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Nexus between Aid and Security: The Case of Pakistan

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1. Introduction

Foreign Aid in developing economies has become an indispensable source of financing economic growth and development. The narrow fiscal space and low levels of foreign exchange earnings imply less financing for infrastructure and social sector development. Successful aid experiences suggest countries achieving higher human capital growth, faster capital accumulation and improved welfare levels (Chowdhury and Garonna 2007).

Critics of existing aid regime have highlighted negative implications of foreign aid which in many countries gets diverted to non-development expenditures and servicing of debt overhang. Furthermore, political instability, frequent changes in policies, misaligned public sector priorities and inefficiency of institutions neutralizes the effect of aid on growth thereby having less than expected impact on poverty reduction. The study on sources of ineffectiveness of aid has occupied substantial attention in the recent literature and explains the slow progress towards millennium development goals (MDGs).

Pack and Pack (1993) argued aid ineffectiveness in developing countries is because of diversion of aid from development to deficit financing (which is largely owed to rising current expenditures) and debt servicing. Burnside and Dollar (2000) find the positive impact of aid in developing countries in presence of prudent policies. However Easterly *et al.* (2003), find no support that aid works well under good policy environment. Chong *et al.* (2009) show significant effect of aid on inequality and poverty reduction. Furthermore they suggest that good institutions may be necessary for aid to reach the poor. When studied for specific indicators Masud and Yontcheva (2005) show that NGO aid reduces infant mortality more effectively than official bilateral aid.

In case of Pakistan two-gap framework might justify the need of foreign assistance (Saeed 2005). Like most developing countries Pakistan's domestic resource mobilization is not sufficient to overcome the rising government expenditures which have recently also ballooned due to the financing of war on terror and destruction due to devastating flash floods. In order to keep growth momentum going during times of conflict requires multisectoral foreign assistance. Upon independence in 1947 the country inherited obsolete or minimal infrastructure in most productive sectors leading to Pakistan approaching the donors relatively early in history. Pakistan's association with for example the World Bank (WB) goes back to 1950. The WB has been the largest provider of development assistance to Pakistan. Between 1952 and 2006, WB has approved 266 financing arrangements for

Pakistan, totalling more than US\$15.7 billion, of which about US\$9 billion remains outstanding.

In 1960 the WB organized the Aid-to-Pakistan Consortium to facilitate coordination among the major providers of international assistance. The consortium's members included the United States (US), Canada, Japan, Britain, Germany, France, and organizations such as the Asian Development Bank (ADB). Most non-consortium funding came from Saudi Arabia and other oil-producing Middle Eastern countries. The US has been a major provider of aid since independence and was the largest donor until the 1980s.

It can be observed in Pakistan's history that periods of intense conflict were not followed by sustainable growth. Due to which macroeconomic situation remained fragile. Since 1988, almost eleven loan arrangements (including the recent \$7.6 billion in 2008) have taken place under various IMF programmes. Almost six loan arrangements were made during the regimes of Pakistan People Party including Standby Arrangement, Structural Adjustment Programs, Poverty Reduction and Growth Facility (PRGF) and Extended Structural Adjustment Programme. Two IMF loan arrangements were made during Pakistan Muslim League regime and two Standby Agreements and PRGF were contracted under military regime (post 1999) to stabilize the economy. There is a significant difference between the loans promised and disbursed under the above mentioned arrangements because national governments were unable to fulfil the stringent conditionalities. Later between 2001 and 2005 Pakistan successfully implemented two IMF-supported programs.

In 2010 WB approved a lending facility of \$6.2 billion for four years focusing on specific areas such as energy management and development, revenue generation and aid to terror-stricken areas. In energy, WB plans to assist the government in making power sector more efficient by optimally harnessing the potential of hydropower sector. The natural gas system will also receive much awaited attention, which presently suffers from higher costs of leakages owing to dilapidated operations management. This arrangement comes at an apt time when the productive sectors are suffering from power shortages and the input costs of industry particularly small and medium enterprises (SME) have led to substantial business closures.

The earthquake of 2005 and destruction in Khyber-Pakhtunkhwa province due to war on terror has led to mass suffering in the region. The WB along with other donors are aiming for intervention in health and education. The overall strategy focuses on putting Pakistan back on

a broad-based pro-poor growth path which ultimately creates employment and reduces poverty. One of the cornerstones of macroeconomic framework will be increasing the tax to GDP ratio which currently ranks one of the lowest in the world. It is essential that value added tax (VAT) reforms are undertaken at the earliest which can form a basis for longer term requirements of human capital and related social sectors. These reforms which also intend to focus on broad basing of tax regime will also reduce reliance on foreign aid.

In this paper we study the link between aid, development and security. The next section describes briefly the role of aid in Pakistan economy, including a review on how aid is motivated by geopolitics and security concerns. Section 3 provides results from a linked computable general equilibrium (CGE) – microsimulation model where we simulate an increase in foreign savings and see its macro – micro impact. Section 4 brings together the current aid regime in Pakistan and how effective it is in the provision of services and infrastructure. We then discuss some key aid experiences of Pakistan with respect to specific programmes initiated during different phases of country’s history. The last section before we conclude, provides a checklist of priorities for aid policy reform in Pakistan.

2. Aid, Security and Development

a. Role of Aid in Pakistan Economy

Pakistan economy has grown at an average growth rate of 5 percent between 2001 and 2010. This period saw the doubling of merchandise exports and remittances from abroad while imports more than doubled. For most part of the decade the improved fiscal discipline helped maintain a high poverty related government expenditure. However in the wake of food, fuel and financial crisis, the economy saw decline in aid and FDI inflows (see Ahmed and O’ Donoghue 2010). The size of external debt and liabilities ballooned and due to the hike in inflation and deteriorating exchange rate, high inflation after 2007 eroded the gains made towards poverty reduction (Table 1). With dwindling foreign exchange reserves, Pakistan resorted to IMF standby arrangement and gradually moved towards a recovery phase during 2008-09. However in 2010 the economy was also hit by a domestic energy crisis, where inter-corporate debt crippled the energy sector and led to electricity and gas shortages for commercial purposes as well as households. With some recovery in large scale

manufacturing the growth in 2009-10 crossed 4 percent and exports remained robust despite the looming global recession. The devastating flash floods of September 2010 destroyed \$ 9 billion worth of infrastructure, in turn putting downward pressure on economic growth and increasing Pakistan's expectation from donors for higher level of aid.

Table 1 Pakistan - Macroeconomic Situation 2001 - 2010

Indicators	2001	2005	2006	2007	2009	2010*
GDP growth (%)	2.0	9.0	5.8	6.8	1.2	4.1
Merchandise Exports (US \$ billion)	9.2	14.4	16.4	17.1	18.9	19.6
Merchandise Imports (US \$ billion)	10.7	20.6	28.6	26.6	31.4	30.5
FDI (US \$ billion)		1.5	3.5	5.1	3.7	2.2
Remittances (US \$ billion)		4.2	4.6	5.5	7.8	8.9
External debt and liabilities (US \$ billion)		34.0	35.9	39.0	50.7	52.7
Poverty headcount ratio	34.5	23.9	22.3		35	
Poverty related expenditure (US \$ billion)		5.3	6.3	7.0	3.8	
Exchange Rate	58.4	59.4	59.9	60.6	78.5	83.6

*Provisional estimates

Source: Economic Survey of Pakistan, State Bank of Pakistan - Annual Report

The history of foreign borrowing in Pakistan goes back to 1950s. The major chunk of aid has come under project assistance which in most cases was tied to source and utilization. The initialization process of project assistance also required participation by the government. The second most important type of aid to Pakistan was in the form of commodity assistance. Various governments preferred this type of inflows as these were not tied to utilization. However Saeed (2005) indicates that commodity assistance to Pakistan as a ratio of total aid had decreased from 34 percent in 1965 to 23 percent by 1980. With in this category Pakistan also received food aid which initially included wheat and edible oils from US government. Finally technical cooperation remained high on Pakistan's agenda as this allowed technical help from sectoral experts as well as training of officials abroad. Brecher and Abbas (1972) provide an analysis of early period when Pakistan received \$3.5 billion in assistance from US over 15 years (1952 – 67). Out of this amount loans accounted for 38 percent, food aid was 37 percent and other grants constituted 25 percent. The majority of aid was concentrated in industrial commodities power, irrigation and transport sectors.

Rahim and Khan (1993) found an inconclusive relationship between aid, savings and economic growth. There is negative coefficient between aid and domestic resource

mobilisation. However aid plays a definite role in determining overall savings behaviour in Pakistan. Khan (1997) taking account of falling concessional aid as percentage of total, higher overtime average interest rates, falling maturity periods and lower grant element, argues that aid has a negative casual impact on GDP and aid has negative impact on economic growth after controlling the supply side shocks. The harsher terms of aid made it all the more difficult to retire debt in the medium to long run. The factors identified for ineffectiveness of aid include project selection biases towards poorly identified and large projects, foreign exchange intensive development programmes, longer gestation infrastructure rather than productive projects, lack of government-donor and intra-donor coordination.

Iqbal (1997) discovered that foreign capital flows channelled through the public sector have a strong positive impact on social and non-development expenditures. However, foreign aid has little effect on development expenditure. The non-development expenditure has strong interdependence with social sector expenditures. Furthermore foreign assistance increases potential of tax revenue generation. Ghulam (2005), found the positive impact of ODA on economic growth. As the flow of foreign capital increases, GDP increases at a decreasing rate. However rising aid flows substituted for domestic savings ultimately increasing the debt burden. Ishfaq (2004) explains that foreign aid, though in a limited manner, has assisted poverty reduction in Pakistan. Vos (1998) suggests that aid flows tend to generate strong dutch disease effects in case of Pakistan.

Figure 1 Debt Stock Outstanding²



Figure 1 shows the outstanding debt stock of Pakistan from 1980 to 2009. The government's domestic borrowing increased much faster than external borrowing and crossed \$50 billion in 2008. Whether or not the rising debt stock is good for the country largely depends upon how these borrowings are spent. If government fails to channelize debt flows in efficient public investment (which in turn provides enabling infrastructure and facilitation to the private sector) there is a possibility that the country ends up embracing a debt trap situation which also brings with it a Dutch disease phenomenon. After 2005 Pakistan's dependence on aid increased substantially, primarily due to two reasons: a) food, fuel and financial crisis and b) war on terror. At the same time Pakistan's involvement in war against terror has worsened the business environment in the country which in turn led to reduced or stagnant domestic revenue generation (Table 2).

² Source: Hand Book of Statistics and Economic Survey of Pakistan

Table 2 Pakistan Tax to GDP ratio

Year	Tax to GDP Ratio
2003	11.4
2004	10.8
2005	10.1
2006	10.5
2007	10.3
2008	10.3
2009	9.5

Source: Economic Survey of Pakistan

Husain (1992) highlighted Pakistan economy's repeated reliance on foreign savings for bridging the gap between domestic savings and investment. However the rising debt burden of Pakistan³ required a gradual shift away from this persistent reliance on foreign resources. In order to avoid the debt crisis the author suggested a strategy where emphasis should be on increasing domestic saving rates, export receipts, foreign investment and a reflow of foreign assets held by Pakistanis abroad. Husain (1999) explains that a major change in Pakistan's debt profile was when the composition of external financing changed from bilateral grants and concessional lending towards multilateral and non-concessional flows. The percentage of grant in total assistance declined from 77 percent in 1960 to 9.6 percent during late 1990s (Table 3). Baqai (1973) while discussing the dominant role of foreign aid in Pakistan's earlier plans, explains that choice is not yet open to developing countries to adopt a development strategy based on aid flows (which Pakistan actually did in Second five year development Plan). The developed countries are unwilling to provide assistance on such a scale.

³ Average debt to export ratio between 1986 – 90 was 241.5 percent and average debt to GNP ratio during the same period was 48.4 percent.

Table 3 Pakistan-Decade-wise Loans and Grants Disbursed (\$ Million)

Year	Loan	Grants	Total	% of Grant in Total
I. Upto 30-06-1960	192	650	842	77.2
II. 2nd Plan (1961-65)	1232	1162	2394	48.5
III. 3rd Plan (1966-70)	2324	719	3043	23.6
IV. Non-Plan (1971-78)	5083	634	5717	11.1
V. 5th Plan (1979-83)	4418	1375	5793	23.7
VI. 6th Plan(1984-88)	5158	2025	7183	28.2
VII. 7th Plan (1989-93)	9540	2541	12081	21.0
VIII. 8th Plan (1994-98)	11522	1226	12748	9.6
IX. 1999-2007	12824	5380	18204	29.6
Grand Total	52293	15712	68005	23.1

Source: Economic Affairs Division

The rate of interest remained relatively low during 1960s to 1970s (Table 4). During 1970s and most part of 1980s grants constituted around 35 to 50 percent of external financing requirements. However by 1995 this ratio was down to 5 percent. The main factors responsible for this were frequent change in political orientations and ‘donor fatigue’ leading to increase in debt servicing costs during 1990s. By 1995 most of the debt as part of official financing was being channelled through international financial institutions and bilateral debt only accounted for less than 35 percent. Out of the total debt stock around 80 percent was for financing of longer term projects and commodity aid and the remainder was credits by banks and IMF.

Table 4 Term Structure of Loans

Period	Interest %	Payment (Years)	Grace period (Years)
1950s	4.6	21	2
1960s	3.3	30	7
1970s	3.6	25	6
1980s	4.8	28	7
1990s	4.4	21	6
2005-09	1.3	25.1	-

Source: Economic Survey of Pakistan

Ahmed and Amjad (1984) discuss that most aid to Pakistan was tied to source and utilization, ultimately resulting in Pakistan purchasing desired goods and services on credit and at uncompetitive prices. The interest rates in most cases were equal to the commercial rates (see also Hamid 1970, Alavi and Khusro 1970).

Pakistan managed to keep a sound current account balance during early phase of this decade. However one can observe a recent jump in external debt to GDP ratio from 27 percent in 2007 to 30.4 percent in 2010. The key contributors to this increase are IMF Standby Arrangement and multilateral loans (Table 5). While the contribution of Paris club only increased by \$ 1 billion during 2005 to 2010, the contribution of multilaterals went up from \$ 15.4 billion in 2005 to 23.2 billion in 2010. In the Paris Club group, Pakistan has contracted loans and signed grant agreements with Canada, Japan, UK and USA in 2009. In the non-Paris Club group Saudi Arabia, Kuwait and China are the main donors. In multilaterals the main sources were ADB, EU and IDA. In mid 1990s when public debt to GDP ratio was hovering around 87 percent with a higher share of external debt, Pasha and Ghaus (1996) explained that the key fiscal management goal in Pakistan should be to keep primary budget deficit at a level which prevents the public debt to income ratio from rising.

Table 5 External Debt and Liabilities 2005 – 2010 (\$ billion)

	2005	2006	2007	2008	2009	2010*
1. Public and Publically Generated Debt	31.1	32.8	35.3	40.2	42.2	42.4
A. Medium and Long Term (>1 year)	30.8	32.6	35.3	39.5	41.6	41.8
Paris Club	13.0	12.8	12.7	13.9	14.0	14.0
Multilateral	15.4	16.8	18.7	21.6	23.1	23.2
Other Bilateral	0.8	0.8	1.0	1.2	2.0	2.5
Euro / Other Bonds	1.3	1.9	2.7	2.7	2.2	1.6
Military Debt	0.2	0.1	0.1	0.0	0.2	0.2
Commercial Loans/Credits	0.2	0.2	0.1	0.1	0.2	0.3
B. Short Term (<1 year)	0.3	0.2	0.0	0.7	0.7	0.6
IDB	0.3	0.2	0.0	0.7	0.7	0.6
2. Private Non-Guaranteed Debt (>1 year)	1.3	1.6	2.3	2.9	3.3	3.2
3. IMF	1.6	1.5	1.4	1.3	5.1	7.2
of which Central Govt.						1.1
Monetary Authorities	1.6	1.5	1.4	1.3	5.1	6.1
Total External Debt (1 through 3)	34.0	35.9	39.0	44.5	50.7	52.7
(of Which) Public Debt	31.1	32.8	35.3	40.2	42.2	43.5
4. Foreign Exchange Liabilities	1.4	1.3	1.3	1.7	1.3	1.2
Total External Debt and Liabilities (1 through 4)	35.4	37.2	40.3	46.2	52.0	53.9
(of Which) Public Debt	32.1	33.8	36.5	40.7	42.2	43.5
Official Liquid Reserves	9.8	10.8	13.3	8.7	9.5	11.2
	(In percentage of GDP)					
Total External debt (1 through 3)	31.1	28.2	27.3	27.0	31.3	30.4
1. Public and Publically Guaranteed Debt	28.4	25.8	24.7	24.5	26.0	24.4
A. Medium and Long Term (>1 year)	28.1	25.6	24.7	24.0	25.6	24.1
B. Short Term (<1 year)	0.2	0.1	0.0	0.4	0.4	0.3
3. IMF	1.5	1.2	1.0	0.8	3.2	4.1
4. Foreign Exchange Liabilities	1.3	1.1	0.9	1.0	0.8	0.7
Total External Debt and Liabilities (1 through 4)	32.3	29.2	28.2	28.1	32.0	31.1

*Data up to March 2009-10.

Source: Economic Survey of Pakistan

For functional use if we bifurcate aid into project aid and non-project aid. Food, non food, relief and balance of payment aid constitute non-project aid. The project aid almost equalled the non-project aid in the earlier phases of economic history of Pakistan (Table 6) however project aid increased much faster from 5th to 8th Plan period. After which increased Balance of payment (BoP) support led to an increase in the non-project aid component.

Table 6 Project and Non-Project Aid Disbursed (\$ Million)

	Project aid	Non-food aid	Food aid	BOP support/ cash receipts	Others Aid	Total non-project aid	Total disbursement
	1	2	3	4	5	6=(2+3+4+5)	7=(1+6)
Upto 30-06-1960	406	244	192	--	0	436	842
2nd Plan (1961-65)	1209	420	765	--	0	1185	2394
3rd Plan (1966-70)	1811	763	469	--	0	1232	3043
Non-Plan (1971-78)	2543	1299	785	1090	0	3174	5717
5th Plan (1979-83)	3363	950	306	531	643	2430	5793
6th Plan(1984-88)	4882	791	776	--	734	2301	7183
7th Plan (1989-93)	7643	1922	1558	413	545	4438	12081
8th Plan (1994-98)	9564	61	1923	1139	61	3184	12748
1999-2009	13269	255	538	16129	51	16973	30242
Total	44691	6707	7315	19306	2039	35353	80043

Source: Economic Affairs Division

Table 7 shows the disbursement of project aid in different sectors of the economy between 2000 and 2009. The sectors that have received the highest foreign assistance include power, water, transport and communication and rural development. However it seems that Pakistan has received low levels of aid for development of science and technology, human resource development and information technology. These neglected areas are critical for sustaining short term growth spurts in developing countries.

Table 7 Sector – wise Disbursement of Project Aid (\$ Million)

Sectors	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Total
Agriculture	68.5	37.7	44.3	10.9	17.7	9.0	19.2	26.0	27.3	32.2	292.8
Education & Training	102.7	74.6	60.4	43.1	57.2	46.2	93.0	111.3	54.3	84.2	727.0
Environment	13.1	8.8	14.7	3.1	11.7	7.2	6.2	15.5	9.9	7.2	97.3
Fuel	164.1	14.9	1.5	0.0	1.5	51.0	0.8	0.2	0.0	0.0	234.0
Governance, Research & Statistics	17.5	41.3	29.4	29.6	35.3	82.7	85.1	84.4	54.9	77.5	537.7
Health & Nutrition	31.2	22.2	14.9	59.8	52.4	78.7	54.3	47.2	51.1	31.0	442.9
Industry & Production	6.6	5.3		2.2	0.5	6.7	3.0	7.9	1.0	6.6	38.3
Information Technology	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Manpower, Employment & HRD	0.0	0.0	0.0	0.0	0.0	0.0	2.2	0.4	0.1	0.0	2.8
Physical Planning & Housing	65.2	31.3	29.0	27.9	37.3	32.5	46.0	51.8	34.5	29.5	385.1
Population Welfare	63.4	5.4	5.8	9.1	5.9	17.6	27.2	27.1	15.6	56.4	233.6
Power	211.7	303.9	176.6	250.6	112.4	59.2	143.6	119.0	116.4	208.3	1702
Rural Development & Poverty Reduction	23.0	35.2	45.8	63.3	50.2	228.8	272.8	97.9	83.3	111.0	1011
Science & Technology	0.3	0.1	0.0	0.3	0.6	0.0	0.0	0.0	0.0	0.0	1.4
Social Welfare	200.8	188.8	92.3	79.6	7.5	15.1	9.2	20.0	20.3	14.3	647.8
Transport & Communication	172.8	152.0	110.9	184.1	129.0	136.7	159.8	197.7	234.9	311.5	1789
Water	121.7	106.8	114.0	68.6	94.6	143.7	121.9	113.4	44.1	91.1	1020
Women Development	0.2	1.3	3.0	13.5	8.4	2.6	0.7	2.6	1.8	1.9	35.9
Total	1263	1030	741.2	845.8	622.4	917.7	1045	922.4	749.2	1063	9199

Source: Economic Affairs Division

Extracting rankings from disbursements shown in Table 7, we see the sectoral preference of donors kept changing between 2000 and 2009. The power sector that ranked first in 2000 had slid to second in 2009 when the priority sector now was transport and communication. The increased focus on rural development and education was seen only recent in 2009. Both sectors were not amongst the top 5 in 2000 (

Table 8).

Table 8 Top 5 Sectoral Disbursements 2000 and 2009

Rank	2000	2009
1	Power	Transport and Communication
2	Social welfare	Power
3	Transport and communication	Rural Development and Poverty Reduction
4	Fuel	Water
5	Water	Education and Training

b. Foreign Assistance and Regional Security

The link between aid and security and how both impact service delivery, poverty and welfare indicators has received substantial attention in the literature. The work done by DAC Fragile States Group Secretariat requires special mention here. DAC (2008) provides understanding of mutual influence of security and service delivery and provides recommendations on how to strengthen service provision and governance. The report also identifies the challenges faced by international development partners in countries with security issues (See also DAC 2008b).

Carment *et al.* (2008) while examining the effects of state fragility on aid allocation explain that aid is usually directed towards states on the basis of their capacity and authority and not on the basis of their legitimacy. Ehrenfeld *et al.* (2003) explain that the potential of aid conditionality to positively influence peace processes depends on successful coordination among donors, understanding of political situation, willingness to act on threats, and suitable rewards and pledges to enhance credibility (See also Boyce 2002, Goodhand and Sedra 2007). Suhrke and Buckmaster (2005) discuss the patterns and purposes of post-war aid. Hansen and Borchgrevink (2006) highlight the intentions and effectiveness of aid sanctions and provide analysis on cutting aid to promote peace and democracy. Svensson (2002) explains that expectation of aid in the future may increase *rent dissipation* and reduce the public goods provision. There seems to be no existence of donors systematically allocating aid to countries with less corruption. Alesina and Weder (1999) show that according to some measure of corruption, more corrupt governments are receiving more aid and there is no evidence that an increase in aid reduces corruption.

Aid flows in Pakistan have suffered from unpredictability in turn affecting the country's development plans as well as ongoing projects. The per-capita aid flows on average have increased between 1960 and 2006. However as shown in Figure 2 these flows followed sharp spikes which made foreign financing an unreliable option for growth over the longer term. There is some evidence that Pakistan's dependence on aid has decreased overtime. Figure 3 exhibits the declining aid receipts as percentage of GNI.

Figure 2 Net ODA Received Per Capita (Current US \$)

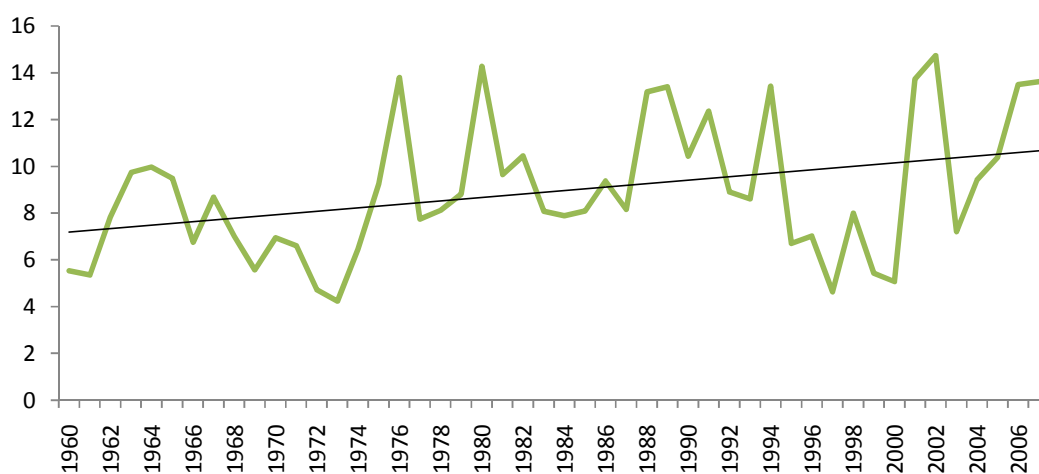


Figure 3 Aid Received as Percentage of GNI (1960 – 2006)

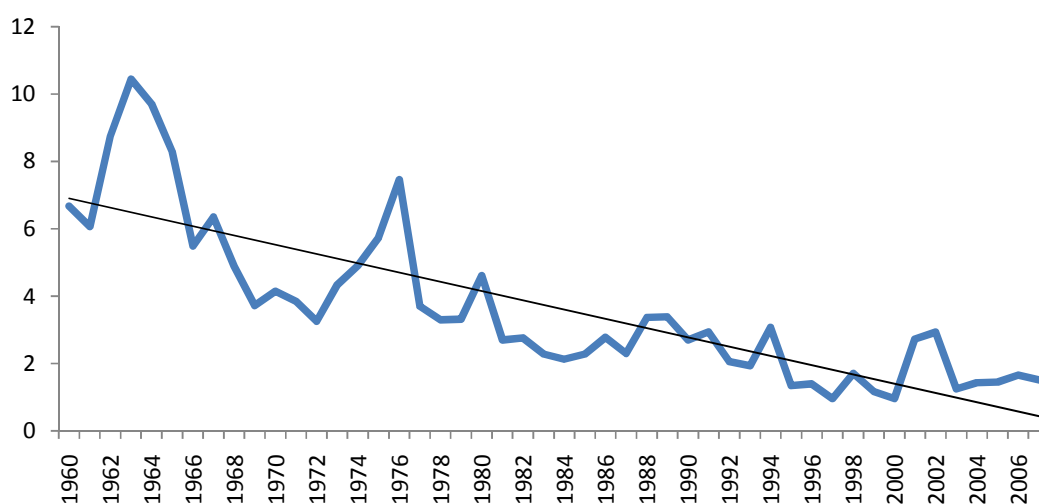


Table 9 Net ODA received Per- capita

Years	Pakistan	India	Bangladesh	Sri Lanka	Indonesia	Afghanistan	Nepal
1960's	7.6	2.0	-	2.2	1.4	3.3	1.9
1970's	7.7	1.8	7.7	10.5	4.6	4.9	3.8
1980's	10.3	2.4	13.7	30.5	6.3	3.0	9.6
1990's	8.6	2.0	12.0	31.3	8.2	11.9	9.8
2000-07	11.0	1.2	8.4	30.0	6.4	65.1	6.2

Source: www.oecd.org/dac/stats/qwids

Table 10 Aid as percentage of GNI

Years	Pakistan	India	Bangladesh	Sri Lanka	Indonesia	Afghanistan	Nepal
1960's	7.0	2.2	-	1.4	4.0	3.0	1.2
1970's	4.4	1.2	6.1	4.9	2.9	2.6	3.8
1980's	2.9	0.8	6.4	8.5	1.2	0.8	15.8
1990's	1.9	0.6	4.1	5.2	1.2	-	-
2000-07	1.7	0.2	2.2	2.7	0.6	32.6	16.9

Source: www.oecd.org/dac/stats/qwids

The argument of Pakistan receiving less aid in comparison with other economies currently facing security threat is strengthened if per-capita aid receipts are taken into account. Recent statistics indicate that regionally Afghanistan remains the highest recipient in terms of per-capita receipts of aid followed by Sri Lanka. Similarly in terms of aid as percentage of GNI Afghanistan, Nepal, and Sri Lanka were the leading recipient.

According to the South Asia Terrorism Portal (SATP) database total number of civilians killed during terrorist violence in Pakistan during 2003 to 2010 was around 8597. During the same period the number of security forces personnel killed was 3141. Being a major partner in the war against terror Pakistan's military forces killed 18100 terrorists. The total number of suicide attacks during 2007 and 2009 was around 197 which took the lives of 735 civilians and 196 security forces personnel. This loss of life, destruction of infrastructure and uncertain business environmental has collectively resulted in an economic loss of \$43 billion between 2005 and 2010 (Table 11).

Table 11 Damage to Pakistan Economy (Rs. Billion)

	2005	2006	2007	2008	2009	2010	Total 2005-10
Direct Costs	67	78	83	109	114	262	712
Indirect Costs	192	223	278	376	564	707	2340
Total	259	301	361	484	678	969	3052
Cost in \$ billion	4.4	5.0	6.0	7.7	8.6	11.5	43.2

Source: Economic Survey of Pakistan

The leakage of domestic output still remains unaccounted. Due to the porous borders and unrest in the neighbouring region with Afghanistan, substantial amount of agricultural items are illegally transported into Afghanistan which in turn makes Pakistan food insecure. This has in the short term led to sharp spikes in food prices. After 2005 industrial items such as

cement and steel were being transported to CIS countries via Afghanistan, ultimately escalating construction costs in Pakistan. Same was true for fertilizer upon which Pakistan had allowed a subsidy however it was priced much higher in CIS market. The price differential prompted smuggling of fertilizer to across the border. The food insecurity has led Pakistan to repeatedly resort to food aid. Table 12 indicates the unprecedented increase in food aid during 1980s and 1990s.

Table 12 Decade-wise Food and Non-Food Aid

Period	Non-food aid	Food aid
1960's	127	134
1070's	167	92
1980's	207	157
1990's	145	321
2000-09	26	27

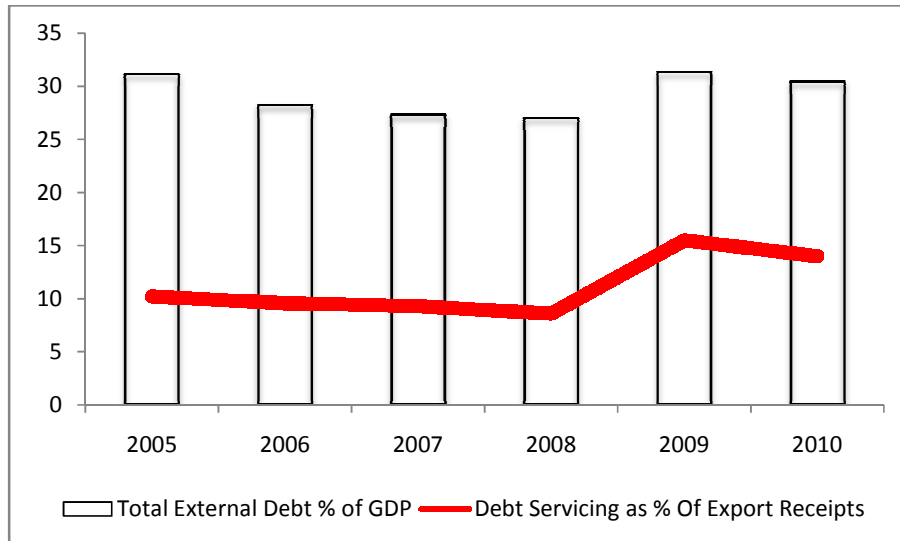
Source: Economic Affairs Division

Pakistan's involvement in anti-terror efforts also led to unemployment in regions which were already suffering economic slump. This not only increased rural poverty but also forced internal migration. In only Swat district around 2 million people have been displaced, education of youth disrupted, economic infrastructure hampered, and the supply of items such as marble, furniture, gems and jewellery, fruits and vegetables has been affected.

While conflict has substantially damaged infrastructure and added to business costs, reduced economic growth has also led to sharp challenges of debt servicing.

Figure 4 shows how debt servicing as percentage of exports increased after 2008 when the military operations in northern areas were coupled with budget and BOP crises.

Figure 4 External Debt and Servicing



The nature of war-related damage in Pakistan and Afghanistan remains similar however in Pakistan it has cost the loss of established socio-economic infrastructure (See Jones 2007). While there has been increased hype about pushing donors to do more in Afghanistan, Pakistan still awaits the fulfilment of promised pledges. Between 2003 and 2007 US had spent \$22 billion in Afghanistan and \$42 billion in Iraq on aid and reconstruction (Tellis 2008). Since 2002 United States provided Pakistan \$12.3 billion out of which less than 27 percent has gone towards development and economic assistance. Annex-I also show the bilateral aid disbursed to a sample of countries along with the share of US in the global bilateral aid.

Whether or not aid has contributed towards rent seeking behaviour in Pakistan needs to be further evaluated. It has been argued by the civil society that aid was one of the factors that help military regimes become stronger. Table 13 shows that in terms of per capita aid, recent military regimes in Pakistan received much higher inflows in comparison to the civilian rule.

Table 13 Aid inflows during Various Political Regimes

Regime	From	To	Per-capita Aid (Current US \$)	Aid Received % of GNI	Total Aid \$ Million
Ayub Khan (Military)	1958	1969	7.6	7.0	5715
Yahya Khan (Military)	1969	1971	6.4	3.9	1770
Zulfiqar Ali Bhutto (Civil)	1971	1977	7.5	4.7	4861
Zia-ul-Haq (Military)	1977	1988	9.5	3.0	14792
From 1988 to 1998 (Civil)	1988	1990	9.4	2.2	24829
Pervaiz Musharraf (Military)	1999	2007	10.3	1.7	21895

3. Macro – Micro Impact of Foreign Resources

The role of foreign savings have been instrumental in leveraging short term growth in Pakistan during the post 9/11 period. Using a linked Computable General Equilibrium (CGE) – microsimulation model⁴ based on 2002 Social Accounting Matrix (SAM) we show that a 50 percent increase in foreign savings leads to an increase in real private consumption by 2.8 percent. Given the greater amount of foreign exchange available, imports increase by 3.7 percent, however exports decline by 6.5 percent. The declining exports indicate deterioration in trade balance. We can observe that trade deficit as percent of nominal GDP increases by 1.8 percent. In nominal terms the foreign savings to GDP ratio increased by 2 percent while the investment and private savings to GDP decline by 0.3 and 2.4 percent respectively⁵.

These results if seen in the light of economic theory, suggest that foreign savings can significantly alter the real exchange rate that in turn causes the trade balance to change. This

⁴ For complete mathematical details see Ahmed and O' Donoghue (2010b).

⁵ This section draws from Ahmed and O' Donoghue (2010c).

also implies that production of domestically consumed goods will alter. This happens in our results because, absorption, which is defined as the total domestic spending on a good calculated at the prices paid by the domestic demanders increases by 2.2 percent in real terms. This increase to some extent is made possible through the domestic (non-tradable) price index which is decreasing.

The value-added prices in our simulation decline mostly for tradable goods. The sectors showing the highest decline are; leather (10 percent), cotton lint / yarn (7.1 percent) and manufacturing (6.9 percent). The prices of several large sectors show an increase such as livestock, wheat milling, housing and private services. These are mostly non-tradable sectors. The direction of change is similar for the case of output prices, however the magnitude of these changes is much smaller given the inclusion of other factors in output prices. Such a change seems pro-poor given that the prices of food and oil show a decline. However the price of housing increases by 6.9 percent in case of value added price and 5.5 percent in case of output price. The decreased prices of cotton and textile also indicate towards increasing export competitiveness, however we know from macroeconomic results above, that the overall exports did not increase because of an exchange rate appreciation.

The returns for labour with farm holding and returns for land decline. The return to capital does not change. Those who gain under this change are agricultural wage labour and non-agricultural unskilled wage labour, whose wages increase by 1.5 and 0.5 respectively. It is broadly recognized that agricultural wage workers are regarded as the poorest of the rural poor (ILO 1996). The overall agriculture incomes are the second most important source, with almost 27 percent of total per capita household income (see Adams 1995). According to the Labour Force Survey around 44 percent of the employed persons (10 years age and above) are working in the agriculture, forestry and fishing sectors. Given this statistics it seems that our simulation results indicate redistribution with-in the agriculture sector, where the returns for farm owners are declining, and the wages for employed labour in agriculture is increasing. The increase in the wages of non-agricultural unskilled labour also indicates a change in favour of urban poor.

The return to land declines for all land classifications in the model. The returns for non-irrigated land decline more than the irrigated land, and with in the later the decline is greater for large and medium farms in Punjab province.

For evaluating the changes in the welfare we first see how household incomes change for our experiments. We can observe that the change mimics what we have seen for changes in factor returns. When foreign savings increase, large or medium farms are the main losers, while all other household groups gain, most notably rural agricultural workers who are landless and small farm owners. We had explained above that this also represents redistribution in favour of low income households. Household consumption however increases for all groups. The increase is greater for rural workers.

In line with the household welfare impact explained above, poverty decreases by 3.1 percent when foreign savings increase by 50 percent. Poverty gap and severity both show a decline. Poverty decreases in all provinces with Punjab having the highest decline by almost 3.3 percent followed by Sindh (2.8 percent). The inequality as measured by Gini coefficient declines by 0.3 percent.

4. Aid Effectiveness in Pakistan

The fundamental notion behind the usage of aid facility should be ownership of development agenda and preferably home grown policies that are envisaged by the recipients of aid in alignment with national strategies. The delivery of aid requires transparency and effectiveness of national institutions, starting from the federal tier to the local or municipality level. Having a constant eye on results and outcomes requires continuous reiteration of development goals at all levels of public sector and civil society. The development parameters should be coordinated and synchronized in order to keep aid flows tractable. The predictability of aid should be accompanied with untied arrangements and finally overarching development agenda of the country should be augmented through appropriate real sector and external account policies.

Most recent aid inflows for Pakistan are associated with geo-political, law and order situation inside the country and the neighbouring region with Afghanistan. The security concern of donors however has hampered future aid flows to Pakistan particularly in long term infrastructure projects. The volatility of assistance in turn results in delayed disbursements, project closures, shifting of aid portfolio from budgetary support to project aid.

The development budget of 2007 indicated 17% foreign funding. It is estimated that only one third external assistance appears in the budgetary record and forms a part of Public Sector Development Programme (PSDP). The optimal absorption of these foreign resources largely depends upon the implementation capacity of federal, provincial and local governments. Donors have at times argued about the duplicity of development policy documents being issued by various government institutions. Apart from the main development dossiers such as medium term plans by Planning Commission, the federal ministries also have their own policy document such as Annual Trade Policy developed by Ministry of Commerce, Textile Policy designed by Ministry of Textile, Investment Policy given by Board of Investment and National Education, Health and Social Sector Policies designed by relevant ministries. This fragmented policymaking makes the development implementation task all the more difficult for stakeholders and leaves foreign assistance misaligned.

The challenge of coordinating fragmented assistance in Pakistan is more difficult in sectors such as governance, education, health & nutrition, gender and environment which are receiving aid for small projects from a large number of donors. The donors should fast come to conclusion about a manageable scale of program and the manner in which delivery of aid is kept strongly grounded in Paris Declaration Agenda. An understanding is also necessary regarding how much of assistance should be managed in a decentralized fashion. The Development Assistance Database (DAD) for 2006 indicates 20 donors who have been regular in assisting Pakistan in recent past. Around five donors which include ADB, WB, Japan, China and US are providing 90% of annual disbursement. These donors need to connect with each other on a more regular basis in order to ensure absorption of disbursed aid. The country representatives of most of the donors are still far from the principles of Paris Declaration being advocated in their top hierarchy.

The coordination between domestic institutions suffers due to lack of clarity regarding rules and responsibility of various authorities. The Paris Declaration survey 2006 had revealed small portion of coordinated technical cooperation. At the government level careful attention should be given to formulation of aid policy, which should define the provision, allocation and coordination of aid. The aid policy once formulated should be able to ensure compliance with conditionalities. The Economic Affairs Division (EAD) working under the Ministry of Finance should also streamline internal procedures in order to ensure the aid effectiveness in line with international best practices. The policy should also streamline a plan for systematic dialogue between donors at various levels of government (currently three federal ministries

deal with disbursement of foreign aid). At the national level, Pakistan Development Forum (PDF) provided opportunity where donors may have detailed sectoral dialogue with recipient institutions. However the inconclusive discussions at PDF indicate the need to restructure this forum and make it more focused towards information sharing dialogue on crosscutting themes and impediments in aid implementation. The establishment of the new consortium led by US, Friends of Democratic Pakistan (FoDP) resulted in discontinuation of PDF. However reduced FoDP inflows have prompted the donors to demand a revival of PDF.

Malik (2009) splits the analysis of quality and coordination of ODA in three main areas of concern namely: a) composition of aid, b) fragmentation of aid and c) aid volatility. Taking lead from Easterly and Pfutze (2008) to highlight that some form of aid and technical assistance may be less effective than others, the author emphasizes the important role of aid-mix in determining flexibility of resources. There is limited need assessment, insufficient local efficiency and communication in design of technical cooperation and not much attention is given to follow up phase which should ideally ensure proper monitoring. Past experience suggests that China (whose aid accounted for 66 percent of total aid commitments in Pakistan) during 2001-2007 and non DAC donors do not participate in aid coordination forums.

The issue of aid fragmentation is most seen in social sector such as governance and education. The higher transaction costs attributed to increased fragmentation take the form of time and money spent on compliance and coordination. Rabia (2005) shows for education sector that aid since 1999 has come from numerous donors in small quantities. However, it becomes difficult to assess the donor influence due to lack of consistent data on performance indicators.

The volatility of aid poses problems that include poor planning , increased number of short term projects, discontinuity of projects and cash flow issues with existing projects. The volatility of assistance has led to a large size of throw forward (public sector projects which stand approved but now lack liquidity). The current PSDP throw forward liability has exceeded Rs 3 trillion. OECD DAC data shows that between 2000 to 2006 Pakistan faced 35% more volatility as compared to an average recipient. The variation in aid composition accounted for 70% of overall volatility during 1997 to 2006. Around 76 % of volatility in grants during 1998 to 2007 originated from the grants provided by US. The unpredicted aid has translated into assistance falling short of the committed amount on occasions. Around 20

% of ODA disbursed has never been released and 50% of donors disbursed less than the committed amount (Malik 2009).

The sources of aid volatility in Pakistan include limited implementation capacity, changing donor priorities and geopolitical conditions. The short term orientation of aid flows has contributed toward unsustainability of development. Around 45% projects which carry 34% of disbursement were of 3 years duration or less.

Pakistan participated in the Paris Declaration monitoring survey 2006, however it did not participate in the next round as the exercise coincided with the election cycle and shifts in development priorities. We may summarize here the results from 2006 survey⁶.

- Around 88 percent of total ODA disbursed by the government sector was recorded in the government system.
- Out of the total ODA provided for technical cooperation in 2005, only 28% was disbursed in support of coordinated capacity development programmes.
- During 2005, 76% of ODA was disbursed by using the public financial management system of the Government. The Government has set up a multi-donor working group to look at improving harmonization of donor financial management and procurement systems, and increasing the alignment and use of the Government procedures.
- Out of the total ODA disbursed in 2005, 68% was disbursed by using the national procurement systems. In total, 7 out of 16 donors used the national procurement systems. However, only three of them (WB, ADB, USAID) account together for 97% of the total ODA disbursed by using national procurement systems. The vast majority of donors disbursed none or very small amounts of ODA by using the national procurement systems.
- Out of the ODA disbursements planned for 2005, 83% was recorded as actually disbursed by the government. While overall predictability, according to the measure used in the survey, seems to be high, government's experience suggests that in-year predictability of disbursements is rather low. At the time when the corresponding commitment is made, many donors do not indicate when (e.g. in which quarter) the disbursement is planned.
- In 2005, 31% of the total ODA was disbursed in support of initiatives adopting programme-based approaches. The majority of the funding disbursed through programme-based approaches was disbursed as budget support (84%). There is very little use of programme based approaches outside of direct budget support. Out of 16 donors, WB accounts for 82% of the total ODA disbursed in support of programme-based approaches.

⁶ This draws from material provided to us by Economic Affairs Division.

- The proportion of joint missions and joint analytical work is relatively low at 12% and 41% respectively. Coordinated missions and analytical work are still only conducted on an ad-hoc basis.

5. Pakistan-Specific Case Studies in Aid Effectiveness

In this section we discuss briefly the key aid experiences of Pakistan under specific programmes. In 1954 with the revamping of individual country program under Foreign Aid Bill, US stepped up aid for Pakistan which continued until mid 1960s. The war of 1965 between India and Pakistan meant that US administration wanted to impose statutory curbs on both countries – a move later vetoed in Congress. A similar action was initiated against Pakistan during civil war of 1971 which called for banning US economic and military aid to Pakistan (Kole 1971).

By end 1970s as the Soviet Union flexed its strength in Afghanistan, US came forward with a series of aid packages for Pakistan which formally started in 1981 and lasted for most part of the military regime in 1980s. After the breakup of Soviet Union, US aid to Pakistan sharply diminished and 1990s saw Pakistan relying on non-concessional sources even to cover its past debt accumulated during the Afghan war period. This implied a movement away from bilateral sources of aid towards multi-donor programmes.

The Social Action Programme mainly designed and initiated by WB in Pakistan in 1992 was aimed at improving human development status and improving socio – economic indicators in Pakistan. Initially the programme’s focus was through primary health services, education sector, population welfare, rural water supply and sanitation aimed to augment the quality and quantity of investment in social services (DFID 2000). The government in partnership with donors agreed to raise spending, improve sectoral policies and make efforts toward removing initial constraints. Despite making progress in growth and investment not much achievement was seen in human development sphere during 1990’s. Among the lapses identified in optimal utilization of programme, predicaments included: inefficient resource allocation, poor design of social services, non-optimal utilization which was in part due to institutional weakness.

In various donor evaluations these difficulties had been attributed to lack of ownership at both political and bureaucratic level. Furthermore the federal administrative structure of country implied that revenues and fund were been generated at the federal tier and social

sectors were been managed by provinces. This not only made the process of implementation more challenging but also required the high level of commitment at both tiers.

From the outset this programme was being considered as WB dominated program, which not only implied the government following the WB style implementation but also meant that other donors did not come forward in a truly coordinated manner for financing the same or similar projects. Provincial government had to go through mundane monitoring processes, where little attention was been paid to overarching theme of social reforms. By 1997 after a review of first phase, WB shifted entire management of Social Action Programme to Pakistan for initiation of second phase. Only this time WB agreed on a more participatory approach among all stakeholders. In DFID (2000) it was again emphasised that WB only held limited engagements.

In its country assistance evaluation (2006) WB highlighted the manner in which bank's assistance strategy was changed overtime. By 1998 when focus of the strategy was completely on service delivery through vehicle of Social Action Programme, targeted programmes were introduced for social protection and it was during this phase when Pakistan Poverty Alleviation Fund (PPAF) was created in 1999 to facilitate in the provision of micro credit and small scale community infrastructure. However 2001 country assistance strategy progress report informed that the program outcome fell short of targets and despite significant investment from government and donors, social sector indicators exhibited dismal performance. In education, particularly primary education, poor governance was held responsible which in turn was an outcome of financial mismanagement and lack of accountability at teacher's level. In health sector the resistance to mobilize NGO's was termed as the main cause of weak result.

At this stage the government adopted new reform program focused on expanding devolution process. It was envisaged that accountability at the local level will improve service delivery. In order to address the gender issues raised by the civil society while increasing the number of seats and capacity building programmes for women parliamentarians, government with support of donors also expanded at the micro level, lady health workers program and conditional cash transfers to female students in primary schoolings.

Three years into the devolution program WB, ADB and DFID published a joint report in 2004 that focused on six districts and found evidence of change where citizens reported that their voices were now being heard at the administrative levels. Recommendations for further

improvement emphasised incentives for efficiency, local accountability and efforts to gradually change existing practices and attitudes. For the overall decentralization process, Keefer *et al.* (2005) suggested embedding of decentralization in the national constitution and improving voter information regarding actions of local officials. The process of political decentralization was supposed to follow fiscal decentralization. However with the return of civilian rule in 2007-08 the new government in a bid to strengthen federal and provincial tiers abolished the local governments - a move which was resented by civil society and smaller political parties.

The aid experiences in Pakistan will be incomplete without the mention of rural support programs. The Aga Khan Rural Support Program (AKRSP) operational in northern Pakistan since 1982 provides an example of private development agencies working towards community – driven participatory rural development through indigenous self-help projects. The aim was to facilitate venture capital for rural enterprise however the pre-requisites required a process of village organization. The villagers should choose leaders, set priorities and select fellow villagers to lead various teams focusing on economic and social ventures. In this process the villagers learn to create a consensus amongst themselves and to keep the new infrastructure maintained (see De Spoelberch and Shaw 1987, Padawangi 2010).

Inspired by the AKRSP model, the government in 1992 launched a nation-wide National Rural Support Program (NRSP). An important feature of scaling-up of rural support programmes (RSPs) was that these were created as independent non-profit bodies. This implied that these RSPs would remain insulated from political and bureaucratic interference. At the initial stages of RSPs the main commitment came from Aga Khan Foundation, Canadian and UK governments however at later stages federal government became the leading resource provider (Malik 2009). Another important contribution of Aga Khan Foundation along with Orangi Pilot Project in Karachi was the initiation of microfinance movement in Pakistan which ultimately became the main objective of establishing PPAF (see Shah 2009 and Muhammad 2010).

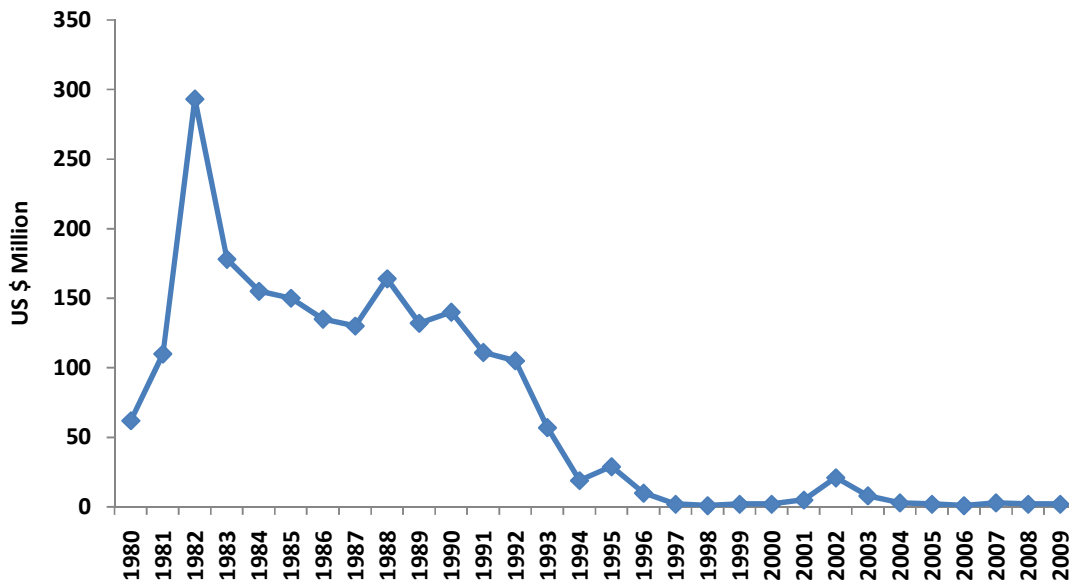
The PPAF largely focuses on enterprise development, water and community infrastructure, education and health. The government receives a soft loan from donors and forwards it to PPAF under even softer terms. The PPAF then identifies non-governmental organizations or other civil society arrangements amongst whom it disburses the funds. Currently this fund has the largest support from the WB. While discussing possible implications for aid

fragmentation, Malik (2009) argues that PPAF model reduces duplication of programs and internalizes the aid arrangement with multiple donors.

Another recent aid experience of Pakistan originates from the 2005 earthquake when almost 73500 people were killed. The aftermath of the earthquake also saw 128000 people with injuries and requiring immediate rehabilitation. Almost 3.3 million people had lost their homes and now required shelter and food. In terms of physical infrastructure the loss included 600000 houses, 6400 km of road network, 6298 schools, 350 health facilities, 3994 water supply lines, and 949 public sector buildings. MacLeod (2006) indicates the success of early recovery programme due to a cluster approach that allowed military and civilian efforts backed by donor community to focus on: protecting most vulnerable, restoring capacities, rebuild livelihoods, secure human development gains, reduce disaster risk, engage private sector, promote self-sufficiency, ensure transparency and accountability, and remain coordinated at all levels of operations.

While documenting the history of aid in Pakistan, one has to also evaluate the impact of assistance for Afghan refugees. Hilali (2002) explains that Afghan war had detrimental impact on internal and external security of Pakistan. After Soviet invasion of Afghanistan in 1979 Pakistan saw a record influx of refugees entering its border. The refugee settlements created political, economic, social, environmental and ecological problems for Pakistan. In various areas of Pakistan the refugees destroyed ecological balance, causing desertification and soil erosion and promoted drug trafficking, Kalashnikov culture, sectarianism, and law and order problems that still persist. The author also explains how the Afghan war corrupted Pakistani elites and provided political legitimacy to military rule and dictatorship in the country (see also Ibrahim 2010). Figure 5 indicates how assistance to Pakistan towards Afghan relief declined pre-maturely. During mid and late 1990s when Pakistan was host to the highest number of refugees in the world, Afghan assistance was at its lowest.

Figure 5 Aid Towards Afghan Relief



6. Priorities for Aid Policy Reform in Pakistan

a. Paris Declaration and Aid Policy Framework

In September of 2008 representatives from developing and developed countries met in Accra, Ghana to reinforce the commitments towards aid effectiveness in Paris Declaration. It was realised that real progress has been made towards improving lives of those under extreme poverty however rising commodity prices now posed a greater challenge if countries are to successfully accomplish MDGs. According to the 2008 Paris Declaration survey, developing countries had started to improve management of public funds and donors were now working in a more coordinated manner. The World leaders in Accra established consensus towards three main factors that can play a vital role in improving aid effectiveness.

First the strengthening of country ownership over development should take the form of deepening country-level policy dialogue on development, expanding the capacity of developing countries to lead and manage development processes and using the institutions and systems available in developing countries to a maximum extent possible for improved service delivery.

Second in order to build more effective and inclusive partnerships for development there is a need to reduce costly fragmentation of aid, increase aid's value for money, encourage a broad base of developing actors in recipient countries, deepen engagement with civil society organizations, and adapt aid policies for countries in fragile situations.

Third in order to move fast towards improved delivery and accounting for development results there is a need to develop information systems which in turn should help in strengthening the quality of policy design. Cost-effective results management is important to assess impact of developing policies. Donors need to align their monitoring with country information systems and incentives to improve aid effectiveness should be strengthened. In order to make aid more transparent there still remains a need to make further improvements to public financial management and to further support ownership the nature of conditionality should be reformed. Finally greater predictability in aid flows is imperative so that developing countries are in a position to manage their own development strategies.

Pakistan in its draft Foreign Assistance Policy Framework⁷ reinforces strengthened collaboration of all development actors in line with principles outlined in Paris Declaration. The two basic principles governing the policy framework include: ensuring compatibility and convergence of foreign – aided development with national plans and improve quality, effectiveness and efficiency of foreign assistance. The policy is based on principles of national ownership, alignment of national priorities, harmonization with national systems and procedures, results-oriented monitoring and evaluation, inclusive dialogue and information sharing.

The national budget streamlines the development priorities in the country. The draft policy therefore prefers budgetary support over other forms of assistance. This is intended to strengthen institutional capacity, reduce transaction costs, improve coordination, and make disbursement and delivery more flexible. The government will further prefer unearmarked funding in order to avoid distortion in allocation of funds. Earmarking by donors reduces government's role in establishing development priorities. The budget support should also be complemented with technical assistance in order to ensure results in line with best practices. In various evaluations project assistance was not found sustainable after a certain period. In order not to see this in future, project assistance should ideally be integrated into programmatic approaches and implemented through national institutional arrangements.

⁷ Currently at consultative stage in Economic Affairs Division.

In order not to further add to the debt burden, government will prefer grants and concessional (soft) loans. The later will only be used where future cash flow is expected and pursuit of economic growth is helped. Loan assistance will be considered for infrastructure development and venues that help foreign exchange earnings. The feasibility study component of loan based programmes will be completed through grants which in turn will mean minimal expenditure on foreign consultants. The aid provided should be untied however goods and services equivalent to a certain proportion of total financial volume may be allowed if some specific project requires niche technology or expertise. Even in case of technical assistance (which should ideally be financed through grants) tying with source or origin of financial assistance will not be desired.

While maintaining the independence of non-governmental organizations (NGOs) the government believes in sharing of information regarding funds and activities so that no duplication takes place at the national level. The government will work closely with NGOs in developing standard codes for NGO transparency and accountability.

A proper division of labour mechanism among development partners should be established in future. In order to avoid excessive fragmentation the government will aim to ask donors to work in thematic areas outside of which all donors should support that development partner which is already active in other areas.

The proposals for financial assistance should follow aid prioritization criteria that includes: conformity with fiscal responsibility and debt limitation law, complimenting domestic budgetary resources outlined in national plans, contribution towards achievement of regional balance by targeting underdeveloped areas.

b. Friends of Democratic Pakistan (FoDP)

Pakistan Development Forum (PDF) has served as a dialogue forum between various development partners. The forum allowed the donors to interact with the officials managing various socio-economic sectors in Pakistan. In the wake of heightened war in the region neighbouring with Afghaistan and a military operation that lasted for several months followed by terror strikes in various cities, US helped in forming a consortium of countries and organizations willing to assist Pakistan in successfully winning the war on terror and reconstruction of war torn areas. The FoDP that has already met twice has asked Pakistan to make further efforts in eradicating terror elements inside its borders and plans to tie aid

programme for Pakistan with security efforts. Many donors believe that this demand from the developed world may take a lot more time than currently being envisaged. Hence many are of the view that replacing PDF with FoDP was a mistake and has disrupted the previous mechanism of structured dialogue.

Pakistan's present dialogue with donors under FoDP focuses on: a) security, b) socio-economic recovery, c) medium term development programme, d) integrated energy development, and e) institution building. The precise summary of proposals for the FoDP meeting in Tokyo focused on: a) food security, b) reducing cost of doing business in Pakistan, c) poverty alleviation, empowerment and employment and d) FATA people empowerment.

In food security cluster, assistance is desired for: a) water management and development and b) development of agricultural resources on cost efficient lines. The proposed projects under water sector include the construction of Bhasha-Diamer dam, rehabilitation of irrigation infrastructure and 32 small dams. In agriculture sector proposed projects include the increasing of post-harvest efficiency, productivity enhancement, value addition and institutional development.

In order to reduce the cost of doing business three specific sectors need attention. First, transport and communication sector will involve maintenance and development of roads, rail network and ports that can reduce the travel time and cost for merchandise goods and in turn increase the competitiveness of Pakistani goods. The mineral development strategy will focus on marble, granite and onyx value chain, iodized table salt plant, and creating a quarry machine tool.

Projects focusing on poverty alleviation, empowerment and employment have been split into four main areas: a) health and population, b) education, c) safety net for the vulnerable, and d) skills development and employment.

Under the health, education and livelihood cluster proposed projects are aimed at: programme for access to health services, girls secondary school education, safety net for vulnerable (which has also translated in to Rs. 70 million worth Benazir Income Support Programme), skills development, national employment programme and population welfare.

The ongoing energy crisis has meant rising costs for businesses and electricity shortages for both industry and household sector. The SME sector in Pakistan has been the worst hit due to unannounced electricity and gas stoppages. Three projects proposed in the Abu Dhabi

meeting with FoDP included: Thar Coal development project, Bunji hydro power plant and Guddu thermal power. The total cost of developing these projects stands at \$8.5 billion in 2009 prices.

A lot of focus in future will be towards the rehabilitation of internally displaced persons (IDPs). Pakistan faced two accounts of forced internal migration namely: a) earthquake of 2005, b) war operations in northern parts of the country that started in 2007. According to 2009 estimates 310,000 people had migrated from their homes. In 12 relief camps approximately 61180 IDPs were residing⁸, 38750 houses had been destroyed⁹. The daily expenditure per capita on food and shelter-related facilities was around US\$1.9. One of the key proposals include empowerment of people in federally administered tribal area (FATA) of Pakistan who were displaced the most. A comprehensive package is required in the region that focuses on providing education, health, food security and infrastructure (including energy) to the people of this region. For social empowerment of people in this region the government proposes scholarships for FATA students, provision of missing facilities in schools, establishing FATA Institute of Medical Sciences and establishing Institute of Engineering and Technology.

The socio economic revival and sustained growth will require help from FoDP on mitigating cost of war on terror, market access and economic cooperation, securitization and debt swaps, and the establishment of proposed FATA Pakistan Trust Fund.

Pakistan is seeking market access and expanded economic cooperation with US, EU and Japan. With the US, plans focus on Reconstruction Opportunity Zones (ROZs) for FATA, Khyber Pakhtunkhwa province, earthquake affected areas and Baluchistan. Appropriate amendments should be made in rules of origin to maximize gains for these zones. Pakistan for a limited period should be allowed unilateral tariff concessions for exports particularly of textiles and garments sector. There should be early finalization of bilateral investment treaty and there should be firm commitment to initiate FTA negotiations. In case of EU, Pakistan is seeking inclusion in GSP+ scheme and initiation of FTA negotiations. In South Asia, EU has already initiated talks with India towards FTA arrangement. With Japan, Pakistan wishes increased market access for its agricultural commodities and an initiation of early negotiation on FTA.

⁸ Others were forced to find residence with friends and relative in other areas of Pakistan.

⁹ Approximate cost of repair is Rs 500000 per house.

The FoDP have also been asked to enter into debt swap arrangements to ease the debt burden of Pakistan. The main item in this arrangement is Paris Club debt which amounted to almost \$10.8 billion in 2009. A deferred oil facility has been requested from Saudi Arabia and UAE. Pakistan has suggested the establishment of a multidonor trust fund to administer the development in FATA, Baluchistan, Khyber Pakhtunkhwa province and AJK.

The fundamental assumption behind productivity-led growth is security of assets and profits. Pakistan requires financial and technical assistance to substantially raise a trained police force in all four provinces. There is a need to provide the police force with forensic and surveillance equipment in order to improve their tracking ability. Women police units in every police station (1200 in number) of Pakistan are desired. These should be autonomous and staffed by female employees.

The institution building cluster comprises of three main sub-sectors: e-governance, human resource development, gender empowerment and partnering with institutions. In case of e-governance the focus should be on e-administration (computerization of urban and rural property records, systems and procedures), e-justice (computerization of judicial records) and e-security (computerization of records of law enforcement agencies). A key project towards improved gender empowerment and HRD is the nursing sector initiative. Emphasis will be on strengthening the quality and increasing quantity of nurses in Pakistan in order to produce a targeted number of nurses to meet both the domestic and international demand.

Pakistan also proposes strategies for partnering with institutions in FoDP countries. Potential ways to collaborate include: 'adopt' an organization, public private partnership, exchange programs, sponsorship schemes, technology transfer and endowment programs. Two potential partnering arrangements may be with Alternate Energy Development Board and Pakistan Agriculture Research Council.

As a result of proposals submitted to FoDP it is estimated that immediate incremental increase in GDP will be around \$8 billion with an increase in employment of around 5.74 million labour. However it is disappointing to note that after the first two meetings, FoDP had pledged \$2.2 billion, which was later slashed to \$874 million. By April 2010, Pakistan had only received \$251 million (excluding \$325 received from Islamic Development Bank). The contributors were Saudi Arabia, US and EU. The US also released the payment towards Coalition Support Fund after considerable delay.

c. Kerry – Lugar Programme for Pakistan

The interests of US that revived in Pakistan after 9/11 incident have translated more recently into expanded USAID programs. The assistance has focused on education, health and technical cooperation. The Kerry – Lugar act 2010 aims to provide an annual \$1.5 billion civilian aid to Pakistan for the next five years. The advocates called this bill a move to rebuild trust with a critical ally.

The new US administration in 2009 framed its thinking in the new USAID Country Assistance Strategy for Pakistan (2010-14). It is realised that in order to meet Pakistan's development needs, assistance should flow from the public and private sector of US in high impact projects that focus on energy, agriculture, education and health. In order to sustain these investments, complimentary efforts should be undertaken to strengthen the human, financial, and institutional capacity. The funding mechanisms will be such that support for infrastructure projects will flow to the national government direct as budget support or public private partnership. Alongside greater emphasis will be on relationship with Pakistani non-profit and non-governmental organizations that are working in social sectors.

The US has formalized its contribution to the FoDP forum in the shape of Kerry Lugar bill which was cleared by the United States House of Representatives in September 2009. This aid program is a step toward socio-economic development at civilian level population and will rejuvenate Pakistan's institutional capacity, developing tribal areas and encouraging multilateral solutions by engaging neighbouring countries such as India and Afghanistan. The program proposed use of NGO rather than government ministries to disburse aid.

This aid arrangement will make Pakistan second largest recipient of U.S. aid in the world. The assistance to be provided to Pakistan will mainly fall under categories¹⁰ such as: a) civil liberties, b) political rights, c) voice and accountability, d) government effectiveness, e) rule of law, f) control of corruption, g) immunization rates, h) public expenditure on health, i) girls' primary education, j) public expenditure on primary education, k) natural resource management, l) business start-up, m) land rights and access, n) trade policy, o) regulatory quality, and p) fiscal policy management.

Critics while admitting that long term non-military aid of \$ 7.5 billion over the next five years is a significant step initiated by US for the socio-economic reforms in the country

¹⁰Categories as described in the annual "Report on the Criteria and Methodology for Determining the Eligibility of Candidate Countries for Millennium Challenge Account Assistance"

argued that for economic growth in the country increased market access for Pakistani goods should have been top on the agenda. The US has again designed a strategy that focuses on aid, not trade. The element of distrust between the two nations that originates from US leaving Pakistan in the middle of an incomplete development agenda as soon as Soviet Union retreated in late 1980s, still explains the apprehensions of people from all walks of life in Pakistan towards the Kerry – Lugar assistance (See Ashraf 2009). Paris (2010) states that *Pakistani opinion is so anti-American that sometimes it is hard to figure out what the US should do in Pakistan*. Kfir (2009) argues that Kerry – Lugar strategy will not help substantially towards improving the socio-economic situation in Pakistan as it ignores the core problem in the region i.e. lack of strong democratic institutions. Nawaz (2010) argues that the war in Afghanistan could be lost if US doesn't start helping Islamabad and discusses the need for US to help Pakistan in rebuilding its infrastructure that could knit the country together and create future employment and investments. The need for establishing education centres by US has been stressed for its benefit in terms of upgrading human capital and strengthening civil society.

O' Hanlon (2010) provides a way forward in promoting regional integration in the region that may well provide the much needed economic stability. The author suggests: the early passing of bill that proposes free trade between Pakistan's tribal areas and US, encouraging Pakistan and India in passing their own free trade accords, helping Pakistan – Afghanistan transit agreement to become a success, building fuel pipelines and electricity lines from Central Asia through Afghanistan and into Pakistan.

Table 14 Aid, Loss of Life and Damage to the Economy

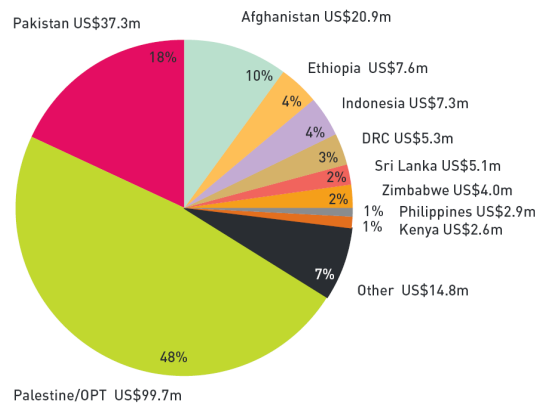
	ODA current (\$ million)	Aid to Death Ratio	Economic loss (\$ million)	Aid to Economic Loss ratio
2002	2136	-	-	-
2003	1071	3.5	-	-
2004	1439	1.5	-	-
2005	1607	1.9	4400	0.37
2006	2140	1.3	5000	0.43
2007	2244	0.6	6000	0.37
2008	1539	0.2	7700	0.20

Source: Data on ODA from WDI, data on number of deaths from SATP database, data on economic loss from Economic Survey of Pakistan 2009-10.

It has been repeatedly said that at the start of collective initiatives against global terror, coalitions usually are enthusiastic to help smaller partners. However as the war prolongs it is

these smaller partners that are left stranded with diminishing assistance. Table 14 indicates that this is precisely what happened in Pakistan more recently. The aid to death ratio (i.e. aid receipts per person killed) has been declining since 2003. Similarly aid to economic loss ratio which was \$0.4 million in 2005 had fallen to half in 2008. Pakistan’s war – related assistance has been one of the major factor in increased aid from non-DAC donors.

Figure 6 Major Recipients of Non-DAC Donor Humanitarian Aid 2009



Source: Development Initiatives based on UN OCHA FTS data

7. Conclusion

Pakistan being a frontline state in the war against terrorism has also remained one of the highest recipients of foreign aid. This paper analyses foreign assistance through four main facets namely: the link between aid, security and growth with special reference to Pakistan, general equilibrium impact of foreign resource inflow on economic growth and poverty, aid effectiveness in Pakistan, and priorities for aid policy reform in the country.

The empirical literature on the impact of aid on economic development in Pakistan is inconclusive due to aid being fragmented and volatile. The donors have remained poorly coordinated with a weak follow up mechanism. Pakistan for its part has seen mixed experiences in aid absorption. While a decade long nation-wide social action program could not translate into improved social and welfare indicators, there are some success stories such as: rural support networks, microfinance opportunities, cluster approach for earthquake relief and recovery.

While the economic implications of prolonged reliance on aid indicate Dutch disease effects at the macroeconomic level in Pakistan, there are more concerning effects at that micro level where society has started to perceive aid as a compensation (and not assistance) for Pakistan's involvement in wars led by developed nations. This behaviour besides corrupting the elite also promotes rent seeking where agents gaining from war have a vested interest in keep the conflict intensified.

Pakistan along with its development partners has taken measures to move towards the directions indicated in Paris Declaration. The EAD is in the process of finalizing Foreign Assistance Policy Framework which is governed by principles that ensure compatibility and convergence of aid with national plans and improve quality, effectiveness and efficiency of foreign assistance. Having a national aid policy is all the more important at this stage when Pakistan is in the process of seeking assistance from the FoDP consortium and Kerry – Lugar arrangement with US. The improved mechanism should include appropriate amendments based upon the lessons learnt from past experiences.

Finally as the reconstruction work takes off in the war-torn areas, there will be increased need for regular quantitative and qualitative analytical work by both government and donors. The research dissemination should then translate in to a process of effective dialogue between all stakeholders.

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9. Annex – I

Table 15 Total Bilateral Aid Disbursed (\$ Million)

Recipient(s)	2004	2005	2006	2007	2008	Total
Afghanistan	2303	2818	2956	3965	4865	16907
Bangladesh	1414	1318	1220	1515	2061	7528
Bhutan	78	90	102	90	87	447
China	1716	1814	1248	1487	1489	7754
India	774	1851	1383	1384	2108	7500
Indonesia	127	2509	1311	896	1225	6068
Iraq	4647	22046	8870	9185	9880	54628
Maldives	28	76	38	37	54	233
Nepal	425	424	511	609	716	2685
Pakistan	1439	1607	2140	2244	1539	8969
Palestinian Adm. Areas	1115	1116	1450	1872	2593	8146
Philippines	449	567	565	647	61	2289
Rwanda	490	577	589	722	931	3309
Sierra Leone	376	340	347	545	367	1975
Somalia	199	237	391	384	758	1969
Sri Lanka	506	1155	786	613	730	3790
Sudan	992	1823	2044	2112	2384	9355
Turkey	285	396	566	792	2024	4063
Vietnam	1846	1913	1845	2511	2552	10667

Table 16 Aid Disbursed by United States (\$ Million)

Recipient(s)	2004	2005	2006	2007	2008	Total
Afghanistan	778	1318	1404	1514	2112	7126
Bangladesh	63	49	42	49	93	296
India	51	57	97	85	52	342
Indonesia	69	156	190	117	115	647
Iraq	3022	11228	4782	3749	2742	25523
Nepal	35	52	62	54	78	281
Pakistan	77	323	478	434	351	1663
Palestinian Adm. Areas	274	181	206	212	491	1364

Philippines	79	97	98	85	71	430
Rwanda	50	57	78	91	117	393
Sierra Leone	30	22	21	21	16	110
Somalia	32	37	95	59	243	466
Sri Lanka	-3	59	29	33	52	170
Sudan	378	759	739	710	848	3434
Thailand	10	21	25	45	40	141
Vietnam	30	28	45	41	63	207