their own, ruling elites had greater compulsions to support the development of productive capacity to accommodate their clients and to generate resources for themselves. Political regimes in Bangladesh therefore actively supported industrialization to a much greater extent in their own self-interest. Differences in the composition and types of aid to the two countries thus reinforced pre-existing differences in their social organization.

The effective exclusion of much of the intermediate classes from access to political resources, or rents, was an important contributory factor behind the growing political violence in Pakistan, particularly in the 2000s. Radical and extremist political entrepreneurs gradually found space to operate in this context of social discontent and poor economic performance, paradoxically making it easier for state elites to argue for even more security-related aid. In contrast in Bangladesh, while the political competition between opposing parties was intense and often violent, excluded political entrepreneurs could expect to gain access to rents through ‘normal’ competitive political processes if they were sufficiently successful as organizers. Ruling elites did not control enough resources to try and stay in power by using repression or trying to exclude new political aspirants. As a result, even though the competition between political factions and parties often ended in violent confrontations, political organizations in Bangladesh were not trying to violently overthrow the state or the political system as a whole.

This analytical narrative of aid and its development impact challenges two conventional views about the relationship among aid, governance, and development. The first is that in developing countries, such as Bangladesh, that score poorly on “good governance,” aid should be used to strengthen progress toward “good governance” (Hermes and Lensink 2001). The experience of Bangladesh suggests that progress on good governance can be slow and development has to be achieved with limited prior improvements in good governance. In these contexts, political stability often depends on an appropriate allocation of rents to powerful political organizations, and economic development depends on support for firms and sectors to allow and to compel them to develop their competitiveness. Aid to Bangladesh was relatively more developmental because it supported some of these processes; the challenge is to move ahead with incremental institutional and policy changes that can sustain and deepen this progress

A second consensus view is that aid to countries, such as Pakistan, that suffer from more severe security challenges should support improvements in security in addition to good governance (World Bank 2011). The experience of Pakistan challenges this view because increased security-related aid was associated with a steep decline in the legitimacy of the state and an increase in violence. The achievement of political stability requires a distribution of resources across competing political groups commensurate with their organizational power. Violence can break out when the ruling coalition does not recognize the organizational capabilities of some groups and refuses to give them commensurate access to rents. The problem of violence in these contexts cannot be solved (as the consensus view argues) by combining the delivery of public goods to "citizens" with greater security expenditures. States cannot buy off powerfully organized discontent in this way. If external security support is provided to a government that faces violent opposition because it has not achieved an acceptable distribution of rents, it is likely to use more force to sustain exclusion rather than use the opportunity to renegotiate a more stabilizing distribution of rents. In Pakistan the legitimacy problem was compounded because the ruling coalition was getting security aid in exchange for supporting the U.S. war in Afghanistan, which was perceived by many Pakistanis to be illegitimate.

The first section of this article outlines the analytical framework describing how economic development and political stability are related to the competition over economic and political rents. The second section provides an overview of aid to the two countries. The third section evaluates the likely effects of aid on the two countries using our analytical framework, and the fourth section offers some concluding thoughts.

Governance, institutions, and development

I analyze the effects of aid on governance using the language of rents and rent-seeking. State policies and interventions create rents, which are incremental incomes that would not exist in the absence of particular policies or interventions. Rents can have a legal or illegal origin (taxes or aid versus expropriation) and they can be allocated in legal or extra-legal ways (subsidies and protection versus illegal allocations of public contracts or allowing corruption by political supporters). Politics involves organizations mobilizing with the purpose of maintaining or changing the allocation of rents. Their activities, both legal and illegal, can be broadly described as "rent-seeking," as they seek to preserve or change the allocation of rents. In advanced countries, politics is based on largely legal processes of rent-seeking, and political activities are legally financed by social interests. The aim of politics is to change legal rents through changes in taxes, subsidies, and regulations.

In developing countries a much larger part of the rent-seeking is funded by money from gray sources, partly because formally organized social interests cannot fully finance politics. In addition, more of the rents are created and allocated in extra-legal ways as the legal fiscal and regulatory capacities of the state are limited. Powerful political organizers and constituencies typically capture off-budget or illegal rents (Khan 2005; North et al. 2007, 2013). There are, therefore, some structural reasons why developing countries generally do not display characteristics of "good governance," defined as governance according to the rule of law, the protection of property rights, and low corruption. However, while no developing country scores well on good governance, there are significant differences in the organization of politics that can make a big difference to development outcomes. Aid in these contexts is important because it can change the supply of rents, the ways in which these rents are allocated, and the strategies of different political players.

Two broad propositions structure our discussion. The first is that a gradual incorporation of politically organized groups into legitimate (though not necessarily legal) processes of political accumulation is a precondition for maintaining social and political stability in developing countries. Political organizations can use a variety of ideological claims to define themselves. Nevertheless, at the heart of most conflicts that are ostensibly ethnic, religious, regional, or ideological there is often a dissatisfied but effective group of organizers that feel their access to rents is less than is warranted by their organizational strength. A country that is on a steady growth path and where the structure of political competition allows the gradual inclusion of new groups is likely to have systemic stability even if its politics appears to be disorderly. On the other hand, a country where the ruling coalition uses an aggressive strategy of suppressing new organizers and buying out some of their supporters from above may appear to be more stable but may build up explosive pressures. This is even more likely to be the case if economic growth is low, limiting the resources that are available for redistribution over time.

Developing countries are therefore more likely to be stable when excluded groups perceive a good chance of gaining access to rents commensurate with their organizational power. Organizational power can be demonstrated in ways that are relatively peaceful, such as public demonstrations or electoral conflicts. But if these types of competition are suppressed or if legal demonstrations of effective power fail to be accommodated, more disruptive or violent conflicts can break out. This can escalate into conflicts that can last a long time until the distribution of rents comes into line with perceptions of the distribution of power that all parties accept as realistic. Societies where challenges to the distribution of rents are incremental and new groups entering the political fray are similar to the ones that are already beneficiaries are more likely to make incremental compromises. However, if many groups are excluded for a long time, their mobilization can result in significant violence because substantial changes in the distribution of rents become necessary. In these contexts a long period of intense conflict can follow and excluded groups may mobilize for overthrowing the political system in its entirety (Khan 2010). This is why democratic processes that appear to be equally messy can be associated with stability in some developing countries and sudden escalations of instability in others.

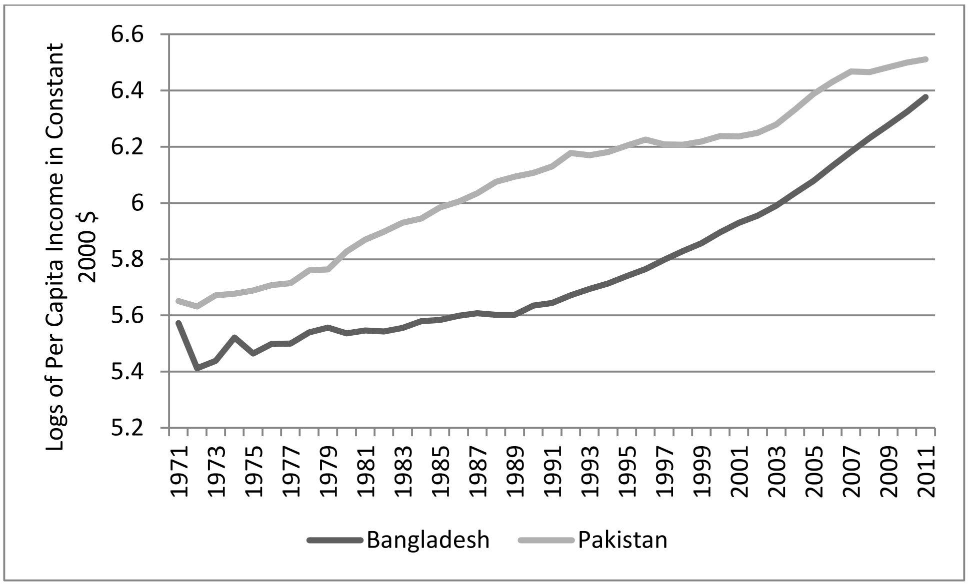
A second and related proposition is that political rent allocation processes should be consistent with (or at least should not block) rent allocation to emerging productive sectors to develop their competitiveness in a global economy. Rents are often required for economic development to help overcome market failures. Business-government links may be necessary for protecting property rights and getting access to resources in contexts where the formal rule of law, the protection of property rights, and the formal policy framework are weak. Support may also be essential for developing technical and organizational capabilities necessary for competitiveness. Many firms in developing countries are not competitive because they lack organizational capabilities. Rents that can be managed with appropriate conditions can be very important for supporting the development of competitive capabilities (Khan 2012b; Rodrik 2007, 99–152). However, business-government links can also end up protecting inefficiency and in these cases the result could be economic stagnation and even decline.

Given these structural features of developing countries, it is misleading to try to identify the content of what is retrogressive or developmental by using the benchmark of "good governance" defined by the protection of property rights, the enforcement of a rule of law, low corruption, and a government that is accountable. These conditions are likely to be absent in developing countries regardless of their developmental success. Rule-following societies with "Weberian" states generally emerge when there are many economic organizations that are productive enough to be profitable in rule-following ways and profitable enough to collectively pay for the enforcement of these rules. Politics becomes rule-following when contributions from legal organizations provide enough resources to pay for political activity and formal taxation provides enough resources for parties to win elections on the basis of their manifestos. These conditions are typically not met in developing countries. Developmental success requires governance arrangements that can achieve political stability and growth in these adverse contexts (Khan 2000b, 2000a, 2004, 2012b). With sustained developmental success, improvements in good governance may be achieved over a longer term. This is not assured, but if development with acceptable levels of stability is not sustained, moves toward good governance are very unlikely. Since aid is a source of rents, the effects of aid on governance have to be understood in the context of the interaction of structures of aid with these ongoing processes of rent allocation.

Aid to Bangladesh and Pakistan: historical trends

Figure 1shows the relative performance of the two countries in terms of per capita incomes. The gap in their incomes widened until the 1980s but then began to rapidly narrow as growth accelerated in Bangladesh and decelerated in Pakistan.

FIGURE 1 Trends in Per Capita Incomes: Bangladesh and Pakistan



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

Table 1 and Table 2 show that in nominal terms aid to Bangladesh roughly doubled between the 1970s and the 2000s while in Pakistan it more than tripled. However, since both countries' populations roughly doubled over this period, per capita aid to Bangladesh remained virtually constant in nominal terms over the period, while it increased by a third in Pakistan. In real terms, per capita aid declined to a third of its initial level in Bangladesh and to half in Pakistan. While the decline in real aid per capita was less steep in Pakistan, its economic growth and political stability fared worse.

TABLE 1 Trends in Total Official Development Assistance (ODA) to Bangladesh

	Average Annual ODA Current Dollars (million)	Aid Per Capita in Current Dollars	Average Annual ODA Constant 2011 Dollars (million)	Aid Per Capita in Constant 2011 Dollars
1971-80	699.0	9.90	2422.2	34.32
1981-90	1452.0	15.73	3182.8	34.49
1991-00	1390.2	11.83	2101.5	17.89
2000-10	1352.5	9.62	1643.5	11.69

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

TABLE 2 Trends in Total ODA to Pakistan

	Average Annual ODA Current Dollars (million)	Aid Per Capita in Current Dollars	Average Annual ODA Constant 2011 Dollars (million)	Aid Per Capita in Constant 2011 Dollars
1961-70	413.1	7.95	2719.3	52.30
1971-80	640.1	9.35	2348.1	34.29
1981-90	957.5	10.03	2068.5	21.67
1991-00	1037.2	8.14	1508.2	11.84
2000-10	1995.7	12.58	2400.8	15.13

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

Bangladesh was a war-ravaged country in 1971 and in the early years more than 70 percent of its aid was food and commodity aid. By the 2000s these had declined to 6 percent, with project aid increasing to 94 percent (Government of Bangladesh 2011, Tables 1 and 2). However, aid continued to finance almost half of public investment. The Annual Development Program or ADP financed public infrastructure and developmental projects. In the early years, aid disbursements covered all of the ADP and by 2000 it still accounted for 46.8 percent (Sobhan 1990; Obaydullah 2007, 181). Over time the share of grants declined and the share of concessional loans increased from less than half in the 1970s to almost 70 percent of total aid by the 2000s (Government of Bangladesh 2011, Table 3).

The sources of aid to Bangladesh from 1971 to 2010 were quite different from Pakistan. Multilateral loans from the World Bank, the Asian Development Bank, and the Islamic Development Bank accounted for around 40 percent of aid to Bangladesh. Of the bilateral donors, Japan was initially the biggest, accounting for 13.4 percent of the total. The United States followed with less than 7 percent over this period as a whole. The share of aid from the United States declined over time and in the 2000s accounted for less than 2 percent of total aid to Bangladesh (Government of Bangladesh 2011, Table 4). The UK became the biggest bilateral donor in 2004, followed by Japan. In contrast, U.S. aid played a much more important role in Pakistan.

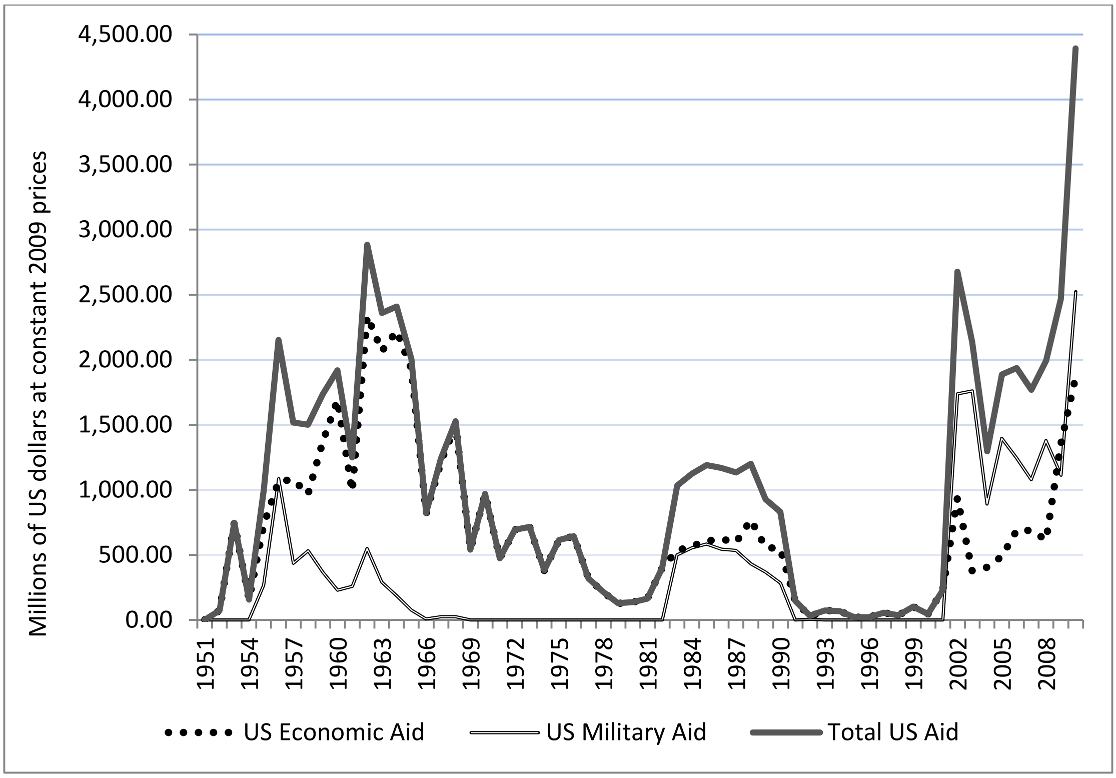
The institutional weaknesses of the Bangladeshi state in the 1970s were somewhat offset by the emergence of nongovernmental organizations (NGOs). They were promoted by donors not only because of their efficiency in some types of aid delivery but also because it was claimed they represented and empowered the poor (White 1999). These strategies were consistent with the ideological preference for liberalization and against state provision in the 1980s. Some Bangladeshi NGOs such as BRAC (formerly the Bangladesh Rural Advancement Committee) did indeed achieve good results in aid delivery, particularly to women and in remote areas. The share of aid channeled through NGOs has continued to grow. In 1990–91, 10.5 percent of total aid went through NGOs, and this grew to around 30 percent of the total by 2005 (World Bank 2006, Table 3.1). However, doubts were expressed from the outset about the NGO model of aid delivery. Such doubts included concern about the extent to which NGOs actually represented the poor (Stiles 2002; White 1999; World Bank 2006). Nevertheless, NGOs ensured that a significant chunk of aid was allocated by organizations led by the broader intermediate classes. Comparable figures for the share of aid going through Pakistani NGOs are not easily available. This is partly because of Pakistan's federal structure and partly because data from many donors are not easily available. The share of aid going through all NGOs may be comparable to Bangladesh, but there are few large Pakistani NGOs such as BRAC, ASA, or the Grameen Bank in Bangladesh (which is a bank with many characteristics of an NGO). Pakistani NGOs are relatively small and much of USAID spending in Pakistan in the 2000s, for instance, was routed through international (primarily U.S.) NGOs (Cheema 2009).

In the 1990s aid conditions changed further with the emergence of the "good governance" consensus (Khan 2004, 2007; Hermes and Lensink 2001). Achieving improvements in "good governance" become an important aim of World Bank lending to Bangladesh, and other multilateral and bilateral donors began to follow this lead (Parnini 2009). From 2003 on, Bangladesh was encouraged to claim "ownership" of good governance priorities in the Poverty Reduction Strategy Papers, which provided a framework for coordinating aid (Government of Bangladesh 2005, 2009, 2003). The swing in the donor consensus was very similar in Pakistan with a focus on good governance and economic liberalization, and a similar focus on the Poverty Reduction Strategy Papers (Anwar 2002; Government of Pakistan 2003, 2010).

Bangladesh's growth accelerated in the 1980s and further in the 1990s, but not because it made any progress in terms of indicators of good governance. Indeed on some of these indicators it actually retrogressed, leading the World Bank to describe Bangladesh as a "paradox" and a "conundrum" (World Bank 2007). In contrast, Pakistan's growth decelerated in the 1990s, with a particularly disappointing performance in its industrial sector. While it is hard to argue that aid had positive effects in Pakistan, much of the economic evaluation of aid in Bangladesh also concludes that aid had limited or negative effects on long-term growth. Razzaque and Ahmed (2000) argue on the basis of an econometric study that aid had a negative long-term effect on domestic savings in Bangladesh between 1973 and 1998. Quazi (2005) argues that the effect of aid on growth was marginal over 1973–99 because the positive effect of loans (which typically finance investment) was diluted by the consumption-enhancing effects of grants. Islam (1992) argues that over 1972–88 foreign resources made no significant contribution to growth but loans were more effective than grants.

This implicit conclusion that Bangladesh may have done just as well or even better without aid is not plausible for a number of reasons. First, relationships that hold for small variations in aid may not hold for big changes. If the econometric evidence suggests that a 5 percent fall in aid is offset by an x percent rise in domestic savings (where x may even be more than five) it does not follow that a 100 percent fall in aid would be offset by a 20x percent rise in domestic savings. Such significant offsetting effects are likely to require major institutional changes. A serious disruption of aid would indeed create a challenge but the outcomes of shocks are unpredictable and may well result in responses that are damaging rather than supportive of developmental outcomes. Second, the econometric identification of the effect of aid works by testing a fixed structure of lagged effects in time series data. This approach may fail to identify the contribution of aid if effects have a changing magnitude and lag over time, which is plausible because the types of aid and other policies have been changing. It may be more useful to analytically examine plausible political economy links among aid, governance, and economic performance that may not be testable using econometric approaches but may be suggestive enough to support deeper empirical investigation.

FIGURE 2 U.S. Economic and Military Aid to Pakistan 1950–2010



Source: Based on data in Elhai (2011)

The configuration of aid flows to Pakistan displays some significant differences compared to Bangladesh. Three critical characteristics stand out in the data. First, aid from the United States has been a significant part of the overall aid received by Pakistan. From 1971 to 2010, the share of U.S. aid to Pakistan was on average around 20 percent of total aid. At its high point in the 1960s the share of U.S. aid was almost 70 percent of the total and in the 2000s it was around 23 percent (OECD 2013) This compares with less than 7 percent of aid to Bangladesh coming from the United States over 1971–2010. Second, the total volume of U.S. economic aid to Pakistan has been strongly correlated with the volume of U.S. military aid. This can be seen in the data collated by Elhai (2011) and summarized in Figure 2. In contrast, U.S. military aid to Bangladesh has been negligible, reflecting the very different strategic significance of the country for the United States.

Finally, and most importantly, military aid to Pakistan fluctuated enormously with changing U.S. regional strategies, with implications for overall aid flows to the country, as can be seen in Figure 2. The first sudden cutback happened when military aid was terminated after Pakistan went to war with India in 1965. U.S. military aid to Pakistan remained negligible throughout the 1970s. Economic aid also declined and kept falling after the 1971 war with India that resulted in the birth of Bangladesh. In the early 1970s the Socialist regime of Bhutto with its policies of nationalization attracted little economic assistance from the United States. In 1977 General Zia-ul-Haq overthrew Bhutto in a military coup and executed him in 1979. In one of the unfortunate coincidences of history, Zia's coup happened at exactly the time that the Soviets invaded Afghanistan in 1979 and U.S. aid policies dramatically changed as Pakistan became a frontline state in the Afghan war.

U.S. military and economic aid to Pakistan shot up in the 1980s while Pakistan was playing a critical role in the war in Afghanistan. In 1988 the Soviets were defeated and with that Pakistan's importance for U.S. regional policy collapsed. In 1988 General Zia also died in a mysterious air crash and was succeeded by the democratic government of Benazir Bhutto, daughter of the man Zia had executed. But now U.S. aid to Pakistan collapsed, ostensibly because of its nuclear program. In 1985, Congress passed the Pressler Amendment, which made aid to Pakistan conditional on an annual presidential certification that Pakistan did not possess a nuclear weapon. The required annual certification was provided by U.S. presidents while the war in Afghanistan was going on. However, when the war ended President George H. W. Bush decided he could no longer provide the requisite certification (ICG 2012, 2–3). Military and economic aid to Pakistan dropped precipitately with a corresponding decline in the trust between the two countries.

The 1990s was a period of weak civilian governments, intense internal political conflicts, and the lowest growth rates in Pakistan's history. U.S. economic aid was close to zero through this period, but aid from multilateral and other bilateral donors kept overall levels of aid stable in nominal terms. However, peacetime aid was now increasingly linked to the new agenda of achieving 'good governance'. The decade of low growth ended with another crisis as Pakistan responded to Indian nuclear tests in 1998 with its own tests and became a nuclear armed country. Economic sanctions followed and Pakistan's isolation increased further with the military coup that brought General Musharraf to power in 1999. The resource constraints and political conflicts that were emerging may have led to a shift in the strategies of the state elites but in another fateful coincidence, 9/11 followed and Pakistan once again became a frontline state. US military aid shot up again, followed by a rise in economic aid, and this time military aid outstripped economic aid (Zaidi 2011). Musharraf stayed in power until 2007 when he was brought down by a movement for the restoration of democracy. The precipitate growth of military and civilian aid in the 2000s was to have far-reaching and largely negative effects on Pakistan's economic and political trajectory.

The Pakistani perception that the United States was only interested in pursuing its own security interests was of course ultimately damaging for U.S. influence. By the late 2000s, and particularly after the restoration of democracy in 2007, the United States was forced to reevaluate its aid strategy. In 2009 the Kerry-Lugar-Berman Bill, also known as the Enhanced Partnership with Pakistan Act, authorized a tripling of civilian aid to $7.5 billion over five years. To help strengthen the government, the U.S. decided that more aid would be channeled through government institutions rather than (largely international) NGOs. However, the proposed expansion of civilian aid did not take place. The U.S. relationship with Pakistan deteriorated after the raid in May 2011 that targeted Osama bin Laden and NATO airstrikes in November that killed twenty-four Pakistani soldiers (ICG 2012). New security concerns, a Pakistani reluctance to authorize projects involving international NGOs, and the weakness of government agencies disbursing aid meant that the proposed increase in civilian aid was not achieved.

The utility of Pakistan as a launching pad for U.S. security strategies in the region has clearly varied over time but this does not explain why U.S. aid flows to Pakistan were so volatile over the last four decades. It would have been more rational for the United States to sustain a flow of economic aid to maintain a close relationship with Pakistan over time. The growing doubts on the Pakistani side about U.S. intentions are likely to have contributed to the Pakistanis hedging their bets in ways that the United States in turn found increasingly irksome. For instance, the Pakistanis often appeared to be dragging their feet in fighting the Afghan Taliban. This could be entirely rational from the Pakistani perspective if they believed the U.S. would withdraw aid from Pakistan once the Taliban were defeated. Since strategic planners on the U.S. side must have understood this, we need to explain why U.S. aid to Pakistan has been so volatile in the past. An important factor may have been successful lobbying on the part of India, in a context where the United States was increasingly interested in maintaining good relations with India for economic and political reasons. This could explain why aid to Pakistan was repeatedly cut when moments of crisis passed (Anwar and Michaelowa 2006).

Aid to Pakistan in the 2000s was very different from the 1950s and 1960s when it was closely linked to development projects. In 1964 aid amounted to around 5 percent of GDP, with GDP growing at almost 7 percent a year (Zaidi 2011, 3). At that time U.S. aid accounted for around 67 percent of all ODA and was almost entirely economic aid. The first half of the 1960s was the most dynamic growth period in Pakistan's history, and aid was an important contributor to that growth (Amjad 1982). It is not surprising that the popularity of the United States in Pakistan was also at its peak during this period. Aid provided finance for lending by development banks such as the Industrial Development Bank of Pakistan (IDBP) and the Pakistan Industrial Credit and Investment Corporation (PICIC), which provided credit on easy terms for investors in new sectors. Both the internal political arrangements and aid flows were disrupted in the second half of the 1960s and neither were to be reconstituted in quite the same way again (Khan 1999). Constructive critics of the U.S. aid strategy in Pakistan have argued that if U.S. goals in Pakistan are to be realized, aid has to be targeted once more toward developmental outcomes. This would require, for instance, using more of the aid to co-finance private investments and insure against investment risks in difficult areas, and to support infrastructure projects (Birdsall, Elhai, and Kinder 2011).

Aid and institution-building in Bangladesh and Pakistan

Aid was thus associated with very different outcomes in the two countries even though in the early 1970s Pakistan and Bangladesh appeared to have some similarities. Immediately after 1971 both went through a period of populist authoritarianism and “Socialism” with Bhutto in Pakistan and Sheikh Mujib (the first prime minister and then president) in Bangladesh. In both cases nationalization was used to create jobs for party supporters. In both, charismatic leaders used increasingly authoritarian methods to control growing demands for rents. In Bangladesh the authoritarianism ultimately took the form of a one-party state while in Pakistan Bhutto was accused of winning elections by rigging and murdering his political opponents (Burki 1980; Wolpert 1993; Khan 2012a, 2013).

Despite these similarities there were important differences between the two countries. In Bangladesh the war had destroyed the political power of the previously dominant economic and political classes. Many of the old elites were non-Bengali, and simply left the country at its independence. The few Bengali capitalists were also expropriated through nationalizations in the early 1970s. Political competition was now driven by new political entrepreneurs from the previously excluded lower-middle classes. The competition for rents among these new groups was intense and resulted in political turbulence and violence, initially within the Awami League and then between it and factions that began to defect from it. However, on the economic front, this process also resulted in the emergence of entirely new classes with money, some members of which could potentially become part of a new productive class.

In Pakistan, Bhutto mobilized the poor but there was no equivalent political rupture with the past as in Bangladesh. Much of the old political classes remained in control of political organizations and rents. The potential upward mobility of new lower-middle class political organizers was much more limited. Bhutto’s attack on big capitalists through nationalizations did inflict a blow on the old economically dominant classes. But here there was no equivalent political rupture that would allow new classes of moneyed individuals to emerge from below through rent capture based on the mobilization of political power. Thus, Bhutto’s strategy in Pakistan had a double negative effect on economic dynamism. The old capitalist class that may have played a productive role in a new cycle of investment was weakened and demoralized. But a new class of medium-sized capitalists, with the potential for developing smaller firms using cheaper labor-intensive technologies, was also constrained from emerging from below.

As the competition for rents became more intense in Bangladesh, Mujib attempted to contain it with the imposition of one-party rule in 1974. The attempt to curtail organizational rights coincided with a famine that led to hundreds of thousands of deaths and the regime lost its legitimacy. In August 1975 Mujib and most of his family were assassinated and the military took over. After a period of uncertainty General Zia-ur-Rahman, a popular freedom fighter, became president in 1977. Zia introduced “authoritarian clientelism,” a system of controlled democracy that reintroduced multiparty competition. The strategy was to encourage multi-party political competition to identify the most powerful and effective organizers and to incorporate them within the ruling party, the Bangladesh Nationalist Party, or BNP. Mujib’s failed one-party experiment proved that the social mobilizations unleashed in Bangladesh after 1971 would be difficult to repress and control from above. In the absence of large resource flows to the top leadership in the form of security aid or natural resource rents, such a strategy was never again contemplated. Instead, Zia allowed aspiring political organizers to capture rents in the form of business contracts and opportunities, as long as the position of the president was not challenged. This resulted in the rapid emergence of new political elites and a new class of medium-sized economic entrepreneurs (Khan 2012a, 2013).

As political entrepreneurs saw that they could compete for rents without recourse to extremist politics, political violence declined. This period also created the foundations for an economic turnaround as the emerging moneyed class was drawn into the garment industry that was to transform Bangladeshi manufacturing. Zia sought to achieve stability and legitimacy by providing policy support for investors in new sectors; he provided assurances and policy support to foreign investors and technology providers and they found this credible because they could see he meant business. These steps were critical for the emergence of the garment industry in the late 1970s, which by 2012 employed almost five million workers and earned 80 percent of Bangladesh's foreign exchange (Khan 2012a, 2013). However, the competition for the presidency was intense within the army and eventually resulted in Zia's assassination. He was replaced by the much less popular Ershad who faced increasing challenges from opposition parties. Ershad was forced out in 1990 and since then there has been a competitive democracy with power alternating between the BNP and the Awami League. However, political stability has been vulnerable with periodic crises when parties failed to agree about the conduct of elections.

In Pakistan, Bhutto was also overthrown in a military coup in 1977. Pakistan's ruler was also a General Zia, but his military rule was much more authoritarian and centralized, helped by the upsurge in U.S. security aid following the Soviet invasion of Afghanistan. Ultimately, the resources controlled by the centre allowed it to by-pass and repress emerging intermediate class forces and to patronize weak organizations that provided short-term support for the regime. Pakistan's Zia appeared to be encouraging new social forces as he tried to bypass Bhutto's Pakistan People's Party (PPP) by promoting weaker political organizations such as the Pakistan Muslim League (PML) and by encouraging the formation of new Islamist groups. However, in the end, Zia's strategy did not result in any fundamental change in the composition of the groups that dominated politics in Pakistan. The new Islamist parties he patronized with money from above did not represent the most powerful intermediate class organizers and in the end they were not incorporated into the dominant structures of rent allocation. The biggest beneficiary was the PML, eventually led by Nawaz Sharif. The Sharif brothers, however, were not political newcomers but representatives of an established business family. Their party had some appeal for the existing business community but created limited spaces for new aspirants from the intermediate classes. Thus, despite Zia's rhetoric of radical Islamism and his antipathy to the established order, the dominant political classes remained substantially unchanged at the end of his rule (Lieven 2011, 76–80).

The effects of the steep increase in military aid to Pakistan in the 1980s can be understood by imagining the counterfactual: what would have happened if the military and political establishment did not have access to these rents at this time. Without the significant spike in security-related aid, Zia would not have had the resources to buy off the more pliable lower-level organizers from above and suppress others. He would have been forced to recognize a broader base of powerful groups, and without the cash to buy them off, he may have been forced to provide them with rents in the form of business opportunities and bank finance, as in Bangladesh. Pakistan's President Zia did support the Sharif brothers in the PML, but as political entrepreneurs to balance the PPP, not as economic entrepreneurs who would bring in new technologies to create jobs. Unlike Zia in Bangladesh, he did not feel compelled to push a broad base of new capitalists toward global competitiveness and not surprisingly, investors did not find his pro-business statements very credible. Instead, Pakistan's Zia achieved what Lieven described as "shallow" economic growth, based on a service and construction boom financed by cash inflows from aid and remittances from Pakistanis in the Middle East (Lieven 2011, 78).

The 1990s saw a return to democracy in both countries, but a democracy that was vulnerable because of intense conflicts between competing parties. The 1990s also witnessed a policy shift among donors toward providing support for liberalization and good governance reforms. The large flows of security-related aid to Pakistan died out in the 1990s and both countries were encouraged to adopt liberalizing policies and "good governance" reforms. But liberalization had different effects in the two countries. In Bangladesh the garment industry was emerging out of the policy support provided in the late 1970s and 1980s and steps towards liberalization assisted its rapid growth throughout the 1990s. In Pakistan there were no new globally competitive industries that could benefit from liberalization. In fact, Pakistan's growth rate collapsed in the 1990s and Bangladesh achieved a higher growth rate from then onwards. To make matters worse, the steep cutback in U.S. aid to Pakistan in the 1990s happened immediately after military rule ended in 1988. The sudden reduction in aid rents before an alternative ruling coalition could consolidate adversely affected political stability. No elected party managed to complete a term in office in the 1990s. Aid from multilateral sources targeted governance reforms such as decentralization but the real challenge was to create a new ruling coalition based on a new distribution of rents. Given the difficulties of institutionalizing good governance in poor countries, it is not surprising that aid supporting these reforms had a very limited impact on economic development or political stability (Cheema, Khwaja, and Qadir 2005).

Both Pakistan and Bangladesh suffered suspensions of democracy in the 2000s. Democracy in Pakistan was suspended under Musharraf from 1999 to 2007 while Bangladesh had a two-year emergency government from 2007 to 2009 following an electoral crisis in 2007. The Bangladeshi emergency government, led by an ex-World Bank bureaucrat, Fakhruddin Ahmed, and backed by the army, enjoyed the support of donors as it promised to carry out a raft of good governance measures under emergency laws. Such measures included an anticorruption drive that swept up the leaders of the two main parties and thousands of others. The result turned out to be a missed opportunity because the good governance reforms attempted were actually unattainable and the government failed to identify feasible reforms that may have made a difference to real political and economic outcomes (Khan 2012a).

The Musharraf interregnum in Pakistan lasted much longer and arguably did much more damage to Pakistan's developmental prospects. Once again it was unfortunate for Pakistan that a military coup was closely followed by a massive upsurge in military aid. This time the security aid did not just enable a top-down allocation of rents with its damaging political consequences. Pakistan's political elites now suffered a new crisis of legitimacy as U.S. aims in the region were now widely opposed in Pakistan. The military-bureaucratic elite in Pakistan sought to satisfy both the United States and its own people and ended up satisfying neither. Musharraf later argued in his memoirs that the Americans had given him an ultimatum after 9/11 to fall in line or "be bombed back to the Stone Age" (Musharraf 2006, 200–1), a charge the U.S. denied. What is clear is that once again the direction of significant security aid to the top leadership blocked the incremental inclusion of new political organizers with their own autonomous organizational capabilities.

The lure of significant centralized aid flows was such that even after 2008 when a new

PPP government was elected to power, it was willing to accept security-related aid flows from the United States with no significant change in the strategy for remaining in power. The PML-N that formed a coalition government after the 2013 elections was committed to a renegotiation of the security alliance with the United States in the context of waning U.S. interest in Afghanistan. But sustainable changes in U.S. strategies towards Pakistan may be disrupted by new crises in the region. Thus, in Pakistan while the good governance rhetoric of Musharraf was similar to that of Fakhruddin, the implications were much more severe than wasted opportunities for feasible reform. The outcome was a growth in violence from suppressed organized groups in society that could exploit the growing loss of state legitimacy to mount increasingly violent challenges even after the return of democracy in 2008.

Conclusion

Aid can affect economic and political outcomes by modifying rent-seeking behavior. The interaction of aid with preexisting economic and political processes can result in cycles of cumulative causation that can be good or bad for economic and political development. An analysis of the effects of foreign assistance has to take into account the initial structure of economic and political organizations in a country and the ways in which they are competing for rents. While aid was a relatively small part of the GNP of both Pakistan and Bangladesh, when we look at these interactive effects, aid arguably had significant multiplier effects on the evolution of social stability and economic dynamism in both countries.

Our analysis questions critical elements of the current consensus on aid. In countries such as Pakistan that face significant internal violence, the current consensus on security and development suggests that development aid should have a security focus (World Bank 2011). However, when we look at the organization of political rent seeking in Pakistan, the delivery of security-related aid had adverse effects on the evolution of viable political strategies with damaging long-term implications. Security-related aid in the 1980s allowed the ruling elites to block the incremental inclusion of powerful political organizers from the intermediate classes and built up conflicts for the future. The second upsurge of security-related aid in the 2000s had even more serious consequences for the country by undermining the legitimacy of the state and allowing excluded groups to mobilize using extremist agendas. Donors are clearly wrong if they believe that their security interests can in general be furthered by ramping up security-related aid to client states. Aid interfaces with internal political and economic processes of competition over rents that are country specific. It could be argued that countries similar to Pakistan could always renegotiate or opt out of assistance that is so damaging. The problem is that negotiations over aid are carried out by the very elites who benefit from aid. It is therefore also important to persuade donors that a simple-minded security strategy may harm their own long-term security interests if the countries they are assisting become more fragile and violent as a result.

In less violent countries such as Bangladesh, the consensus view is that development requires progress toward good governance. This is true in a longer view, but the challenge is to understand better the country-specific processes through which economic and political progress has actually been achieved and to build on it. Attempting to use aid as an instrument to directly achieve good governance has repeatedly proved to be a misguided strategy. These attempts resulted in missed opportunities of supporting feasible institutional improvements to sustain development. Sustaining development may in turn be the most feasible way of strengthening good governance over time. Developmental rent allocations succeeded in creating new sectors such as garment and textiles in Bangladesh, and the challenge is to understand these examples so that policy and assistance can be appropriately used to assist new sectors such as electronics or shipbuilding (Khan 2013). Once again, country specificities are important and the possible interactions of aid and domestic accumulation processes need to be much better understood.

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