

POLICY PRIORITIES FOR FOREIGN AID REFORM IN BANGLADESH

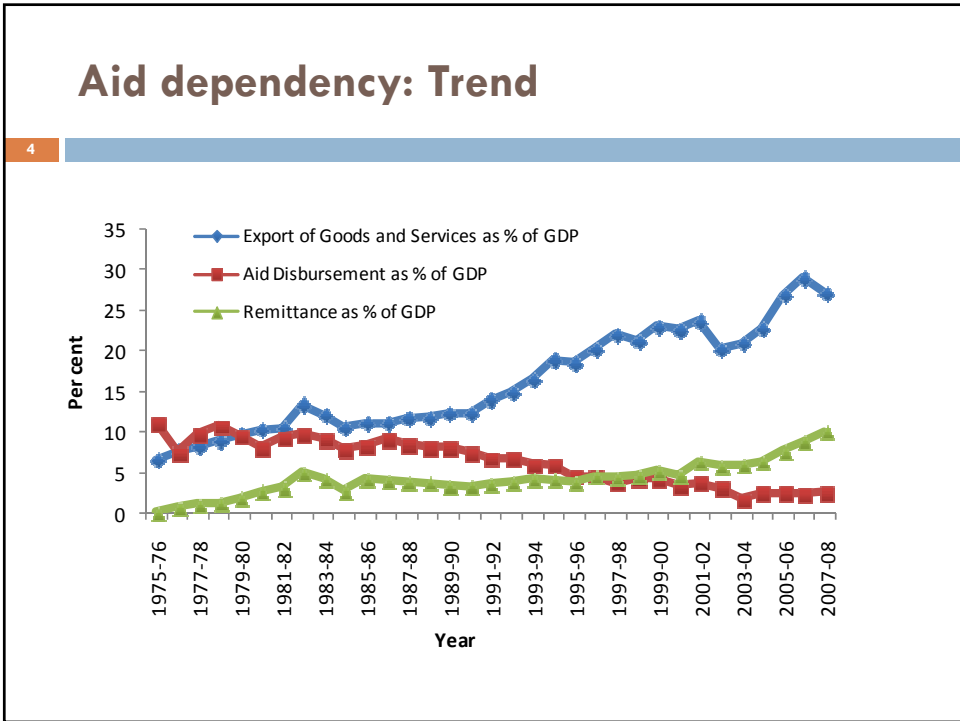
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Outline of the presentation

- Changing pattern of aid dependency in Bangladesh
- Changing pattern of aid composition
- Aid and savings in Bangladesh: Exploring the relationship
- Effectiveness of aid in Bangladesh: Issues and Concerns

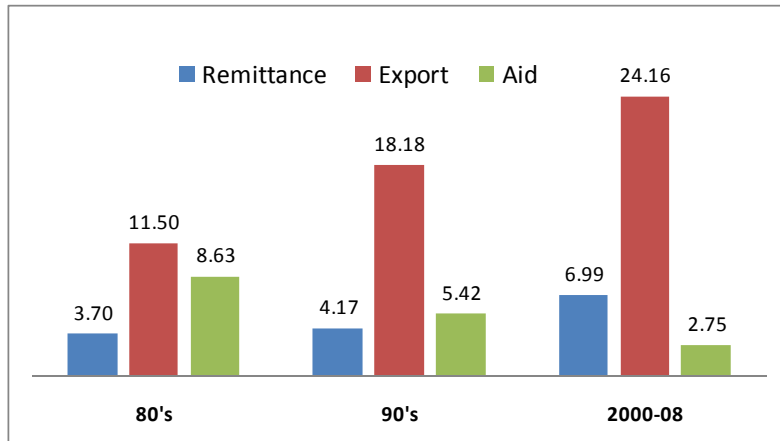
3 **Changing pattern of aid dependency in Bangladesh**



Aid dependency: Decade average

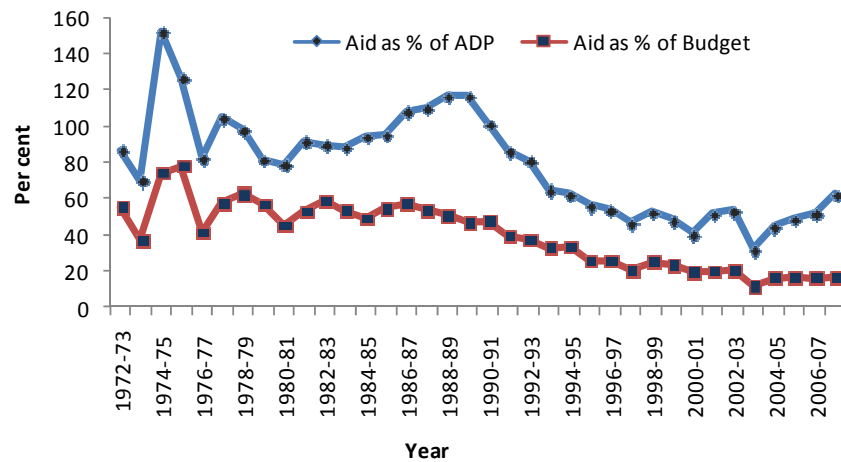
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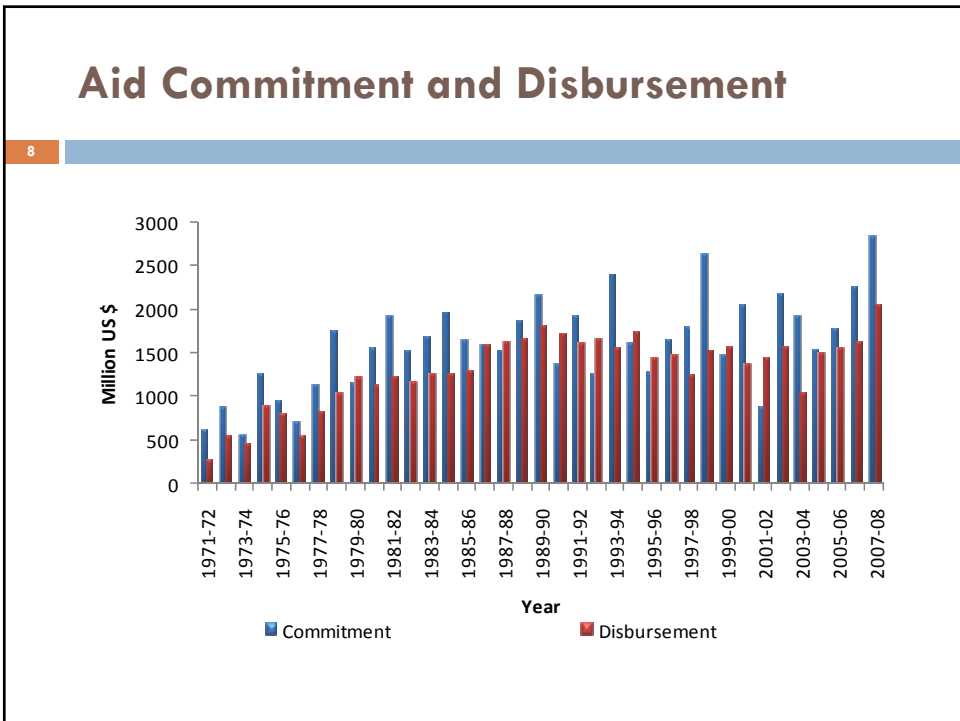
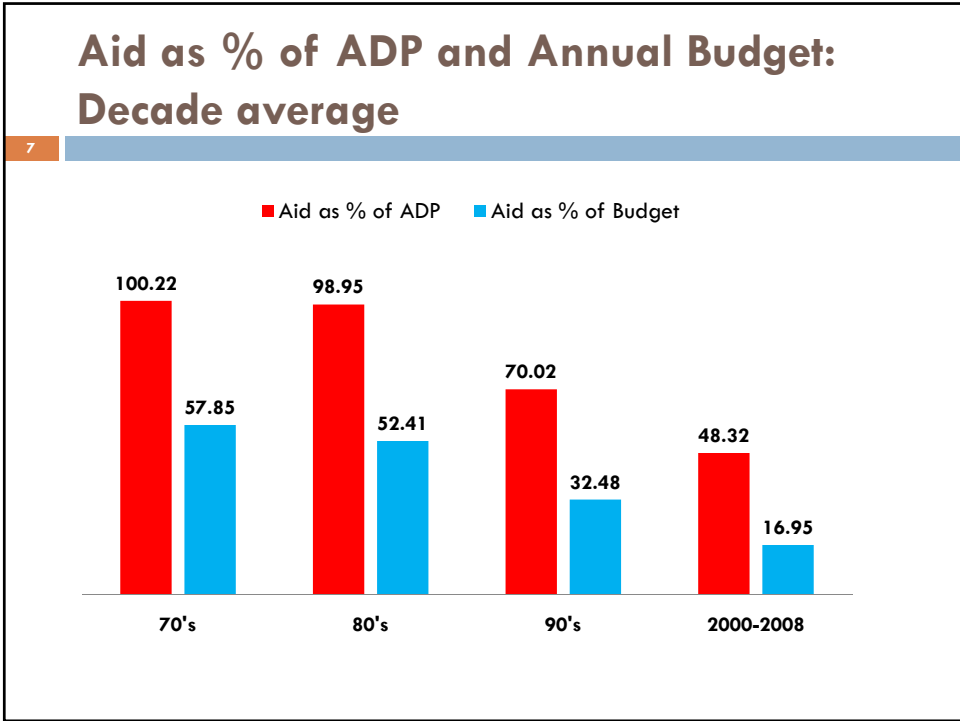
% of GDP



Aid as % of ADP and Annual Budget: Trend

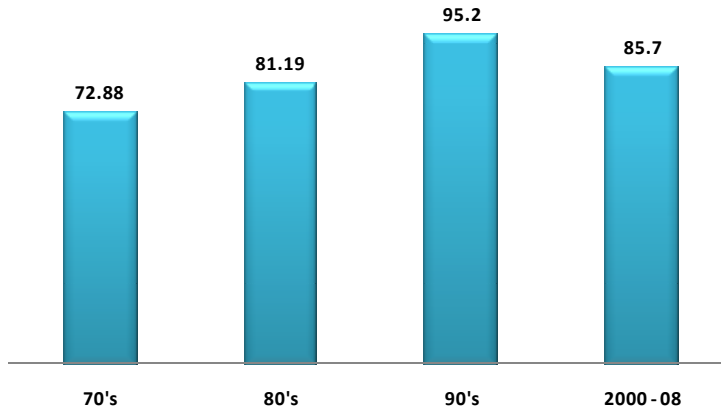
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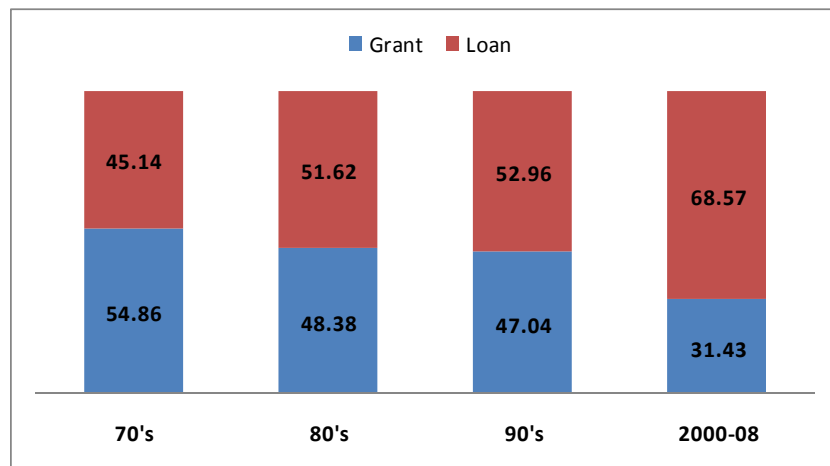
Decade Average Disbursement as % of Commitment

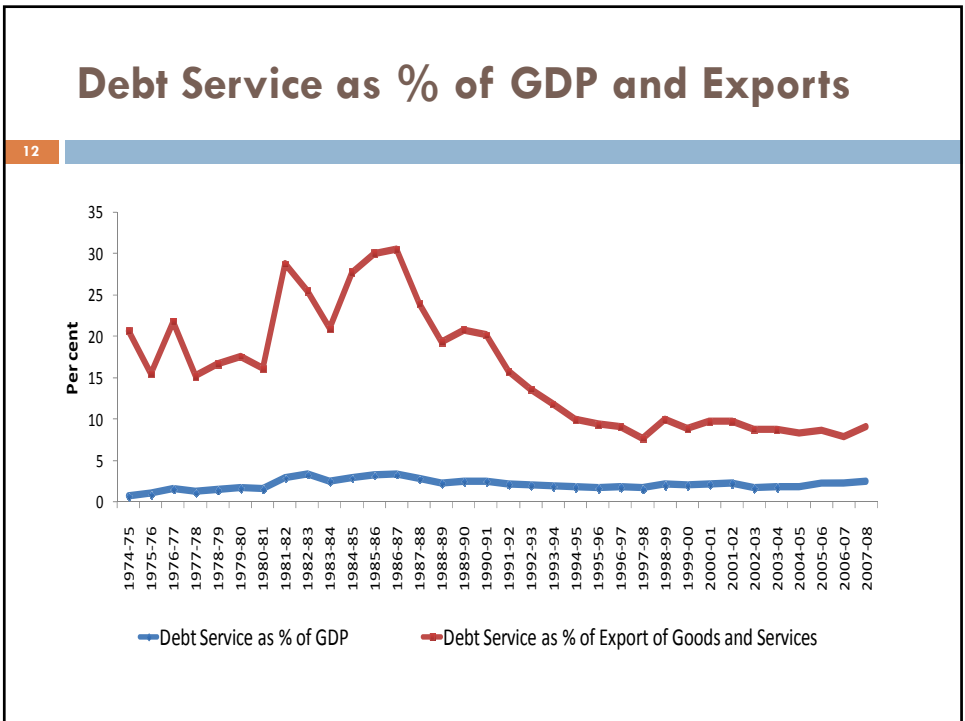
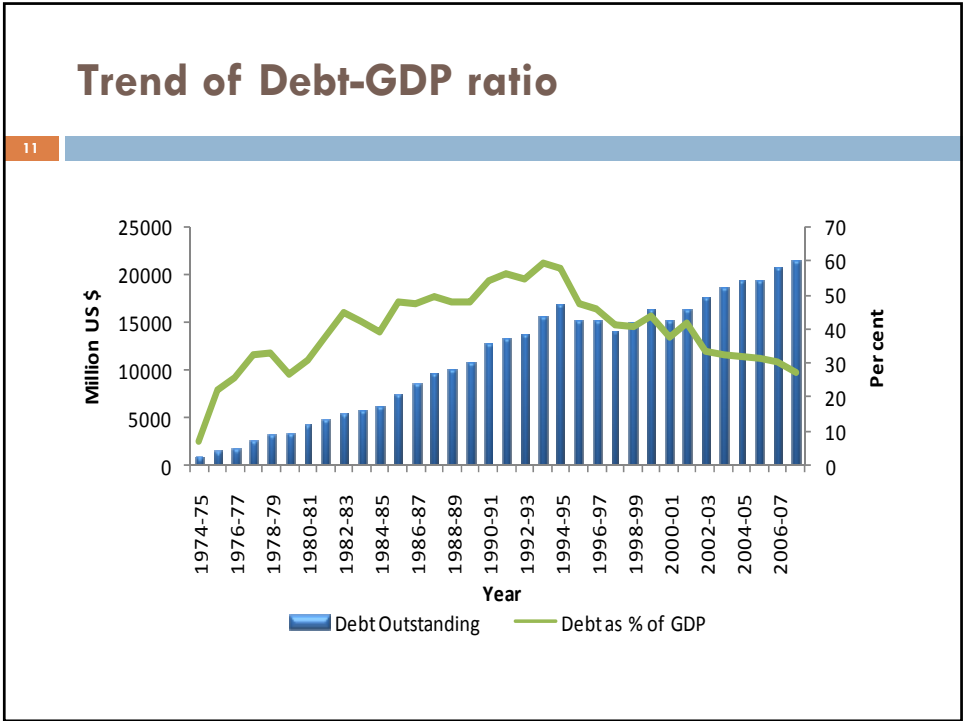
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Share of Grants and Loans in Aid

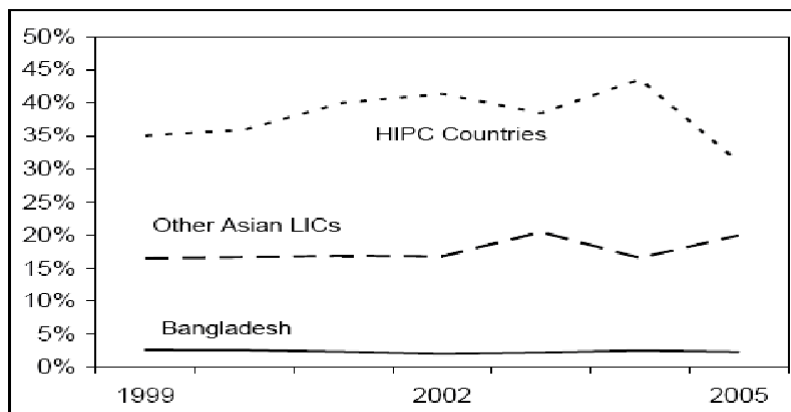
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Net ODA: Bangladesh, HIPC and LICs (% of GDP)

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IMF (2007)

MDG Needs Assessment

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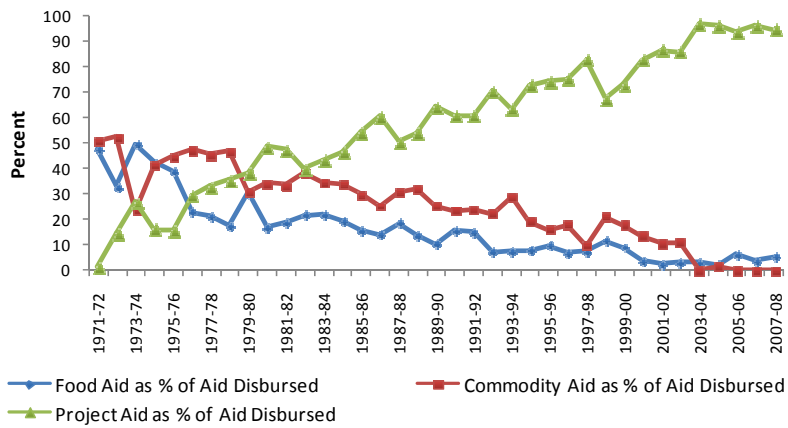
- Raihan and Khondker (2010), using a macroeconomic framework, estimated the need for external assistance for the attainment of MDGs.
- In terms of financing the resource gap, ODA would appear to account for 12% in Base case and only 3% in High growth case.

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Changing Pattern of Aid Composition

Trend in Aid Composition: Purpose

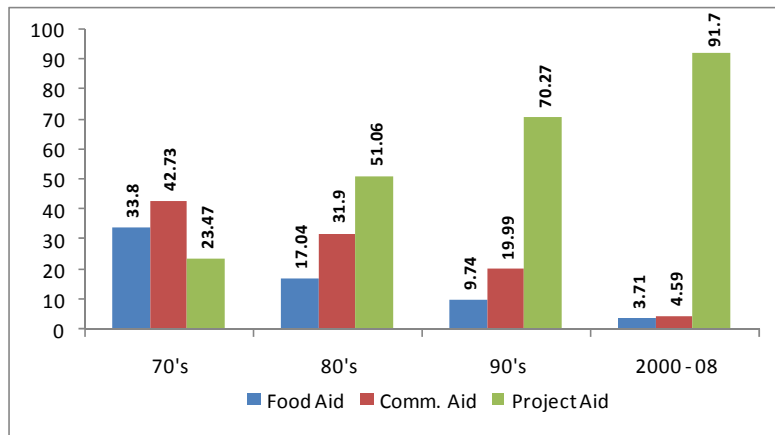
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Decade Average Aid Composition: Purpose

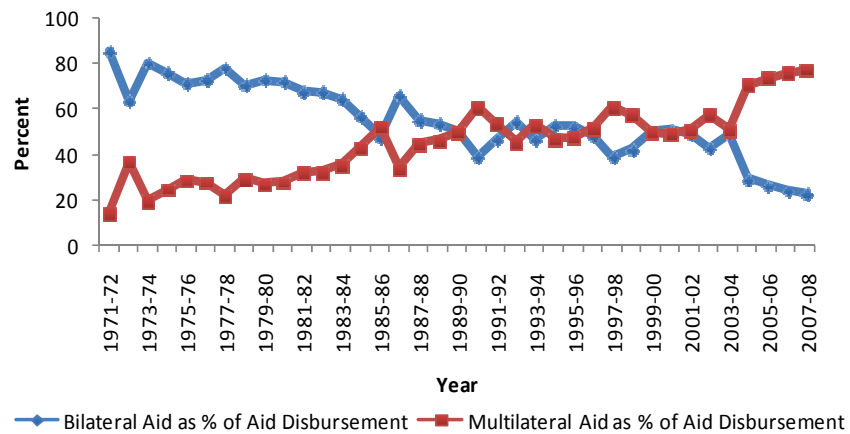
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% of Aid



Trend in Aid Composition: Source

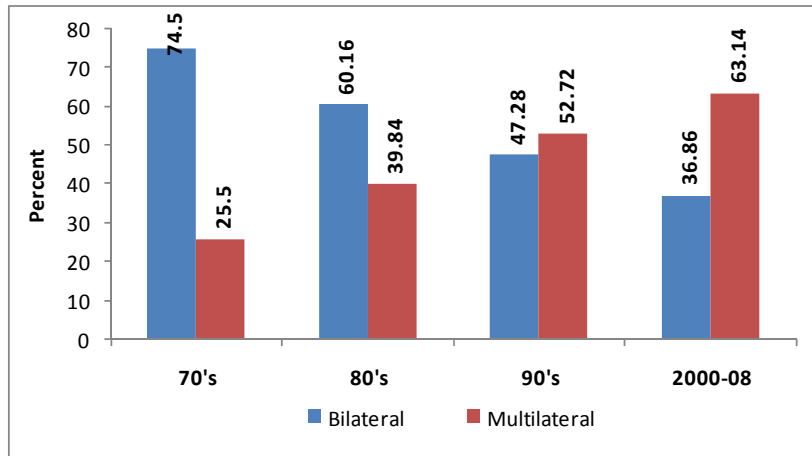
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Decade Average Aid Composition: Source

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% of Aid



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Aid and Domestic Savings in Bangladesh

Unrestricted Error Correction Approach

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- The model is as follows:

$$\Delta PCS = C + \beta \Delta PCY + \gamma \Delta PAID + \Gamma_1 PCS(-1) + \Gamma_2 PCY(-1) + \Gamma_3 PAID(-1) + error$$

Where,

PCS = per capita savings

PCY = per capita real GDP

PAID = per capita real foreign aid

- Data for the period of 1973-2006
- All three variables are non-stationary on their levels, but stationary on first differences. Thus, PCS, PCY and PAID are integrated of order one.

Regression Results

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Variables	Estimated coefficients (t-ratio)
Intercept	-1.43 (-0.64)
$\Delta PCY(-1)$	0.095 (1.21)
$\Delta PAID$	-0.98 (-6.54)
$PCS(-1)$	-0.77 (-5.48)
$PCY(-1)$	0.09 (2.86)
$PAID(-1)$	-0.95 (-3.33)
Adjusted R ²	0.86

The Long run coefficients

$$PCS = 1.86 + 0.12 PCY - 1.23 PAID$$

Summary of regression results

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- The negative relationship between foreign aid and domestic savings can be explained in two ways:
 - It is possible that foreign aid is being substituted for domestic savings and a significant proportion of foreign aid is used to increase consumption – the issue of ‘fungibility of aid’. In Bangladesh, ADP projects, which are largely financed by aid money, involve substantial current expenditures which is likely to increase consumption propensity.
 - Domestic resource mobilisation efforts by the government. Since, the late 1980s, a sharp decline in the PAID has been accompanied by the a rise in PCS

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Effectiveness of aid in Bangladesh: Issues and Concerns

Changing Focus of Aid

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- The initial period (1970s / early 1980s) focused on scarcity of supplies (food, fertilizer, fuel mainly) and damaged infrastructures; resources were provided for import and rehabilitation. Grants featured largely in the aid bucket.
- The second phase (mid-1980s / 1990s) continued to provide resources for import and projects, including for rehabilitation. The share of grants shrunk. Structural adjustment / policy conditionalities were the dominant feature of the period.
- The third phase commenced in late 1990s with PRSP as its most important feature.

Aid Conditionalities

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- The conditionalities were *thin* in the initial phase, and grew *dense* in the second phase.
- The conditionalities in the current phase are very similar to the second in terms of the economic logic and objectives; however, the operations have been softened by balancing delivery of aid by way of loose connection between compliance and tranche release, single tranche operations, etc. The flexibility allows greater responsiveness to the needs of the recipients.

Donor's Perspective

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- Donors now undertake 'independent' reviews of their programs through their in-house evaluation departments with some regularity.
- These reviews—which are essentially subjective and based on a set of predetermined broad criteria such as relevance, efficiency, efficacy, impact etc - are important, as they provide the donors' with evaluations of their own programs and performance.

Assessment by World Bank

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- The World Bank is the coordinator of aid donors to Bangladesh. It is also the largest lender to Bangladesh, as well as the most influential, since its independence.
- It has helped shape the country's institutions and policies more than any other agency. For these reasons, the role of the World Bank is singularly important in any discussion of aid effectiveness in Bangladesh.

Assessment by World Bank..

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- In the 1970s, during the initial phase of its operations, the World Bank concentrated largely on project lending with a focus on four objectives: achieving food self-sufficiency, mobilizing domestic resources, improving social indicators, and enhancing project implementation.
- During the next phase of its operations in the late 1980s, the World Bank focused on policy reforms to create an environment conducive to private sector development. The efforts yielded mixed success and no dramatic results.

Assessment by World Bank..

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- To address the governance issues, the World Bank imposed more stringent policy conditions in the 1990s, but yet again, according to the World Bank, the government did not fully implement these reforms.
- Poor project implementation performance no doubt reflected the country's capacity constraints, but at the same time, this was not entirely a domestic problem, but stemmed from the multiplicity of donors with diverse reporting and accounting requirements that made heavy demands on scarce domestic managerial capacity.

Summary of Donor's Perspective

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- From donors' perspective, aid effectiveness has been mixed in Bangladesh.
- Donors consider their investment projects to have been more successful than their policy loans.
- The failure of policy reforms, that is, the country's failure to implement prescribed policy reforms, is, however, not unique to Bangladesh but is common across the developing world.
- Indeed, the successful Asian countries, including the East Asian newly industrialized countries and such high performing countries like China and India had exerted a high degree of autonomy from the international agencies when formulating their economic policies.

Effectiveness of aid in Bangladesh

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- The effectiveness of aid has recurrently been a subject of much investigation.
- Though results have been mixed, a consensus that foreign assistance does not automatically benefit its recipients sufficiently has emerged.
- Several observers argue that a large portion of foreign aid flowing from developed to developing countries is wasted and only increases unproductive public consumption.
- Poor institutional development, corruption, inefficiencies and bureaucratic failures in the developing countries are often cited as reasons for these results.
- Also the problem of aid-tying practices and conditionality

Effectiveness of aid in Bangladesh...

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- Best practices in aid delivery indicate that donors must be responsive to partner countries' priorities for aid financed projects.
- This is particularly true for aid for trade, where export promotion projects will be ineffective unless tailored to the needs of the private sector; and technical assistance and government support must form part of the local administrations' broader development plan.
- Donors must ensure that aid complements and strengthens a country's own plans, budgets, and structures, rather than undermining them by parallel donor-run administration.

Some realities

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- Dependence on aid will continue for quite some time to meet the savings-investment and foreign exchange gaps.
- The argument for giving up aid does not give enough attention to the weakness of exports, vulnerability of remittances however remote, and the inadequate capacity of the economy to absorb shocks.
- Budget deficit is an important consideration for aid.
- Reforms are difficult to implement; they are better implemented if the conditionalities originate within, have sustained commitment of the country, and the functionaries participate actively in their design.

Some realities..

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- The development partners should be sensitive to the macroeconomic implications of actual aid flows; budget support is a useful vehicle for fast disbursement when needed and should continue on the basis of reasonable performance.
- Institutional development, particularly those relating to politics and accountability, is difficult; the development partners should nurture them to higher level of competence which they need. Long term commitment is necessary for institutional development.
- The ownership of programmes is important.