Aid Effectiveness in Bangladesh

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Aid Effectiveness in Bangladesh

Bangladesh has come a long distance in its journey of economic development. When it became independent in 1971 following a bloody war, many were skeptical about the country's long-term economic viability. Some observers predicted a state of perennial aid dependence,[1] while others referred to it as a "test case of development" (Faaland and Parkinson 1976), implying that if a country with the myriad problems and challenges of the magnitudes that Bangladesh was facing could make development happen, then any country could.

Despite the naysayers' gloomy predictions and the widely shared pessimistic outlook, Bangladesh has made significant economic and social strides in the last three decades or so of its existence: it is no longer considered a basket case. Notwithstanding its large population, the country has achieved a measure of food self-sufficiency (although the food-population balance remains precarious). In the face of low per capita incomes and widespread illiteracy, it has made successful strides toward demographic transition and reduced its population growth rate from 2.5 percent per year in the 1980s to less than 1.5 percent per year in 2005 (Bangladesh Bureau of Statistics 2007b). In a number of other social indicators, such as infant mortality, life expectancy, primary school enrollment, female enrollment in school, and adult literacy, Bangladesh has made considerable improvements over the years. With respect to many Millennium Development Goals (MDG) indicators,[2] it now compares favorably with India even given the latter's higher per capita income, higher growth rates, and higher social expenditures per capita (ADB 2006).

[1] At the onset of the Bangladesh liberation war, Henry Kissinger, then U.S. secretary of state, is said to have famously remarked that Bangladesh was going to be a "basket case" and be permanently dependent on foreign aid.

[2] The MDGs are a set of development targets aimed at eradicating extreme poverty and hunger; achieving universal primary education; promoting gender equality and the empowerment of women; reducing child mortality; improving maternal health; combating HIV/AIDS, malaria, and other diseases; and ensuring environmental sustainability. These targets, to be achieved by 2015, were set by members of the United Nations during its millennium session in 2000.

Nevertheless, despite this success, Bangladesh is still at a rudimentary stage of economic and social transformation. As Sachs (2005, p. 14) notes, it has merely managed "to place its foot on the first rung of the ladder of development."

Most economic successes are outcomes of domestic efforts, and Bangladesh is no exception. As was the case in the past, Bangladesh's future success will depend largely on the quality and quantity of its efforts directed at meeting emerging challenges; however, this process can be facilitated by external assistance in mobilizing financial resources and improving institutions.

As development theory and empirical experience from other countries suggest, external assistance can fill in for lacking resources by (a) augmenting limited domestic savings, (b) providing the additional foreign exchange required to finance critical capital requirements and imports of raw materials, and (c) assisting with the development of human capital and the promotion of domestic capacity. However, as recent history indicates, frequently these potential benefits of external assistance have not been realized, and instances of aid ineffectiveness appear to be as numerous as instances of aid effectiveness. [3]

Many of the failures are an outcome of varied and sometimes conflicting circumstances. Often, the flow of aid has been too small and erratic to have any significant impact. Paradoxically, the flow of aid has sometimes been too large in relation to domestic capacities and has been rendered ineffective. Countries have often been circumscribed by their absorptive capacities, whose roots can be either endogenous or exogenous, that is, they can be due to a lack of domestic capacities to handle large amounts of aid or to the maddening array of cumbersome reporting requirements imposed by different donors that paralyze the government. If the flow of aid is substantial, it can also fail because of the emergence of Dutch disease, that is, the flow of aid may cause the real exchange rate to appreciate and thereby impede the growth of exports. Similarly, aid can fail because it obviates the need for hard choices and genuine reforms, and thus leads to the

[3] The term "aid effectiveness" is largely self –explanatory. It refers to the effectiveness of foreign assistance in promoting economic development. However, as the perspective on development has evolved over the years, so has the meaning of aid effectiveness—the goals that the international community seeks to achieve through foreign assistance. The goals have varied over the years—from increasing savings and investment to raising economic growth and per capita income to reducing poverty in its multi-dimensions. In recent years, the international development agencies have come to equate aid effectiveness with attaining the MDG goals.

persistence of bad policies, poor governance, and endemic corruption, which keep countries locked in a state of economic stagnation and extreme poverty. Finally, foreign aid can fail if the cookie cutter approach of donor agencies results in the imposition of inappropriate policies and institutions that are out of step with the country's real requirements, and thereby immobilize and/or debilitate the economy.

This paper provides a critical review of aid effectiveness in Bangladesh (for earlier accounts of foreign aid and its impact on economic development in Bangladesh see Islam 2003 and Sobhan 1982). It focuses on the contributions of three major, high-profile donors: the World Bank, the Asian Development Bank (ADB), and the Government of Japan (GOJ). In assessing aid effectiveness, the paper uses a qualitative triangulation approach based on the subjective judgments of donors and recipients. This approach is dictated by the deficiencies of quantitative methods for this purpose and the lack of adequate and reliable quantitative data. Those familiar with recent aid effectiveness literature are aware that the regression-based cross-country literature has created more confusion than conclusions and produced few robust empirical results (Quibria and Murshid 2007; Rajan and Subramanian 2005a; Roodman 2007).

The next section of this paper discusses the importance of foreign aid to Bangladesh as it has evolved over time. This is followed by a critical assessment of the economic and social impact of aid based on both donors' and the recipient's perspectives. The paper then discusses the causes of aid ineffectiveness. As this theme has a wider resonance beyond Bangladesh, the discussion next turns to the experiences of the developing world as a whole. Recommendations for making aid more effective follow, and the paper ends with some concluding remarks.

THE ARITHMETIC OF AID FLOWS

Bangladesh has received a sizable amount of foreign assistance over the years, with the annual flow of aid has ranged from about US$1.0 billion to some US$1.5 billion. Even though official development assistance is still a significant source of foreign exchange, its importance has declined over the years as other sources of foreign exchange, such as exports and workers' remittances, have picked up (Figure 1). In addition, as the economy has grown, the flow of aid as a proportion of gross domestic product (GDP) or a percentage of investment has declined over time. In the 1970s through the early 1990s, the net flow of aid as a percentage of GDP was more than 6 percent, but this declined to about 2 percent in 2005 (Figure 2). In the 1970s, soon after independence, external resources financed more than 70 percent of the country's investment, but this had fallen to less than 10 percent in 2005 (World Bank 2007b). This reflects the government's relative success at domestic resource mobilization and the increasing vigor of the private sector. Note also that in recent years Bangladesh has received less foreign aid as a percentage of GDP than either heavily-indebted poor countries (HIPCs) or other low-income countries (LICs) (Figure 3 and Figure 4), including others in Asia with the notable exception of India, which given its recent vigorous economic growth and new-found confidence in its own economic capabilities has decided to drastically reduce its dependence on foreign aid.

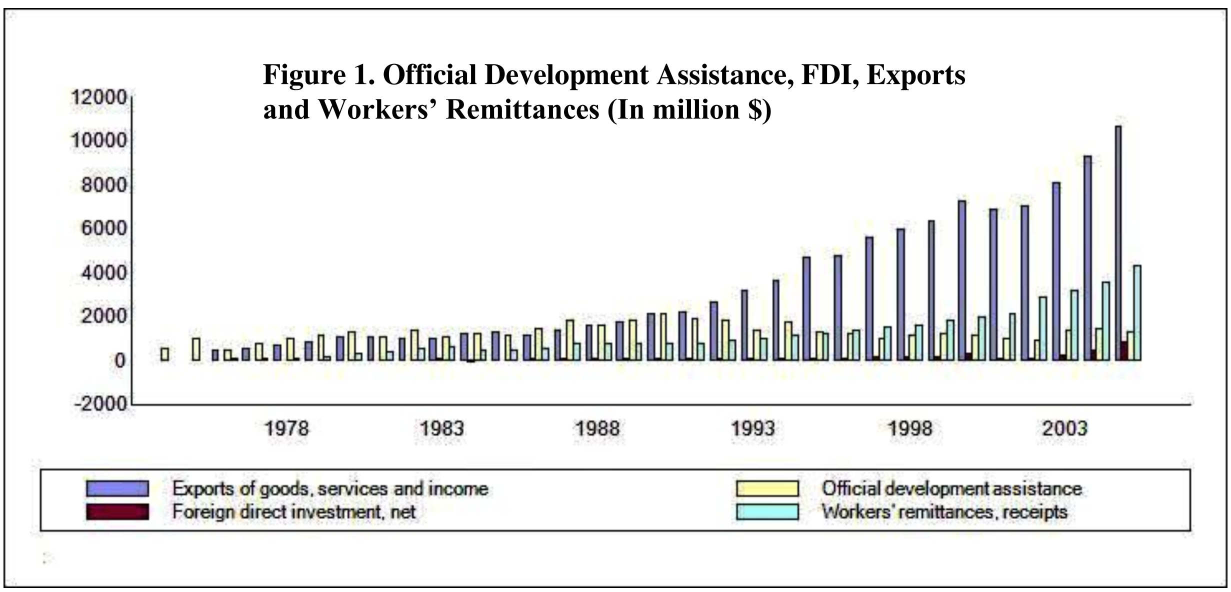


Figure 1. Official Development Assistance, FDI, Exports and Workers' Remittances (In million $)

Source: Data from World Development Indicators (2007)

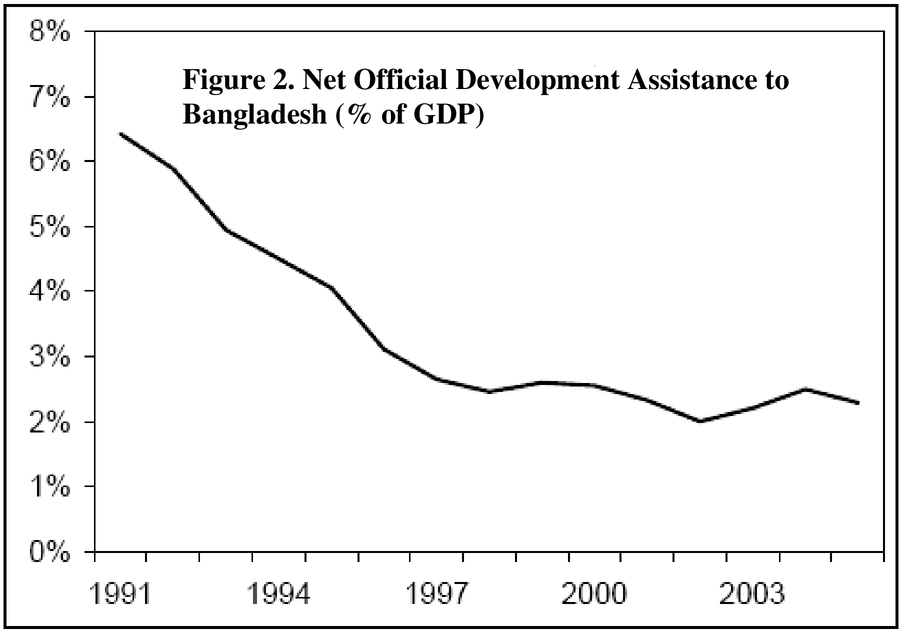


Figure 2. Net Official Development Assistance to Bangladesh (% of GDP)

Source: IMF (2007)

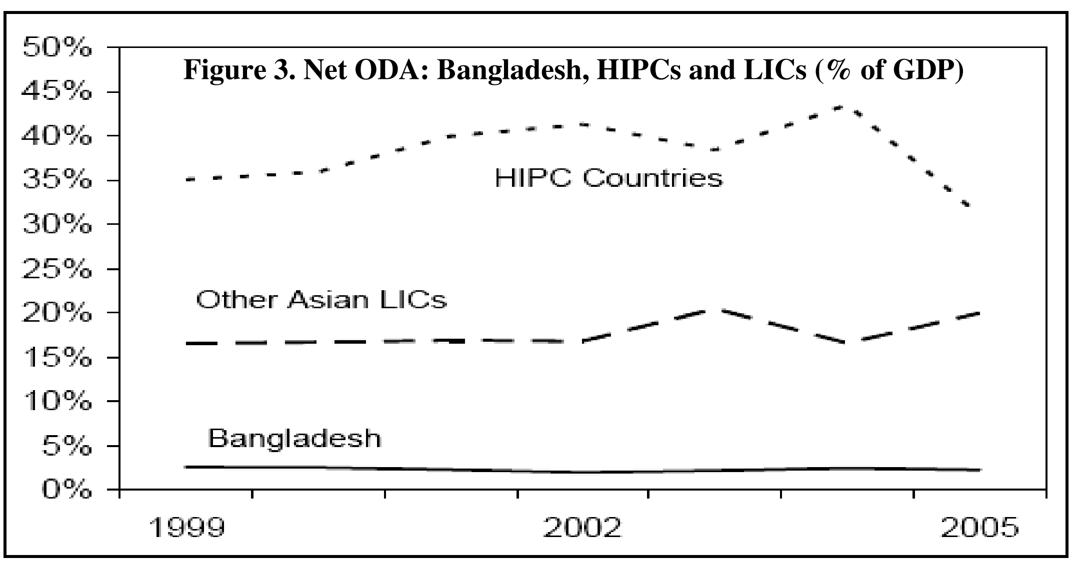


Figure 3. Net ODA: Bangladesh, HIPCs and LICs (% of GDP)

Source: IMF (2007)

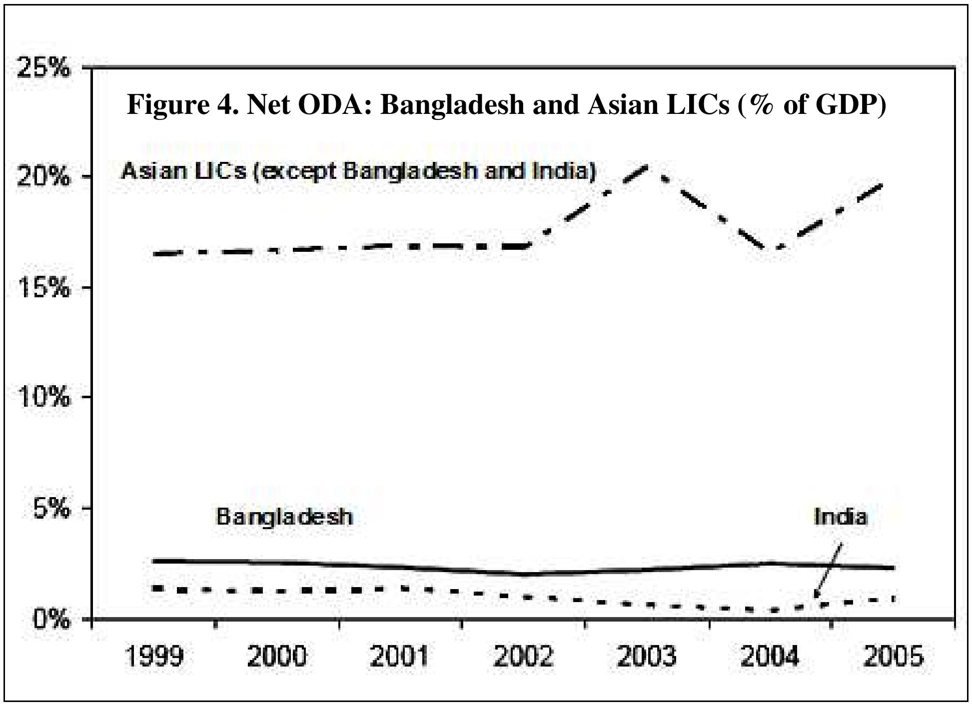


Figure 4. Net ODA: Bangladesh and Asian LICs (% of GDP)

Source: IMF (2007)

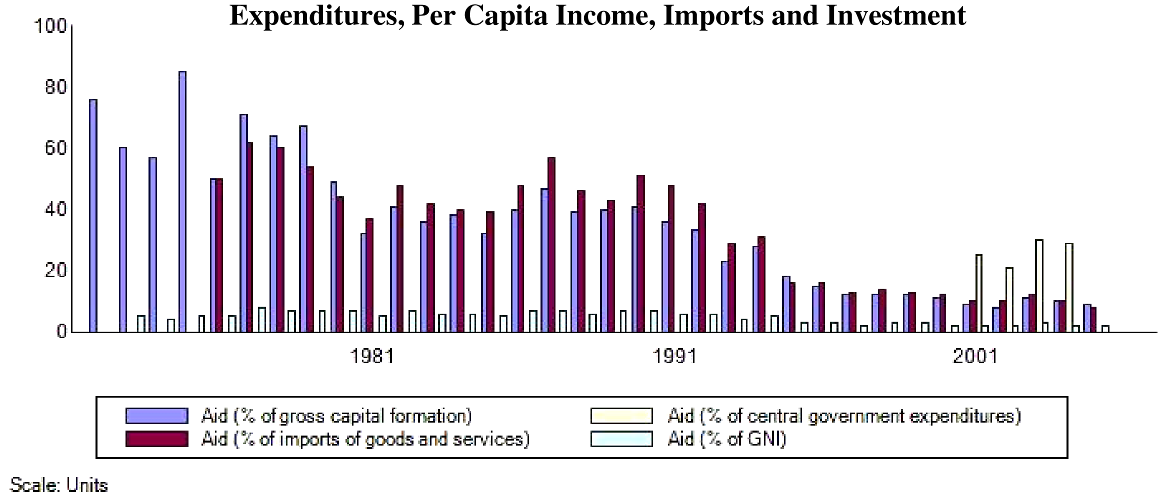
Given the growth in agricultural productivity, the role of food aid has become virtually nonexistent as the economy has become more self-sufficient in food[4], a dramatic contrast from the period immediately after independence, when food aid played a significant role (see Table 1). However, because of the sizable pipeline from earlier commitments by donors, disbursements continue to flow even in the absence of new commitments. With regard to commodity aid, both commitments and disbursements have remained close to zero with no buildup of the pipeline. Finally, in keeping with the general trend in international development assistance, policy lending—both at the macroeconomic and at the sectoral level—has become an important,

[4] Currently, in 2008, Bangladesh is faced with a shortage of food supply due a number of adverse economic shocks, leading to a substantial food import. However, there are reasons to believe that this is more a short-term blip than a long-term trend.

established part of the assistance program , and in some cases has supplanted simple project lending. This development has been accompanied by increasing economic and sector work—so-called knowledge products—by the multilateral financial institutions. Nevertheless, despite the apparent increase in policy lending, data on policy lending are not readily available and the government is maintaining its old classification system that lumps both project and policy lending together under "project aid."

Paradoxically, while aid related to investment and economic development has waned, its significance as a catalyst for policy change has strengthened. In recent years, aid has accounted for less than 10 percent of gross investment and finances a smaller proportion of total import bills than in the past (Figure 5), yet the influence of donors in policy matters continues unabated, and indeed, has increased significantly. The locus of activism of donor agencies seems to have broadened to encompass almost all aspects of the economy and of society, from formulating technical economic policies to providing advice on broader societal issues, from guiding the functioning of democracy to holding dialogues between political adversaries. In recent years, donor representatives have not only become ubiquitous, but also seemingly omniscient, lavishly dishing out wisdom on virtually everything, above and beyond their specific areas of economic assistance!

Figure 5. Foreign Aid as a Percentage of Government Expenditures, Per Capita Income, Imports and Investment



Source: Data from World Development Indicators (2007)

The multilateral international financial institutions are the principal source of aid for Bangladesh (see Table 2), although the role of bilateral sources such the governments of Japan, the United Kingdom, and Canada is also significant.[5] Bilateral sources were almost as important as the multilaterals through the early 1990s, but now account for half of what the multilaterals provide. Many believe that multilateral aid is more economically oriented and less political than bilateral aid ; however, this argument does not seem to stand up to scrutiny, given that the ownership structure of the multilateral financial institutions remains concentrated and a good deal of consensus is apparent among the major donors. The two main sources of multilateral aid for Bangladesh are the World Bank and ADB, which have provided assistance largely, though not exclusively, from their concessional windows. However, the terms and conditions of the International Development Association and the Asian Development Fund have somewhat hardened, and in addition, ADB is now classifying Bangladesh as a blend country—a country that borrows from both concessionary and nonconcessionary sources—which has contributed to the dilution the grant element of the foreign assistance it receives.

Finally, as most of the foreign assistance the country receives is concessional, the buildup of debt has been slow. The total external debt of the public sector is less than US$20 billion, equivalent to about 32 percent of GDP and some 130 percent of export earnings. Compared with other developing countries, Bangladesh's external debt is not exceptionally high and has stayed within prudential limits.

[5] The role of the US as a source of bilateral aid has declined significantly over the years, making it a marginal contributor to the country's development process. In addition, much of the US assistance is channeled through non-governmental organizations that are often pre-selected, a fact that tends to undermine the quality of its foreign aid.

Table 1. External Aid Commitments and Disbursements, 1999/00-2005/06

(In million U.S. dollars)

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Food aid							
Opening pipeline	211	55	250	265	225	200	173
Commitments	51	245	51	9	6	6	15
Disbursements	142	51	36	48	32	33	97
Grants 1/	142	51	36	48	32	33	97
Loans	0	0	0	0	0	0	0
Adjustment 2/	-65	0	0	0	0	0	0
Closing pipeline	55	250	265	226	200	173	90
Commodity aid							
Opening pipeline	155	40	75	64	12	12	12
Commitments	175	222	144	123	0	22	0
Disbursements	283	184	155	175	0	22	0
Grants 1/	280	145	155	175	0	22	0
Loans	3	39	0	0	0	0	0
Adjustment 2/	-7	0	-1	0	0	0	0
Closing pipeline	40	79	64	12	12	12	12
Project aid							
Opening pipeline	5,615	5,657	5,533	5,121	5,971	6,699	6,510
Commitments	1,254	1,585	684	2,048	1,917	1,553	1,773
Disbursements	1,150	1,134	1,251	1,362	1,002	1,434	1,470
Grants 3/	304	309	288	287	307	190	403
Loans	846	825	963	1,075	695	1,244	1,067
Adjustment 2/	-72	-204	155	164	310	-309	-225
Closing pipeline	5,647	5,904	5,121	5,971	7,197	6,510	6,587
Total Aid							
Opening pipeline	5,980	5,752	5,858	5,450	6,209	6,912	6,695
Commitments	1,481	2,053	879	2,179	1,923	1,581	1,787
Disbursements	1,575	1,369	1,442	1,585	1,033	1,489	1,568
Grants	726	504	479	510	338	244	501
Loans	849	865	963	1,075	695	1,244	1,067
Adjustment 2/	-143	-204	154	164	310	-309	-225
Closing pipeline	5,742	6,233	5,449	6,209	7,408	6,695	6,689

Source: IMF (2007)

Table 2. External Aid Disbursements by Donors, 1999/00-2005/06

(In millions of U.S. dollars)

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Bilateral donors	785	706	709	667	495	440	406
Australia	8	7	0	9	6	6	11
Belgium	0	0	3	0	0	0	0
Canada	28	19	18	23	21	8	62
China	18	26	12	0	0	19	33
Denmark	29	5	29	46	20	5	14
France	1	6	20	1	7	0	0
Finland	0	0	0	0	0	0	0
Germany	21	43	21	6	26	24	15
India	4	20	7	3	4	26	0
Japan	390	316	287	243	79	45	31
Kuwait	8	36	12	33	7	5	9
Netherlands	28	19	1	9	41	5	13
Norway	19	17	9	50	6	4	11
Saudi Arabia	4	0	7	0	7	0	0
Sweden	20	16	7	15	11	0	2
Switzerland	4	7	2	4	5	0	0
United Kingdom	61	53	21	40	94	85	157
United States	92	39	20	35	12	8	4
U.S.S.R. 1/	0	0	0	0	0	0	0
Suppliers' credits	43	75	229	157	149	161	44
Other	7	1	3	3	...	39	...
Multilateral donors	790	663	733	908	538	1,049	1,162
Asian Development Bank	283	236	182	207	172	208	265
IDA	354	299	323	561	225	696	635
European Union	5	32	80	19	21	8	73
IFAD	15	0	12	21	15	9	14
UNDP	7	17	10	38	36	...	111
World Food Program	68	1	30	0	0	0	
UNICEF	27	49	46	39	30	26	18
Ford Foundation							
Islamic Development Bank	16	16	23	12	17	70	25
OPEC Fund	6	8	14	6	10	3	2
Other	9	4	12	5	12	28	19
Total aid disbursements	1,575	1,369	1,442	1,575	1,033	1,488	1,568

Source: Economic Relations Division, Ministry of Finance.
1/ The Baltics, Russia, and other former Soviet Union Countries.

Source: IMF (2007)

ECONOMIC AND SOCIAL IMPACT OF AID

Since independence, Bangladesh has made significant economic strides despite its still low levels of per capita income. Its economic performance compares favorably with that of other developing countries; indeed, it is one of the most rapidly growing low-income countries in the world. As noted earlier, it has attained virtual self-sufficiency in food (except in times of natural disasters). Rising incomes and increasing food availability have helped reduce poverty significantly, although the extent of poverty remains substantial.[6] Bangladesh has shown significant improvements in key social indicators such as fertility, life expectancy, school enrollment for girls, and child immunization (Table 3) and has successfully eradicated polio, which still infects some neighboring countries. It has already achieved one MDG—gender parity in primary and secondary education—and is on track to meeting several others, including halving poverty.

Table 3 . Social Changes over Time

Indicators	Before	Now
Secondary school enrollment	19 (1990)	43 (2005)
Primary school enrollment	71 (1990)	93 (2004)
Fertility rate	6.1 (1972)	3.0 (2005)
Immunization , DPT (% of children ages 12-23 months)	1 (1980)	88 (2005)
Immunization, measles (% of children ages 12-23 months)	1 (1982)	81 (2005)
Improved sanitation facilities (% of population with access)	20 (1990)	39 (2004)
Life expectancy at birth	45 (1972)	64 (2005)
Malnutrition prevalence , weight for age (% percentage of children under 5)	68 (1983)	48 (2004)
Malnutrition rate (children under 5 per thousand)	239 (1970)	73 (2005)
Mortality rate (per one thousand live births)	145 (1970)	54 (2005)

Source: World Bank (2007)

[6] According to the latest available figures (Bangladesh Bureau of Statistics 2007a), the incidence of poverty declined by 9 percentage points between 2000 to 2005. If the higher (national) poverty line is used, the incidence of poverty declined from about 49 to 40 percent of the population; if the lower poverty line is used, it declined from about 34 to 25 percent of the population during the same period. However, as it is the case with many other developing countries, these figures are fraught with controversy, though few would disagree with the direction of this change.

While some of the achievements in social and economic indicators can be attributed to the positive contributions of aid, establishing a quantitative causal relationship between aid and economic development in a rigorous manner is difficult. As the cross-country empirical literature on aid effectiveness suggests, attempts to establish such a relationship have proved to be highly elusive. Thus rather than following this well-beaten but indecisive track, this paper explores the issue of aid effectiveness in Bangladesh essentially based on qualitative evidence.

Donors' Evaluations

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. This review looks at three major donors to Bangladesh.[7]

The World Bank

The World Bank is the coordinator of aid donors to Bangladesh. It is also the largest lender to Bangladesh (with a cumulative lending of around $12.5 billion in 2007), 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.

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. Even

[7] The International Monetary Fund was excluded from this review because its direct contribution to economic development and poverty reduction is marginal. This is because its mandate limits its activities to maintaining macroeconomic stability, a role that is important, but does not have a direct and immediate bearing on economic development.

though over time the country attained varying degrees of success in all these areas, the pace of progress was slow in the 1970s.

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. These reforms were addressed at removing the distortions in trade, pricing, credit allocation, and interest rates. Once again, the efforts yielded mixed success and no dramatic results. In its evaluation report, the World Bank attributed these mixed results not to any deficiencies in its own program, but to the government's failure to implement reforms. Indeed, the World Bank went so far as to argue that "a core constraint in the development process in Bangladesh was the government itself and its unwillingness to enforce the needed public sector reforms" (World Bank 1998b, p. 56).

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. The Bank went on to interpret this as follows: "Government, both at local and national levels, has yet to define a proper enabling environment that reduces transaction costs and allows entrepreneurship to flourish" (World Bank 1998b, p. 53). Part of the vacillation on the part of the government may have had to do with political economy constraints, but part was due to the intellectual basis of the reforms, about which there was always a general degree of skepticism not only in Bangladesh, but also elsewhere.

The World Bank's evaluation assessment about policy reform in Bangladesh was both disingenuous and self-serving. It was disingenuous in the sense that changing policies or institutions is a gradual process, as it is evident in all countries, including the advanced countries. It was self-serving because the World Bank heaped all the blame on the government, but part of the responsibility must lie with the World Bank for proceeding without a thorough analysis of Bangladesh's political economy constraints and for imposing conditionalities that were unrealistic and beyond the government's capacity to deliver.

The late 1980s and the 1990s were a time when the international organizations as a whole pushed policy lending to bring about policy change. Much of this lending involved excessive conditionalities (policy changes attached to policy lending) that were beyond the implementation capacity of recipient countries; was based on the cookie cutter approach of the Washington consensus, that is, on privatization, liberalization, and stabilization with insufficient analysis; and imposed policy conditionalities with the "agreement" of the bureaucracy, but the exclusion of society as a whole, and even of parliaments. The consequence has been inappropriate policies, undermining of democratic processes, and poor economic outcomes.

Notwithstanding all these problems, the World Bank considers its assistance program to Bangladesh "effective" even though the evaluation statistics point to a mixed outcome. According to the most recent publicly available country evaluation report (World Bank 1998b), the percentage of Bank projects that were deemed unsatisfactory was higher than Operations Evaluation Department averages Bank-wide. With regard to sustainability, the performance of projects in Bangladesh was unfavorable, as many had negligible institutional impacts. The report also noted that lending to Bangladesh was inefficient: loans were more time-consuming and compared unfavorably with the Bank-wide average. This 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.[8]

The Asian Development Bank

In many ways, the findings from ADB's evaluation of its country assistance program (with a cumulative lending of $8-plus billion in 2006) are similar to those of the World Bank. Like the World Bank, ADB (2003) considers its program to be relevant and successful in a number of areas. These areas include support to agriculture to achieve the objective of self-sufficiency in food. Similarly, ADB considers its assistance in the energy and transport sectors to have been beneficial and to have "made an important contribution to facilitating the acceleration of gross

[8] International aid agencies have recently recognized that part of the implementation problem stems from donors' diverse procedures and standards and are working toward harmonizing these procedures and standards. aligning them with countries' own systems. To date, however, other than a number of "high-level" meetings and communiqués, few concrete results have materialized.

domestic product growth in the late 1990s" (ADB 2003, p. iv). However, it considers its initiatives in the late 1990s in the areas of agriculture, forestry, and the social sectors, particularly health and education, to have had little impact on poverty. Interestingly, ADB does not attribute this lack of success to the general slowdown in poverty reduction Bangladesh experienced in the 1990s (due to shifts in income distribution), but to the lack of alignment with the so-called Partnership Agreement on Poverty Reduction.[9]

Like the World Bank, ADB berates the government for its failure to implement reforms to foster development, which according to ADB accounts for its general failure in relation to policy lending. ADB, however, traces this failure to vested interests and goes on to emphasize "the importance of identifying vested interests opposed to policy reform," without however, specifying what to do about them. It also had second thoughts about policy lending for capital markets and railways, because these are two areas that play "a relatively limited role in the economy, governance issues are entrenched, and commitment to reforms has been lacking." ADB also suggests reducing its involvement in sectors where "sector performance has been poor, the potential for catalyzing impact is limited and ADB has no comparative advantage" (ADB 2003, p. v). Other than being an explicit admission of failure, this suggests limiting assistance to sectors where success has been limited. If this strategy is followed, this would imply drastically limiting ADB operations in Bangladesh. In particular, this may mean that ADB would shy away from areas involving policy reform and analysis.

The Government of Japan

[9] The Partnership Agreement on Poverty Reduction is the pretentious initiative that ADB took, somewhat akin to the World Bank's Poverty Reduction Strategy Papers, but that it had to discard because of pressure by the World Bank and the International Monetary Fund. As of 2000, to receive development assistance, low-income countries (with the exception of India) are required to prepare national poverty reduction strategies. The governments, in collaboration with World Bank and International Monetary Fund staff, are supposed to prepare these national strategy documents, known as Poverty Reduction Strategy Papers. The papers describe countries' macroeconomic, structural, and social policies and programs to promote growth and reduce poverty, along with their associated external financing needs. According to the World Bank, these papers are guided by five core principle, namely, they should be (a) country driven, involving broadly based participation by civil society and the private sector in all operational steps; (b) results oriented, focusing on outcomes that benefit the poor; (c) comprehensive in recognizing the multidimensional nature of poverty; (d) partnership oriented, involving coordinated participation by development partners (bilateral, multilateral, and nongovernmental); and (v) based on a long-term perspective for poverty reduction. For details see World Bank and International Monetary Fund (2005).

Japan is the largest bilateral donor to Bangladesh and accounts for a sizable portion of the country's foreign assistance. GOJ implements its development assistance program through a combination of governmental agencies—the embassy, JICA, Japan Bank for International Agencies and Japan External Trade Organization—and the stated objectives of its country assistance program are economic growth, social development with human security (including health, education, gender equity and environmental protection) and governance. However, in reality, Japan has focused on physical infrastructure more than any other donor and has taken a lead role in funding a number of high-profile bridges such as the Jamuna, Paksey, Rupsa and Padma bridges.

The recent country evaluation by JICA (2004) found that its program was more or less consistent with country priorities as expressed in the Five-Year Plan and the Poverty Reduction Strategy Paper (PRSP), though JICA had little involvement in gender and governance issues. It noted certain deficiencies in program formulation, coordination, and implementation from the Japanese side.

Even though JICA has been investing in agriculture and agricultural productivity has been on the rise, the country evaluation concludes both modestly and wisely that it is hard to see how Japan's assistance contributed to macro indicators. JICA also made significant loans for rural infrastructure and social sectors. Overall, JICA (2004) concludes that the impact of Japanese assistance on macroeconomic indicators was difficult to observe, both because of the short gestation period (with respect to the evaluation) and because of the relatively small amount of aid in relation to total investment in the economy, though some results were perceptible in the health sector. However, JICA hopes that Japanese aid will be more effective and have a greater impact on the economy in the future, as its assistance for the construction and maintenance of major bridges and it technical cooperation in the fields of power and infrastructure development begin to bear fruit.

Summing Up

Thus 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.

The Recipients

In 2006, the Center for Policy Dialogue organized a policy seminar on aid that was attended by senior civil servants, economists, selected members of the media, and business leaders, or, in short, it reflected the "voices" of society's elites. The dialogue highlighted their views on aid and why it has achieved such mixed results. Participants' comments, which are reproduced verbatim, included the following (Center for Policy Dialogue 2005):

(i) *Donors' influence is disproportionate*: The significance of aid in influencing the policy agenda seems singularly disproportionate to the declining significance of aid in the country's macroeconomics.

(ii) *Conditionality is limiting the degree of policy autonomy*: Multilateral aid is not always unrelated to political variables and is usually associated with a wider variety of conditionalities that restrict policy autonomy.

(iii) *A disconnect is apparent between the benefits and costs of adjustment*: Resources accrue to the government because of adjustment credit, but reforms relate to the sectors, and as the sectors do not get the money, they do not have any incentive to implement the reforms. (Mashiur Rahman, p. 10)

(iv) *Home- grown reforms and vetting by parliament are needed*: The government should form committees in ministries or independent commissions to formulate reforms that could later be discussed and vetted by parliament.

(v) *Donors have little impact on poverty reduction*: The donors have done little in relation to poverty alleviation. Except for Food-for-Works, all programs were home-grown and the donors helped only in not cutting down social expenditures under adjustment programs.

(vi) *More aid to higher education should be provided*: More grants and sectoral programs in higher education are needed.

(vii) *Reforms are not owned because they are imposed*: Bangladesh needs aid for development and revenue support. As a result, when donors propose any aid with conditionalities, the government does not have the courage to say no. This is the reason Bangladesh does not own any reforms.

(viii) *The PRSP is a poor substitute for planning*. It is an inadequate substitute for the overall planning of the economy. The PRSP remains a wish list.

(ix) *Donor policies are inappropriate*: Some donor policies are very good, but their implementation is extremely difficult because they are not easily acceptable by society.

(x) *The Washington-consensus has yielded few benefits for Bangladesh*: Policy and prescription of undiluted privatization rather than development of the private sector, sudden liberalization rather than gradual adjustment, and deregulation rather than regulatory redesign have not resulted in any major breakthrough in economic growth, poverty alleviation, and equity.

The foregoing comments suggest that aid has been less than effective and has had little direct impact on poverty reduction; that it has led to a plethora of inappropriate policies imposed exogenously by donors who have exerted a disproportionate influence on policies that were neither owned by the country nor went through the usual democratic vetting mechanism; and above all, that the PRSP exercise, which was artificially imposed by donors, has few indigenous roots and has helped undermine the traditional planning mechanism.[10]

AID EFFECTIVENESS ISSUES

The foregoing discussion highlights a number of issues that seem to have constrained the effectiveness of foreign assistance in Bangladesh. However, these issues are not in any sense unique to Bangladesh, but have a wider relevance. In light of the generic nature of these issues, the following posits the discussion within a general framework that can draw on, and be informed by, broader international experience.

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[10] India refused to go along with this process and asked the World Bank to anchor its assistance program to the country's Five-Year Plan. In the case of Bangladesh, the PRSP has virtually replaced the Five Year Plan which has become practically defunct. In the absence of such a plan, the medium-term budgetary framework reported in the budget has become "a summary reflection of CAS (country assistance strategy of the World Bank) containing just enough to meet the enquiry of IMF and WB." (Rahman 2008, p14).

Absorptive Capacity Constraints

It is almost an article of faith among development economists that developing countries suffer from absorptive capacity constraints, that is, they are limited in terms of the amount of foreign assistance they can productively utilize. It is also widely believed—for a review of this literature, see Quibria and Murshid 2007— that there are diminishing returns to aid; that is, as developing countries have low levels of human capital and limited physical infrastructure, the returns from foreign assistance decline as the flow of aid increases (this idea originally dates back to Chenery and Strout 1966; Millikan and Rostow 1957; and Rosenstein-Rodan 1961). Annual portfolio performance reviews carried out by donor agencies often highlight these absorptive capacity constraints, which are reflected in delays in implementing programs and in achieving sufficient development impact. As noted earlier, donors have documented numerous issues in relation to the implementation of projects and programs in Bangladesh in their country evaluation reports and annual portfolio reviews. Even though these issues reflect the country's human resource and bureaucratic constraints to a great extent, attributing all the problems to the recipient country is unfair.[11] Many of the problems also stem from the cumbersome policies, procedures, and practices of donor agencies, each of which have copious reporting demands and insist on their particular ways of doing things. (For an interesting account of the bureaucratic rigmarole surrounding the delivery of foreign assistance, see Easterly 2003a.)

Real Exchange Rate Appreciation

Whether through binding capacity constraints or diminishing competitiveness, the effectiveness of aid can decline as its volume increases, suggesting a nonlinear relationship between aid and growth. Even if one accepts that the impact of aid is subject to diminishing returns, the possibility is moot for most aid-recipient countries, as the point at which aid starts to have a

[11] Some of the institutional mechanisms donors have introduced to circumvent the absorptive capacity issues have their own drawbacks. One such institutional mechanism is the project implementation unit, coordination, management, and implementation entity for aid-financed projects intended to fast-track the implementation process. While the unit may circumvent some of the implementation issues, it also creates its own set of problems, such as vested interests and competing incentives, and results in thwarted local institutional development.

negative effect on growth is much higher than the levels of official development assistance currently available to most low-income countries.[12]

According to Rajan and Subramanian (2005b), the key to understanding weak associations between aid and growth is the real exchange rate overvaluation associated with any large windfall, that is, the so called Dutch disease.[13] The mechanism through which Dutch disease operates is straightforward. An inflow of foreign aid leads to an increase in expenditures on nontraded goods. This increases the prices of goods and services produced in the nontraded sectors as well as the prices of domestic inputs that are used to produce them. This erodes the competitiveness of those export sectors that also depend on those nontraded inputs.

Why the mechanisms leading to real overvaluations should operate so strongly within developing countries is not clear. These countries typically produce far below capacity, while the symptoms of Dutch disease arise when countries producing close to their production possibilities frontiers are unable to respond quickly to sudden increases in demand (McKinley 2005). An increase in expenditures following an inflow of foreign aid may therefore have limited price effects in developing countries, which are usually characterized by high unemployment and idle capacity. Moreover, if foreign assistance is directed toward improving the economy's productive capacity through investments in infrastructure, education, institutions, and health, this productivity increase could potentially offset any loss of competitiveness resulting from Dutch disease (Adam and Bevan 2006). However, a shortage of human capital and public infrastructure can cause severe bottlenecks in many developing countries, limiting their ability to absorb large amounts of aid. Real exchange rate overvaluation and an erosion of export competitiveness—the factors that Rajan and Subramanian (2005b) argue are responsible for aid ineffectiveness—may therefore simply reflect the capacity constraints in developing countries. In such circumstances, rather than

[12] The total flow of aid to low-income countries (those whose annual per capita income is less than US$825) was US$34 billion (in current dollars) in 2004, compared with $44 billion in total workers' remittances that same year. This flow of aid translates to less than US$15 per capita and about 2.8 percent of the aggregate gross national income of low income countries (World Bank 2006).

[13] In recent years, a number of authors, including Adenauer and Vagassky (1998), Nyoni (1998), Vos (1998), Vos and Johansson (1994), and White and Wignaraja (1992), have analyzed the Dutch disease effects of aid inflows. However, these studies differ significantly in their conclusions regarding the impact of aid on real exchange rate overvaluations and the competitiveness of export-oriented sectors.

aggravating the problem of Dutch disease, a larger inflow of aid can help alleviate these constraints and become an important part of the solution strategy.

In the case of Bangladesh, there is no evidence to suggest that foreign aid has led to a serious overvaluation of the real exchange rate and an erosion of export competitiveness. Indeed, compared with its neighboring countries, Bangladesh's real exchange rate has become increasingly more competitive over time (Figure 4). Thus the apprehension that aid may cause Dutch disease and an overvaluation of the real exchange rate is unwarranted. What has really hampered the growth of exports has not been exchange rate factors, but the various supply constraints arising from physical infrastructure bottlenecks and skills shortages.

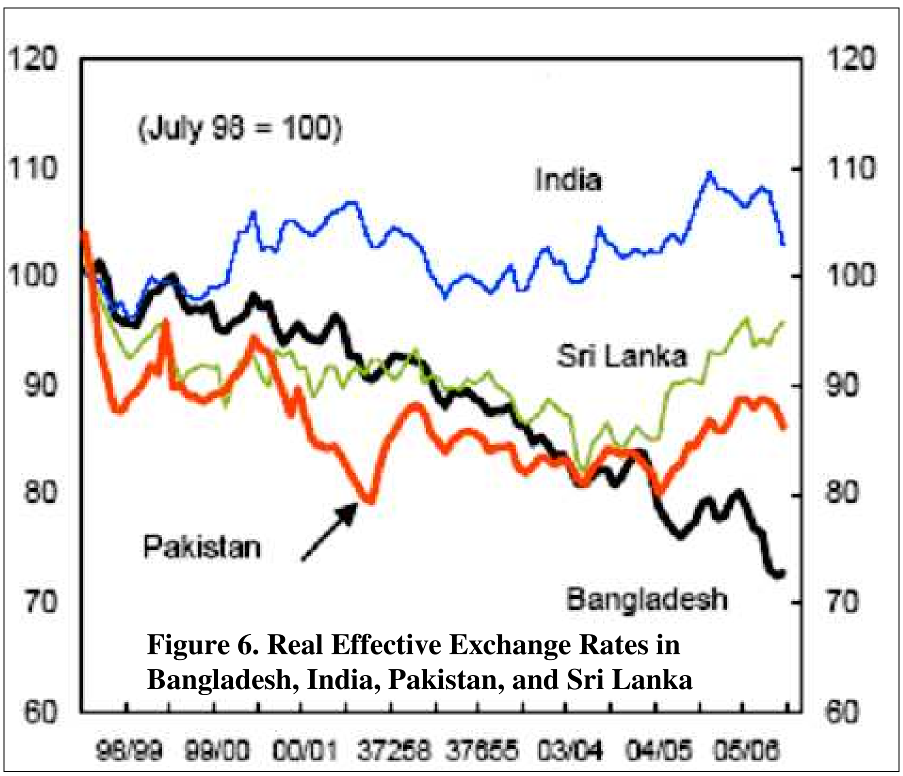


Figure 6. Real Effective Exchange Rates in Bangladesh, India, Pakistan, and Sri Lanka

Source: IMF 2006.

Governance and Corruption

Rajan and Subramanian (2007) suggest that foreign aid has a negative effect on economic growth through its adverse impact on governance. They argue that manufacturing is highly dependent on the quality of governance, and that as the volume of aid increases, it reduces the government's accountability. In particular, the government slackens its efforts to maintain the rule of law, ensure predictable judicial outcomes and contract enforcement, and limit corruption.[14]

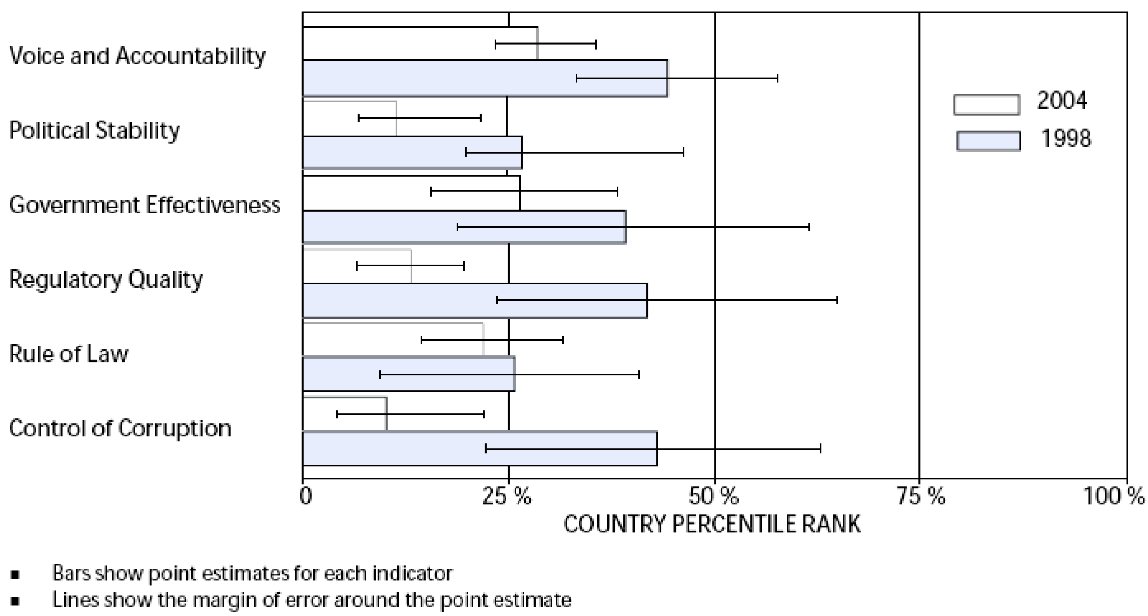
As far as Bangladesh is concerned, Transparency International has ranked it as the most corrupt of countries for five consecutive years. Given that the Transparency International index is largely subjective, whether such a precise ordering of countries is meaningful is questionable. Nevertheless governance, in particular corruption, is clearly a serious concern for Bangladesh. Even though the current government may have arrested Bangladesh's further downward slide into corruption, the extent and magnitude of corruption remains significant, and foreign aid may have been an important conduit of corruption. To the extent that foreign aid has indeed been a source of corruption, the culpability lies with both recipients and donors, as the aid delivery process—including procuring materials and awarding contracts and consultancies—is under the dual control of both donors and recipients. In an article that draws on Bangladesh's experience, Rashid (2004) argues that foreign aid makes domestic institutions porous and amenable to outside influences, thereby making them incapable of administering the laws and rules that are the reason they exist in the first place.

According to World Bank indicators, the overall quality of governance in Bangladesh has shown little or no improvement over time—indeed, some indicators have experienced some worsening (Figure 5). However, this apparent deterioration has had little impact on either economic growth or poverty reduction. This lack of correlation between governance and growth, which the World Bank (2007a) has labeled the Bangladesh conundrum, is not unique to Bangladesh, but is equally applicable to a number of high-performing economies, such as China, India, and Vietnam.[15]

[14] One can also conceive of an opposite scenario, namely, foreign aid provides a country with the wherewithal to pay greater attention to governance issues, as many dimensions of good governance entail greater investments of resources in physical and social infrastructure. This may be the basis of the simple correlation between governance indicators and per capita income.

[15] The relationship between governance and economic development is a complex one , which cannot be codified into a simple formula. See Dixit (2007) and Quibria (2006) for discussions of some of the underlying issues that can skew the relationship between governance and development and obfuscate the case for reform.

Figure 7. Governance Indicators 1998 and 2004



Source: World Bank (2007a)

Conditionality and Ownership

A common complaint among donors is that policy conditionality has not worked in Bangladesh.[16] However, this is not unique to Bangladesh. Indeed, the World Bank's (1998a) celebrated report *Assessing Aid* notes this lack of a connection between aid and policies in a wider context. The report notes the existence of "surprisingly little relationship between the amount of aid and policies" (p. 47) and of "a mountain of literature [that is skeptical] about the ability of conditionality to promote reform in countries where there is no strong local movement in that direction" (p. 51) In short, a sizable body of literature suggests that policy conditionality does not work.

[16] Conditionality in the traditional sense refers to policy conditionality. In recent years, however, the emphasis has shifted from policy conditionality to process conditionality that links lending to changes in the design and delivery of aid . The putative purpose of process conditionality is to minimize corruption, foster respect for human rights, and engender greater accountability of the government to its citizens. Process conditionality, which seeks to involve participation by local stakeholders in discussions of programs and policies, is not, however, without its flaws. It requires donors to make intrusive and difficult judgments about the quality of openness and the democratic nature of recipient countries, factors that are hard to assess and even more difficult to measure. In addition, process conditionality may undermine indigenous institutions of accountability, such as local government and civil society organizations, and overemphasize internationally visible nongovernmental organizations.

Policy conditionality is ineffective for many reasons.[17] First, the donor and the recipient often have different views about the program. This divergence may not necessarily relate to primary issues, such as the program's content, but to secondary matters, such as the best means for achieving the program, the sequencing of actions, or the timeframe. Second, perhaps the most fundamental problem with policy conditionality is its dynamic time inconsistency problem. The recipient government may agree to a reform program prior to receiving aid, but it may renege on its promise as incentives change following the disbursement of aid. In other words, the issue of conditionality goes beyond designing an incentive-compatible contract in a static principal-agent framework. The interactions between donor and recipient are both dynamic and asymmetric, elements that make the relationship inherently more complex than standard static principal-agent problems. Third, other influences on the donor side tend to adversely affect the final attainment of conditionality. These relate to the incentive structure of donor agencies and the so-called Samaritan's dilemma. Existing incentive systems in donor agencies place a high value on aid disbursement, which encourages aid officials to maximize aid disbursements even if this means overlooking the failure of conditionality. Such failures may also arise from compassion and the desire to help the poor in aid-recipient countries. However, while the poor may benefit from policy conditions in the long run, a trade-off often exists between relatively small short-term gains versus potentially larger long-term benefits. This can lead aid agencies to overlook the lack of fulfillment of policy actions in poor countries (Kanbur 2006).

The ineffectiveness of policy conditionality has elicited two different types of reactions. The first type—associated with Mosley, Harrigan, and Toye (1995), among others—has been to argue that conditionality works in theory, but that its application has been flawed in practice. According to this view, conditionality should be simpler, deviations from committed reform programs should be punished consistently, and a critical element for effective reform is country ownership.

[17] The reasons may differ from country to country. Rahman (2008) provides an interesting personal account, based on his own experience as the top civil servant coordinating foreign aid resources of the country. He notes that while Bangladesh government officials collaborated with donors in the design of programs and reform agenda in such diverse sectors as jute, energy, railways, industries, telecommunication, health and education, the role and participation varied significantly across sectors. He also notes that though donors and recipients always agreed on the desirability reforms at the general level, they often tended to diverge significantly on specifics— but at the end the donors prevailed. He concludes that while government participation enhances the probability of — but does guarantee— success of a policy reform agenda.

Country ownership has been defined in different ways,[18] but it generally refers to a country's commitment to pursue reforms independently of incentives provided by donors. However, the meaning of country commitment has varied from broad definitions to narrow definitions. Sometimes it is broadly interpreted to mean commitment by the entire recipient society—including the government, civil society, and the private sector—while at other times it may be narrowly defined to mean commitment only on the part of the government. Given the various senses in which the term country ownership is used, many, for example, Buiter (2004), find it to be an unhelpful and misleading concept whose time has passed. Nevertheless, despite the amorphousness of the concept, donor agencies have continued to stress the importance of country ownership, while at the same time they often tend to undermine ownership by maintaining various types of control over the design and implementation of reform programs.[19] The World Bank, the International Monetary Fund, and other international donor agencies now build their respective aid programs for poorer countries around the PRSPs, an attempt to confer greater ownership to recipient countries.[20]

The second type of reaction is to accept that traditional policy conditionality does not work and therefore needs to be abandoned. This point of view suggests a different type of conditionality that is tantamount to selectivity,[21] that is, aid should be given to countries on the basis of ex post policies. This approach abandons the imposition of ex ante conditionality and argues that

[18] The World Bank's Operations Evaluation Department has set four key criteria for country ownership: (a) the locus of initiative must be in the government, (b) the key policy makers must be intellectually convinced, (c) the top political leadership must provide evidence of public support, and (d) the existence of broadly-based stakeholder participation must be apparent. Fostering country ownership therefore entails extensive government consultations with other segments of society, including civil society and the private sector. The putative purpose of such consultation is to elicit new ideas, knowledge, and opinions and to promote consensus on the strategy. As this definition involves large elements of subjectivity, any assessment of ownership remains largely subjective.

[19] Stiglitz (1999) suggests that the role of donors in the design and implementation of reforms should be drastically limited to that of economic advisers who make countries aware of prevailing views.

[20] However, this attempt to bestow greater ownership has at best achieved only limited success. First, PRSPs continue to be mostly donor rather than country driven, particularly where domestic capacity to formulate such a strategy is lacking (Easterly 2006b). Second, even where such capacity exists, the PRSP process often turns into what Van de Walle (2005) calls an act of ventriloquism— that is, when recipient countries present their PRSPs, they present precisely those programs and strategies that the donors favor in order to receive funds. Finally, as the PRSP process is a great strain on scarce resources, it should be abandoned in favor of the five-year plans that most countries prepare on their own.

[21] In its traditional sense, a country receives aid on the basis of a promise to undertake a stipulated set of policy actions. In other words, conditionality entails a set of prior actions before the loan is disbursed, and is thus based on ex ante reform. Selectivity, by contrast, relates to ex post reform: aid is made available on the basis of the success of ex post reform. In practice, selectivity is combined with process conditionality.

selectivity will ensure a superior outcome. In a "repeated game," as long as the donor consistently rewards countries that demonstrate good policies with aid, it will elicit "good" behavior from recipients.

Gunning (2000) lists four frequent objections to selectivity. First, by definition, selectivity excludes countries with poor governance and unsound policies. This will exclude not only countries with malevolent leaders but also countries with enlightened leaders who are hamstrung not by a lack of will, but by a lack of institutional capacity to address governance issues (Barder and Birdsall 2006). Consequently, poor people living in those countries with weak governance who could potentially benefit from foreign assistance suffer. Second, countries with good policies can generate adequate domestic and foreign private investment without foreign assistance. Third, selectivity makes aid allocation contingent on the definition of good policies. While some aspects of good policy may be objectively defined, others involve subjective judgments resulting in little consensus on what constitutes good policies and results in bargaining between donors and recipients. Fourth, selectivity may conflict with ownership. This happens when donors attempt to provide detailed, multidimensional definitions of "good" policies that are inconsistent with the recipient government's own development objectives.

Gunning (2000) considers the first two objections unsustainable. With respect to the first objection, he argues that poor people in poor countries will not in any case benefit from foreign assistance when the quality of governance is questionable. One way to circumvent this problem is to bypass the government and assist the poor through other conduits, such as nongovernmental organizations. With respect to the second objection, Gunning argues that even if policies are good, poor countries do not metamorphose into developed countries overnight. In the interim period, when domestic savings and foreign private investment remain limited, foreign aid continues to play a key role in the transformation process.

In sum, ex ante policy conditionality appears to be largely ineffective in practice; however, selectivity, which is now commonly used in conjunction with process conditionality, has also not proved to be as fruitful as originally anticipated. In view of this, to further enhance aid effectiveness, recipients need to be given greater real autonomy over the deployment of aid resources and the formulation of policies. This has led some authors, for example, Kanbur Sandler, and Morrison (1999) and Ranis (2006), to suggest that aid from all agencies should be pooled and allocated as lump sum transfers, with recipient countries given full responsibility for allocating it across sectors and for implementing projects without donor interference. Similarly, Barder and Birdsall (2006) propose a hands-off approach to foreign aid, which they call payments for progress. Under this proposal, foreign aid would be offered to poorer countries based on evidence of progress, which would be measured in terms of outcomes, and not policies and other intermediate inputs. Barder and Birdsall argue that this would give local institutions flexibility and autonomy, as well as space for institutional experimentation, while at the same time ensuring that aid pays only for real and measurable progress.

Measurement of Aid Effectiveness

The choice of measure matters for aid effectiveness. Under current practice, the implicit metric the international community uses is some measure of recipient countries' policies and institutions. The World Bank, for example, allocates aid largely on the basis of its country policy and institutional assessment index, which consists of 16 components grouped into 4 categories: macroeconomic policies, structural policies, public sector management, and social inclusion (for more information on recent changes to this index see World Bank 2005). Similarly, the success of policy-based lending is measured by the extent to which countries' meet policy conditions. However, these are all indirect and convoluted ways of viewing aid effectiveness, which should instead be measured directly on the basis of economic outcomes. Indeed, many development practitioners have come to this conclusion in recent years and an intellectual shift in favor of outcome-based conditionality rather than policy-based conditionality is under way. Under outcome-based conditionality, donors focus on impacts and outcomes rather than on inputs, activities, and outputs.[22] The European Commission has recently introduced a form of outcome-

[22] Inputs refer to the financial, human, and material resources used for a development intervention, for example, the budget used to construct schools or health centers. Outputs refer to the products, goods, and services that result from a development intervention, for example, the number of schools built and the number of health centers opened. Outcomes refer to intermediate indicators of results, such as the number of students who graduate from the schools and the number of visitors to the health centers. Impact refers to the long-term consequences of the intervention, for instance, improvements in health and education indicators. Given the difficulties inherent in distinguishing between medium-term outcomes and long-term impacts, they are often lumped together under the heading of outcomes.

based conditionality for its adjustment aid to African, Caribbean, and Pacific countries (Adam and others 2004).

The main arguments advanced in favor of policy-based conditionality rather than outcome-based conditionality are that policy changes are easier to observe and monitor and have greater incentive effects. Policies are more directly controllable by governments than outcomes and their implementation can be monitored more easily. Outcomes are not under the full control of governments and reflect a variety of influences, including negative exogenous shocks. Moreover, a long time lag often occurs between policy decisions and outcomes in terms of economic growth and poverty reduction. This combination of time lags and weak links between policies and outcomes can further dilute incentives for governments to undertake positive policy actions.

The main argument put forward for outcome-based conditionality is that it promotes greater ownership and accountability. Some observers, for example, Gunning (2000), argue that the current practice of donors undertaking detailed assessments of a country's entire policy environment is unnecessary and tends to undermine ownership. As donors should be more concerned with outcome indicators and not the means for attaining them, governments should be given free rein to choose their policies, which would help promote ownership of policies and strengthen accountability, thereby enhancing private sector confidence.

The main argument against policy-based conditionality is that it is imperfect in the sense that it will not be able to achieve a first-best outcome. Drazen and Fischer (1997) identify three reasons for this. First, government policies are imperfectly observable. Second, results are not fully determined by policies but are also influenced by luck. Third, governments have varying degrees of competence that cannot readily be distinguished ex ante. In addition, a good deal of uncertainty—as well as lack of knowledge—surrounds the "results chain" that tracks the causation of a development intervention from inputs and activities to outputs, outcomes, and impacts.

At the same time, outcome-based conditionality is also fraught with practical difficulties. The indicators commonly suggested for outcome monitoring are GDP growth, changes in poverty, and changes in child mortality, but unlike for growth rates, current data on poverty and mortality are not always readily available. In addition, as most outcome indicators are likely to change only gradually, any meaningful impact assessment can only be undertaken after a number of years, plus such assessments may reward or punish a current government for the actions of a previous government.

In light of these difficulties, outcome-based conditionality that purports to monitor long-term impacts and medium-term outcome indicators may need to be selective and may have to be supplemented by output indicators and other indicators of intermediate results. Depending on the availability of data on different types of indicators, as well as the accuracy with which they can be monitored, the final choice may necessitate a mixture of output and intermediate result indicators, but not inputs.

RECOMMENDATIONS

Current aid practices are flawed in a number of respects and need to be amended to make foreign assistance more effective. Some recommendations to this end are as follows:

First, as currently practiced, the bulk of effort in relation to aid effectiveness is anchored in a notion of "good" institutions and policies that aid agencies strive to foster across the developing world. If aid agencies are interested in enhancing the effectiveness of aid, they should abandon this cookie cutter approach, recognize the diversity that exists among countries, and give countries the space to design their own policies and institutions (UNCTAD 2006).

Second, currently donors allocate aid based on some notion of selectivity. However, such selectivity should be based on actual economic and social outcomes, that is, on concrete and measurable results, and not on subjective assessments of policies and institutions as is currently the predominant practice.

Third, policy-based lending founded on ex ante policy conditionality has proved to be largely ineffective. One way to improve conditionality is to promote country ownership of strategies and policies, a concept that has been formalized in the PRSP process imposed by the international donor agencies, but even though the emphasis on ownership is correct, it remains poorly defined and measured. When a country is genuinely in charge of its development process, it can not only better identify with its policies and strategies, but can also bring local knowledge to work. Thus some have suggested that recipient countries should be given complete autonomy in managing their aid resources without donor interference and on the basis of national plans.

Fourth, under the new international development compact, the principal basis for allocating aid should be national plans and MDG assessments. These documents, which should be coherently linked to each other, would define a country's external finance requirements and development strategies. According to this perspective, a country's development performance would be measured in terms of its progress toward achieving the MDGs over a given time frame and further scaling up of assistance would be linked to this progress. When the data to monitor progress are not available, monitoring may be limited to a few strategic variables.

Fifth, maximizing the impact of aid on poverty reduction requires identifying and eliminating the major constraints to poverty reduction in a particular country, and this is where donor agencies can play an important supporting role.

CONCLUDING REMARKS

The mixed success of foreign aid in Bangladesh can be traced to shared failures on the part of both the government and donors. Donors' current approach to aid suffers from some generic problems. The foregoing analysis highlights some of the issues and suggests measures to address them. These measures, which are intended to (a) introduce greater flexibility in the delivery of aid, (b) provide recipient countries with more policy space, and (c) emphasize results, will by themselves be insufficient to ensure aid effectiveness unless recipient countries adopt complementary measures. These measures include enhancing domestic capacity to implement sophisticated projects and creating an appropriate economic environment for the economy to flourish.

In the past, Bangladesh's domestic capacity constraints; inability to create an equitable, transparent, and accountable governance structure; and the absence of a policy environment conducive to business growth undermined it efforts to achieve more rapid economic development. Even though Bangladesh made the transition from authoritarianism to democracy more than a decade ago, it continues to be a fledgling, illiberal democracy (Zakaria 1997). It turned out to be a "tyranny of the majority" (de Tocqueville 1969) that permitted few genuine economic freedoms, spawned massive corruption and rent-seeking and allowed little room for economic talents to flourish. The governance problem was greatly compounded by the absence of enlightened leadership with a grand vision and a sophisticated understanding of the economic development process, the leadership traits that are particularly germane during the current period of rapid globalization.

The governance issues notwithstanding, Bangladesh has attained a measure of success in many areas of the economy, which is a testament to ordinary people's entrepreneurial abilities and the vigor and dynamism of civil society organizations. However, the requirements of governance vary from one stage of development to the next, and many aspects of governance that were unimportant in the past are likely to become more important as the economy becomes poised to make the transition from being predominantly rural and agricultural to urban and industrial. The hope is that the new leadership that has recently come into power will be more enlightened than past leadership, that the governance structure will evolve to meet the requirements of the economy, and that the policy environment will improve in step with the changing exigencies of the economy. If this happens, foreign aid could be an enormous catalyst for economic development and poverty may become a thing of the past much sooner than the early prognosticators of doom had ever imagined.

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