Aid Effectiveness in Bangladesh: Development with Governance Challenges

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By

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Abstract

This paper provides a critical review of aid effectiveness in Bangladesh. Focusing on the contributions of major donors, the paper uses a triangulation approach to assess aid effectiveness, based on the evaluations of donors and recipients. This approach was motivated by the deficiencies of the currently available "rigorous" quantitative methods and by a lack of adequate and reliable quantitative data.

Foreign aid has had a mixed performance in Bangladesh. The responsibility for the failure lies with both the government and donors. Donors' current approach to aid delivery has many shortcomings. Addressing them would require changes that (a) allow for greater flexibility in the delivery of aid; (b) provide recipient countries with more policy space; and (c) emphasize results. However, these steps, by themselves, will be insufficient, unless followed with complementary measures by the government to ensure good governance and to enhance domestic capacity to implement sophisticated projects.

In the past, despite many bottlenecks, the economy achieved considerable success in many areas. If the country can maintain its current growth momentum, it will soon join the ranks of the middle-income countries, but the path to this middle-income status is paved with many obstacles: policy, infrastructure, and weak governance.

Even though Bangladesh made a transition from authoritarianism to democracy, it shares many of the flaws of a fledgling illiberal democracy: it lacks the institutions of restraint provided by an independent judiciary, by separation of powers to maintain law and order, to ensure the rule of law, and so on. These governance problems notwithstanding, the country did well in the past. However it would be wrong to extrapolate the past into the future, as the role of institutions varies from one stage to another; many aspects of governance that were less critical in the past will become more central in the future, as the economy makes the transition from a predominantly rural and agricultural phase to one that is urban and industrial. The hope is that the political leadership will initiate changes in policies and institutions in synchrony with the evolving exigencies of the economy. If that happens, foreign aid could be an enormous catalyst for economic development—and poverty may soon become a thing of the past.

Keywords: Aid Effectiveness, Bangladesh, Governance, Poverty Reduction
JEL Classification: F35, F63, I31, P48

1. INTRODUCTION

From a precarious beginning, Bangladesh has achieved notable progress in economic and social development in the last four decades or so. When it became independent in 1971 following a bloody war, there were many skeptics about the country's long-term economic viability. Some observers predicted a state of perennial aid dependence,[1] while others viewed Bangladesh as a "test case of development" (Faaland and Parkinson 1976), implying that if the country with its myriad problems and challenges could make development happen, so could any country.

Despite this widespread pessimism, Bangladesh has made considerable economic and social strides in the last four decades: 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: it reduced its population growth rate from 2.5 percent per year in the 1990s to less than 1.2 percent per year in 2012 (World Bank 2014). In 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 with the latter's higher per capita income, higher growth rates, and higher social expenditures per capita (Dreze and Sen 2013). Despite this success, Bangladesh is still at a rudimentary stage of economic and social transformation. It is still one of the poorest nations of the world with many human-development challenges. In the human-development index of the United Nations, Bangladesh ranked 146 among 187 countries in 2013 and was placed in the "low human-development" category. As Sachs (2005, p. 14) noted, Bangladesh has barely managed "to place its foot on the first rung of the ladder of development."

Economic development is largely an outcome of domestic efforts; Bangladesh is no exception. As in the past, Bangladesh's future success will depend largely on the quality and quantity of its own efforts to meet the emerging economic and social challenges. Nevertheless, this process can be facilitated by external assistance.

As development theory and empirical experiences from other countries suggest, external assistance can substitute for lacking resources by (a) augmenting limited domestic savings; (b) providing additional foreign exchange to finance critical imports of capital and raw materials; and (c) assisting in the development of human capital and domestic capacity. However as recent history indicates, these benefits of external assistance were often not realized; there are as many instances of failures of aid as of success.[3]

There are many reasons for aid ineffectiveness. Sometimes aid has been too small and erratic to have a significant impact; sometimes the flow of aid has been too large in relation to the country's absorptive capacity, either because of limits in domestic implementation capacity or because of excessive donor fragmentation, leading to government paralysis. Aid can also fail because of the emergence of Dutch disease; that is, flow of aid leading to the appreciation of the real exchange rate, thereby impeding the growth of both exports and income. Similarly, aid creates circumstances that obviate the need for hard choices and genuine reforms: aid can perpetuate bad policies, poor governance, and endemic corruption, which can lock countries in a state of economic stagnation and extreme poverty. Finally foreign aid can be ineffective when the donors adopt a cookie-cutter approach, a uniform set of policies and institutions, across countries, inappropriate for a particular country's requirements for growth and poverty reduction.

This chapter provides a critical review of aid effectiveness in Bangladesh (see Islam 2003 and Sobhan 1982 for earlier accounts). 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 chapter uses a qualitative triangulation approach[4] based on the evaluative assessments of donors and recipients. This approach is dictated by the deficiencies of the currently available quantitative methods, as well as by a lack of adequate and reliable quantitative data. It may be noted in this connection that with the recent empirical literature on aid effectiveness, which relies on cross-country growth, regression yielded few robust empirical results (Quibria 2014; Rajan and Subramanian 2008; Roodman 2007). In addition this method has contributed little when it comes to individual country level aid effectiveness. Finally in recent years, the method of randomized control trials has gained increasing popularity in assessing the impact of individual (micro-project level) interventions; but the approach has its own limitations for drawing conclusions or deriving policy lessons[5] (Deaton 2009). In light of the above-mentioned shortcomings of the current empirical literature, it seems that the best way to study aid effectiveness at the macro-level is to undertake in-depth country studies, exploiting the available qualitative and quantitative information.

Section 2 of this chapter discusses the importance of foreign aid to Bangladesh, followed in Section 3 by a critical assessment of the economic and social impact of aid, based on both donor and the recipient perspectives. Section 4 discusses the causes of aid ineffectiveness. As this theme has a wider resonance beyond Bangladesh, the discussion in this section turns to the experiences of the developing world as a whole. Recommendations for making aid more effective follow in Section 5, and the chapter ends in Section 6 with some concluding remarks.

2. THE ARITHMETIC OF AID FLOWS

Bangladesh has received a sizable amount of foreign assistance over the years, with the annual flow of aid ranging from between $1 to $2 billion. Even though official development assistance is still an important source of foreign exchange, its relative importance has declined significantly over the years. This reflects the fact that while exports and workers' remittances have risen significantly over the years, official development assistance has remained relatively flat. In addition, as the economy has grown, the flow of aid as a proportion of gross domestic product (GDP) 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 less than 2 percent in 2012 (Figure 1). In recent years Bangladesh has received relatively less foreign aid as a percentage of GDP, much less than the average for other low-income countries, including those classified as the heavily indebted poor countries.

Figure 1. Trend of Aid Dependency

Insert Figure 1 here

The composition of foreign aid has evolved over the years. With improved agricultural productivity, the economy has become largely self-sufficient in food; consequently food aid has become virtually nonexistent.[6] This is in stark contrast with the situation immediately after independence when food aid was significant (see Figure 2). However, even in the absence of new donor commitments, because of the sizable pipeline from earlier commitments, disbursements continued. 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 macro and sector level, has become an important, established part of the assistance program; in some cases it has supplanted simple project lending. Policy lending has been accompanied by increasing economic and sector works, so-called knowledge products, by the multilateral financial institutions. Nevertheless despite the increase in policy lending, data on policy lending are not readily available, as the government maintains its old classification system that lumps both project and policy lending together under "project aid."

Figure 2. Changing Composition of Aid

Insert Figure 2 here

The importance of aid as a source of investment has waned over the years. In the 1970s, soon after independence, foreign assistance financed more than 70 percent of the country's investment, but in 2012, this fell to about 7 percent of gross investment (World Bank 2014). This decline partly reflects the government's relative success in mobilizing domestic resources for public investment. In 2012, aid financed about 5.4 percent of the total import bills, much lower than 12.6 percent in 2003 (Figure 3).

Despite this decline in the relative importance of aid as a source of investments, or for financing import bills, donors' influence on policy matters has not waned. On the contrary the locus of donor activism seemed to have widened over the years, encompassing all aspects of society, from economic to social to political. In recent years donors have emerged as regular arbiters between feuding political parties in bitter political disputes, which have become increasingly common. As politics became more fractious, it created more space for donors to take a more active public role, a role that seems a bit excessive even by the norms of the developing world.

Figure 3. Foreign Aid as a percentage of Government Expenditure, Per Capita Income, Imports, and Investment

Insert Figure 3 here

The multilateral international financial institutions are the principal source of aid for Bangladesh. They accounted for around 20 percent of total foreign aid in the country in 1978, whereas the remainder, of about 80 percent, came from bilateral sources. However over time, the role has reversed: in 2012, bilaterals accounted for about 33 percent of total foreign aid (Figure 4). Among the bilaterals, major donors include: the governments of Japan, the United Kingdom, the United States, and Canada.[7]

Till the early 1990s, bilateral sources were almost as important as the multilaterals, but in 2012, they accounted for half of what the multilaterals provided.[8] The two main sources of multilateral aid for Bangladesh are the World Bank and the ADB, which provide assistance largely, though not exclusively, from their concessional windows: the International Development Association and the Asian Development Fund. However the terms and conditions of these multilaterals has somewhat hardened in recent years, in particular, the ADB now classifies Bangladesh as a blend country: a country that borrows from both concessionary and non-concessionary sources. In short, there has been dilution of the grant element of the foreign assistance Bangladesh receives.

Figure 4. Changing Role of Bilateral versus Multilaterals

Insert Figure 4 here

Finally, as most of the foreign assistance the country receives is concessional, the buildup of debt has been slow. In 2012 the total external debt was around US$27 billion, lower than other developing countries in Asia, except Sri Lanka (Figure 5). However, when expressed as a percentage of GNI(gross national income), Bangladesh's external debt was lowest in the group of developing countries, represented in Figure 6 (it was approximately the same as that of India's): in 2012, Bangladesh's external debt was around 20 percent of GNI, well within prudential limits (Figure 6).

Figure 5. Total external Debt from 1980–2012

Insert Figure 5 here

Figure 6: Total External Debt as a percentage of GNI for selected countries in FY 2012

Insert Figure 6 here

3. ECONOMIC AND SOCIAL IMPACT OF AID

Over the years Bangladesh has made significant economic and social strides, despite myriad challenges, such as famines, natural disasters, and political and social instability. After a tumultuous beginning in the 1970s, the economy started to stabilize in the 1980s with steady growth and low inflation. Since the 1990s GDP growth has been strong, averaging over 5 percent per annum. The GDP growth rate has further accelerated since 2001, when the average GDP growth rate reached nearly 6 percent. In terms of GDP per capita, the country doubled its rate of growth from 1.6 percent in the 1980s to more than 3.3 percent since the 1990s. In terms of per capita GDP, the growth rate compares favorably with other low-income developing countries or countries that borrow from the International Development Association (IDA) of the World Bank. What is remarkable is that this acceleration in economic growth was achieved in the face of significant reductions in foreign assistance per capita (from about $20 in 1990 to about $9.5 in 2010). Much of the domestic savings-investment gap was met by net foreign income from workers' remittances, which exhibited robust growth in recent years and amounted to almost $14 billion dollars in 2012, almost six times the foreign aid the country received in 2012. In short, while in recent years there was a spurt in GDP growth in Bangladesh, there was a simultaneous decline in the role of foreign aid as a source of investment finance. This suggests an increasingly diminishing role of foreign aid in the economic growth of the country.

However the progress of a country should not be measured only by economic growth; a metric of progress should also include the impact on poverty and other social indicators of the population, which are briefly discussed in the following.

As noted earlier the country has attained virtual self-sufficiency in food (except in times of natural disasters). This increasing availability of food, along with rising per capita income, has contributed to a gradual reduction in poverty over the years. According to the latest available statistics from 2005 to 2010, if the higher (national) poverty line is used, the incidence of poverty declined from about 40 to 31.5 percent of the population; if the lower poverty line is used, it declined from about 25 to 21 percent of the population during the same period. The corresponding data for the international poverty line ($1.25 a day) poverty was estimated for 2010 to be 43.3 percent (World Bank 2014). However as it is the case with many other developing countries, these figures are fraught with controversy… even though few would disagree with the direction of change.

Bangladesh has made impressive advances in the last decade or so in key social indicators, such as fertility, life expectancy, school enrollment for girls, and child immunization (Table 1), which compare favorably with other low-income countries, including its South Asian neighbors (with the exception of Sri Lanka). Bangladesh has successfully eradicated polio, which still affects some of its South Asian neighbors. Though child and infant mortality rates continue to be high, its rate of improvements has been faster than in most low-income countries. These improvements in infant and under-five mortality had a significant, positive impact on life expectancy, which went up by a decade within a short span of time. Much of this success in health-related indicators can be traced to the high priority the government accorded to health sectors. In addition to foreign aid, the government also devoted its own resources to these sectors.

In education in 2011, the country achieved a gross enrollment rate of about 115 percent at the primary level, which is one of the highest among low-income countries. Bangladesh has achieved its MDGs in such areas as gender parity in primary and secondary education and is on its way to achieve it in poverty reduction. Although Bangladesh has allocated a lower amount of resources than its neighbor India, its allocation was more geared toward elementary education, a fact that partly explains its success in primary enrollment. In addition, both the ADB and the World Bank have provided financial assistance, conditional cash transfers, targeted to promote female education. Finally, Bangladesh has a dynamic NGO sector that played an important role in improving social indicators, including in primary and female education. The success of the country in reducing the fertility rate can be attributed to the role played by the NGO sector in the delivery of family planning services, as well as in providing micro-credit to women that empowered them in their reproductive decisions.

While Bangladesh still has still some way to go, its achievements in social indicators are impressive given its low per capita income. These achievements in social and economic indicators, in some measure, can be attributed to the positive contributions made by aid; however establishing a causal, quantitative relationship between aid and economic development is difficult.

Table 1. Social Indicators in Bangladesh

Indicators	1975–1990	1998–2008	2001–2010	2011
Gross Primary School Enrollment	71	103	109	–
Gross Secondary School Enrollment	19	43	48.1	51.9
Fertility Rate	6.1	2.9	2.65	2.2
Immunization, DPT (% of children ages 12–23 months)	1	88	92.1	96
Immunization, Measles (% of children ages 12–23 months)	1	81	86.1	96
Access to Improved Water Sources (% of population)	71	80	80.5	83.2
Life Expectancy at Birth	55	67	67.1	69.9
Child Mortality (per 1000 children under 5)	205	69	63.2	43.8
Infant Mortality Rate (per 1000 live births)	129	52	48.5	35.2

Source: World Development Indicators online database

3.1. Donors' Evaluations

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

This review looks at three major donors to Bangladesh.[9]

3.1.1. THE WORLD BANK[10]

The World Bank is the coordinator of aid donors to Bangladesh. It is also the largest, as well as the most influential lender to Bangladesh; its cumulative support (loan plus grants) as of 2012 amounts to $15 billion 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 particularly 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 for achieving food self-sufficiency, mobilizing domestic resources, improving social indicators, and enhancing project implementation. Even 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. 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" (1998b, p. 56).

To address the governance issues, the World Bank imposed more stringent policy conditions in the 1990s, but they yielded little positive results, as the government was not enthusiastic in implementing these reforms. No doubt part of the inaction in implementing reform by the government was due to the political economy constraints; but it also reflected the widespread skepticism in the country, as elsewhere, regarding the intellectual basis of the reforms. While these reforms were discussed with the government, many were not mutually agreed on but were imposed in any case, unilaterally, on the government.

As in many other countries, the World Bank approach to policy reform in Bangladesh was both a bit disingenuous and self-serving. It was disingenuous in the sense that the World Bank ignored the fact that changing policies or institutions is a gradual process, as was evident from the experiences of other countries, including the advanced countries. It was self-serving because the World Bank heaped all the blame for the failures on the government, even though part of the responsibility must belong to the World Bank for proceeding without recognizing the 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 effect expeditious policy changes. This effort largely failed for a number of reasons. First much of this lending often involved excessive conditionalities (i.e., policy changes attached to policy lending) far beyond the implementation capacity of the recipient country. Second, it was based on a cookie-cutter approach grounded in the Washington consensus, that is, on privatization, liberalization, and stabilization, without local-level differentiation. Finally it imposed policy conditionalities with the "agreement" of the bureaucracy, while excluding the larger society, even the parliament. The consequence had been not only inappropriate policies, but also weakened democratic processes and poor economic outcomes.

In the new millennium, governance became the principal focus of the World Bank assistance program in Bangladesh. The other areas of operation included human resource development, environmental management, gender equity, integrated rural advancement, and private-sector growth. The latter focused on strengthening the financial sector and promoting private investment in energy, infrastructure, manufacturing, and services.

The latest country-level evaluation by the World Bank (2009) rated its assistance program to Bangladesh only "moderately satisfactory"; however it viewed the outcomes in civil service reform, legal and judicial reform, transport, and water supply and sanitation falling short of objectives. Though the government did reasonably well in macroeconomic management or coping with natural disasters, its performance remained weak in public finance management, tax collection, procurement, and financial controls. In education and the health sectors, though some progress had been made, many problems still persist. In particular, the quality and efficiency of service delivery remained poor, which created a role for NGOs. In the area of rural development, the World Bank has not done much lending recently, although it was one of its focus areas.

In private sector development, much remains to be done; there are still serious bottlenecks in electricity, power, and transport. The financial sector remains fragile with large debts owed by state enterprises; opening and operating a business is riddled with many challenges, including various types of extra-legal payments and political coercion. In the area of environment, Bangladesh faces many challenges, the most immediate and pressing being the management of water resources and air quality and pollution. In the area of gender, the World Bank's projects and programs had a direct contribution toward reducing gender gaps in school enrollment and promoting income-generating activities.

The World Bank considers its assistance program to Bangladesh effective, even though its evaluation statistics point to a mixed outcome. The World Bank's assessment of its existing portfolio in Bangladesh for 1995–2007 compares favorably with the bank-wide average and the average for South Asia region. This result indicates progress compared with the earlier period. According to the earlier country evaluation report (World Bank 1998b), the percentage of the World Bank's projects deemed unsatisfactory was higher than the Operations Evaluation Department's bank-wide average. With regard to sustainability, the performance of projects in Bangladesh was unsatisfactory, as many had negligible institutional impacts. The report also noted that lending to Bangladesh was inefficient: the Bank's loans required more time for processing than the bank-wide average on this. This poor project implementation performance no doubt reflects the country's capacity constraints; but part of the problem stems from donor fragmentation: multiplicity of donors with diverse reporting and accounting requirements, thereby making heavy demands on scarce domestic managerial capacity.[11]

3.3.2. The Asian Development Bank

The ADB is the second largest lender to Bangladesh after the World Bank. Its total cumulative lending, as of 2013, amounted to about $15 billion, covering many sectors of the economy. ADB supports almost all key sectors, but during the early phase of its lending, till the mid-eighties, the major focus of its activities was agriculture and natural resources. Gradually during the nineties, it shifted its activities more towards infrastructure, energy, and transport. In recent years its operation also included governance, education, and water supply and other municipal infrastructure and services. The stated main objective of current ADB lending is to contribute to the government's Sixth Five-Year Plan goals and commitments for enhancing growth and reducing poverty.

The findings of ADB's evaluation studies (ADB2003 and ADB 2009) are in many ways similar to those of the World Bank. The earlier country evaluation study, ADB (2003), found ADB's program to be relevant and successful in a number of areas, including its support to agriculture to achieve self-sufficiency in food. Similarly it concluded that ADB's assistance to energy and transport sectors were beneficial and made a significant contribution to GDP growth in the late 1990s. However in terms of poverty reduction, it considered its initiatives in agriculture, forestry, and the social sectors, particularly health and education, did not make a major impact. While this might have reflected the fact there was a general slowdown in poverty reduction in Bangladesh in the 1990s (due to shifts in income distribution), curiously, ADB (2003) attributed this to its program's lack of alignment with the so-called Partnership Agreement on Poverty Reduction.[12]

The recent review (ADB 2009) found that the overall performance of ADB's assistance program as satisfactory, with energy and education making the strongest contributions. Like the World Bank, ADB viewed weak governance and structural problems as a main constraint to Bangladesh's development. While it acknowledged some progress in the separation of powers of the executive, legislative, and judicial organs of the state, it emphasized the need for stronger government commitment to transparency and accountability in governance. ADB suggested the need for strengthening the anti-corruption institution. However given the rampant political interference and lack of organizational and financial autonomy, further strengthening of the anti-corruption agency might not be feasible under current circumstances.

ADB, like the World Bank, found delays in the implementing development projects a big challenge in aid effectiveness, a challenge that usually arose from prolonged procurement of consulting services and under performance of civil works contractors.

3.3.3. The Government of Japan

Japan is the largest bilateral donor to Bangladesh and accounts for a sizable portion of the country's foreign assistance. Since independence its total support to the country, as of 2012/2013, amounted to about $8 billion, most of which were grants. GOJ implements its development assistance program through a combination of governmental agencies, the embassy, Japan International Cooperation Agency, the Japan Bank for International Agencies and the 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, and Rupsa bridges.

Country evaluation by JICA (2004) found that its program was consistent with Bangladesh priorities, as expressed in the Five-Year Plan and the Poverty Reduction Strategy Paper (PRSP); however JICA did not directly involve itself in such broader issues as gender and governance (also part of the country's priorities and are major issues). The evaluation, however, noted certain deficiencies in the JICA program from the delivery side in program formulation, coordination, and implementation.

Even though JICA investment in agriculture and agricultural productivity had been on the rise, the country evaluation concluded that it was hard to see how Japan's assistance contributed to macro indicators. The other areas for significant JICA lending were rural infrastructure and social sectors. Even though some results were tangible in the health sector, overall, JICA (2004) concluded 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. However JICA hoped that in the future, Japanese aid would have a greater impact on the economy, as its assistance in the construction and maintenance of major bridges and in power and infrastructure development begins to bear fruit.

3.3.4. Summing Up

Thus from the donors' perspective, aid yielded mixed results in Bangladesh. Project implementations issues, such as delay and poor quality, continued to be a problem, as was the long-term sustainability of some of these interventions. Donors considered their investment projects to be more successful than their policy loans. The failure of policy reforms, that is, the country's failure to implement prescribed policies as per schedule and as agreed, however is not unique to Bangladesh; it is common across the developing world. This failure may reflect political-economic constraints or simply disagreement with the policy reforms suggested. Indeed many successful Asian countries, including the East Asian newly industrialized countries, as well as China and India, exerted a high degree of autonomy from the international agencies when formulating their economic policies.

3.2. The Recipients' Evaluations

The government does not undertake any formal evaluation of aid effectiveness. However there is no dearth of such assessments from various nongovernmental sources, including academia, the media, and the civil-society organizations. In 2005, the Center for Policy Dialogue, a premier think-tank of the country, organized a national conference on aid effectiveness participated by economists, senior civil servants, the media, and business leaders. While some of the discussion was anecdotal and experiential, it identified numerous issues with the design and delivery of the existing aid programs that lead to such mixed results. The following is a brief summary (Center for Policy Dialogue 2005).

(i) *The donors have a disproportionate influence on policies*: While the significance of aid in relation to the macro economy of the country has been on the decline, the influence of donors in shaping and setting the policy agenda seems be on the increase. This disconnect between financial contribution and policy influence leads to a policy agenda at odds with the requirements of the macro economy and does not necessarily bode well for it.

(ii) *Conditionalities limiting the policy autonomy of the government:* Multilateral aid is not always based on pure economic considerations. It is usually associated with a wider variety of conditionalities that restrict policy autonomy of the government.

(iii) *There is an apparent disjunction between the benefits and costs of adjustment loans that act as a disincentive to implement reforms:* When the government contracts a policy loan, its resources are augmented but reforms relate to the sectors; and as the sectors do not receive the money, they do not have much incentive to implement the reforms.

(iv) *The reforms should be home-grown and vetted by parliament:* Currently most reforms are imported and introduced as part of the aid package, which explains their lack of ownership. 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 had little impact on poverty reduction of the country*: The donors have done little in relation to poverty alleviation. Except for Food-for-Works, all successful programs that have a direct bearing on poverty reduction were home-grown. Often the only help the donors provided was limited to not radically trimming down social expenditures under adjustment programs.

(vi) *There should be more aid to higher education*: Bangladesh, which is poised to move to the next higher stage of economic development, requires foreign assistance in higher education for skill-formation and technological innovation. However this is one area where donors' priority and assistance is conspicuously lacking.

(vii) *Reforms are not owned because they are imposed*: Bangladesh, like many other developing economies at a similar stage of economic development, requires foreign aid for budgetary support, as well as for economic development. As a result when donors propose any aid with conditionalities, it reluctantly accepts many of the conditionalities, which are not to its liking. This explains the lack of ownership of many reforms, as well as their unenthusiastic implementation.

(viii) *The PRSP is a poor substitute for planning*: It is an inadequate substitute for the overall planning of the economy, embodied in traditional five-year or long-term planning documents. The PRSP remains no more than a wish list.

(ix) *Donor policies are inappropriate*: While some policies advocated by donors are good, they are often formulated in the abstract, without considering the complex political-economic realities of the country. As a consequence it is difficult to implement these policies in the face of general unacceptability by society.

(x) *The Washington-consensus has yielded few benefits for Bangladesh*: Donors have usually taken a cookie-cutter approach to policy by promoting the Washington-consensus. They have often advocated policy prescriptions that implied undiluted privatization rather than development of the private sector, sudden liberalization rather than gradual adjustment, and deregulation rather than regulatory redesign. These policies have contributed little to economic growth, poverty alleviation, or promoting equity.

In short the foregoing assessments by societal stakeholders suggest that aid had been less than effective and had little direct impact on poverty reduction; that it led to a plethora of inappropriate policies imposed exogenously by donors; that donors had 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, had few indigenous roots and had helped undermine the traditional planning mechanism.[13]

4. 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 way unique to Bangladesh; they have a wider relevance. Given the generic nature of these issues, we discuss them within a generalized framework that draws on, and is informed by broader international experience.

4.1. Absorptive Capacity Constraints

It is almost an article of faith among economists that developing countries suffer from absorptive capacity constraints; that is, there is an upper-limit to an individual country's capacity to utilize foreign aid productively. This idea of absorptive capacity constraint originally dates back to Chenery and Strout (1966), Millikan and Rostow (1957), and Rosenstein-Rodan (1961). The recent empirical work on aid effectiveness also corroborates the fact that there are diminishing returns to aid: given that developing countries have low levels of human capital and limited physical infrastructure, the returns from foreign assistance tends to decline as the flow of aid increases (see Quibria (2014) for a review of the literature).

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.[14] Many of the problems also stem from the cumbersome policies, procedures, and practices of donor agencies, each of which have copious reporting requirements 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 (2002)).

4.2. Real Exchange Rate Appreciation

Whether because of 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: the point at which aid starts to have a negative effect on growth is much higher than the levels of official development assistance currently available to most low-income countries.

According to Rajan and Subramanian (2011), the key to understanding weak associations between aid and growth is the real exchange rate overvaluation associated with any large inflow of foreign exchange; this is labeled in the literature as Dutch disease.[15] The mechanism through which Dutch disease operates is straightforward. An inflow of foreign aid leads to an increase in expenditures on non-traded goods and services. This increases the prices of non-traded goods and services, as well as the prices of domestic inputs that are used to produce them. This erodes the competitiveness of those export sectors that depend on those non-traded inputs.

However it is not clear why the mechanisms leading to the appreciation of the real-exchange rate should operate so strongly in developing countries. These countries typically produce far below capacity, while the symptoms of Dutch disease arise when countries produce close to their production possibilities frontiers and 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 constitute 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 (2011) argued are responsible for aid ineffectiveness, may therefore simply reflect capacity constraints in developing countries. In such circumstances rather than aggravating the problem of Dutch disease, an 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 that foreign aid has led to a serious overvaluation of the real exchange rate and to an erosion of export competitiveness. Indeed data suggest that Bangladesh's real effective exchange rate (REER) remained largely stable and competitive over time (even in the face of reserve buildup due to robust export growth, especially in ready-made garments over the years) (Figure 7). Indeed, a comparison by the International Monetary Fund (IMF) of the REER movements of a number of Asian countries that compete with Bangladesh in international markets, such as Cambodia, Sri Lanka, and Vietnam, indicated that Bangladesh had had the lowest growth in REER compared with these competitors from 2006–2011 (IMF 2011). Thus the apprehension that aid may have caused Dutch disease and led to the overvaluation of the real exchange rate is unwarranted. For Bangladesh the principal constraints to further growth and diversification of exports lie in various bottlenecks of physical infrastructure and skills, not in the possible real exchange rate appreciation, associated with the inflow of foreign aid.

Figure 7. Trend of Bangladesh's Real Effective Exchange Rate

Insert Figure 7 here

4.3. Governance and Corruption

Rajan and Subramanian (2007) argued that foreign aid leads to a deterioration of governance; in particular they claimed that as the volume of aid increases, it reduces the government's accountability; that is, the government slackens its efforts to maintain the rule of law, ensure predictable judicial outcomes and contract enforcement, and limit corruption.[16] All this has a particularly adverse effect on manufacturing (highly dependent on the quality of governance) and on overall economic growth.

How relevant is the above finding to Bangladesh? With respect to corruption, Transparency International ranked Bangladesh as the most corrupt country in 2005; in 2011 and 2012, it was ranked 120 and 144, respectively in the same index. While one should take these rankings of countries with a grain of salt (as they are perception-based and largely subjective), they certainly point to the existence of a serious corruption problem in the country.

This corruption problem has been further corroborated by the World Governance Indicators (WGI) of the World Bank; these indicators provide a broader picture of governance than simple corruption. The WGI dataset covers more than 200 countries over the period 1996–2012 and presents information on six aggregate indicators: (i) voice and accountability, which considers various aspects of the political process, civil liberties, and political rights; (ii) government effectiveness, which incorporates measures on the quality of public service provision and the bureaucracy, the insulation of the civil service from political pressures, and the credibility of the government commitment to policies; (iii) political stability and absence of violence; (iv) regulatory quality, which measures the incidence of market-friendly policies and the burdens from excessive regulations; (v) rule of law, which includes indicators that gauge the confidence of the agents in, and their compliance with, the rules of society; and (vi) the control of corruption, which measures the perception of corruption in the government .

According to the WGI, the performance of Bangladesh remains much below the global median in all dimensions of governance. Indeed except for voice and accountability, it lies in the lowest quartile. Data also suggest that the performance of Bangladesh in overall quality of governance has shown little or no improvement over time (Table 2).

Despite the depth and pervasiveness of governance weakness, it is not clear the extent to which foreign aid has contributed to it; however based on fragmentary and anecdotal evidence (see the next section on the alleged Padma Bridge corruption), one may infer that foreign aid may have played a part in it.

However even though 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 dual-controlled by both parties. Nevertheless this apparent deterioration of governance has had little impact on either economic growth or poverty reduction. This lack of correlation between governance and growth, which the World Bank (2007) labeled as the Bangladesh conundrum, however, is not unique to Bangladesh: it is applicable to a whole host of high-performing Asian economies, such as China, India, and Vietnam.[17]

*Table 2.*Bangladesh Governance Indicators (2002–2012)

Indicator	Year	Governance Score (−2.5 to + 2.5)	Percentile Rank (0–100)	Standard Error
Voice and Accountability	2002	−0.52	33.65	0.17
	2007	−0.54	31.25	01.2
	2012	−0.42	34.12	0.11
Political Stability and Absence of Violence/Terrorism	2002	−1.08	17.75	0.30
	2007	−1.50	9.13	0.24
	2012	−1.35	9.00	0.22
Government Effectiveness	2002	−0.70	27.32	0.16
	2007	−0.68	27.67	0.18
	2012	−0.83	22.49	0.19
Regulatory Quality	2002	−1.01	18.14	0.21
	2007	−0.91	18.45	0.18
	2012	−0.96	19.62	0.17
Rule of Law	2002	−0.90	22.49	0.17
	2007	−0.83	22.49	0.15
	2012	−0.91	19.43	0.14

Control of Corruption	2002	–1.18	4.88	0.16
	2007	–1.05	11.17	0.17
	2012	–0.87	21.05	0.15

Source: WGI online database

4.3.1. THE PADMA BRIDGE AND CORRUPTION[18]

During 2011–2012, the alleged corruption in the construction of a bridge over the River Padma, the Bangladeshi part of the River Ganges, became the source of an acrimonious controversy between the Bangladesh government and the World Bank. The proposed bridge, to be the largest in the country, would connect the south-west region of the country to the capital. A multipurpose bridge, it is designed to carry a four-lane highway on the upper level and a single track railway on the lower level. It was considered a critical infrastructure project for the country for improving its transportation network and for fostering regional economic development. For the south-west region, which has a population of over 30 million and covers about 30 percent of the total area of Bangladesh, the bridge has been a beacon of hope for its social, economic, and industrial development.

The project cost for the bridge was estimated at around $3 billion to be shared by a consortium of donors, such as ADB ($650 million), the World Bank ($1.2 billion), JICA ($415 million), and the Islamic Development Bank ($140 million). The Bangladesh Bridge Authority initiated the prequalification tender for the project in April 2010. Construction of the bridge was expected to commence by early 2011, be ready for major completion in 2013, and all sections complete by late 2015.

However a stalemate arose between the government and the World Bank over allegations of graft. The World Bank claimed that it had credible evidence, corroborated by a variety of sources, of a high-level corruption conspiracy involving SNC–Lavalin, a Canadian engineering and construction company, which had made improper payments to Bangladeshi government officials to win a contract related to the bridge. This led to the freezing of the Bank's loan, two raids by police of the firm SNC–Lavalin, and debarment of units of the firm from World Bank contracts.

The World Bank submitted its evidence from its investigations to the Prime Minister, the Minister of Finance, and the Chairman of the Anti-Corruption Commission of Bangladesh (ACC) in September 2011 and April 2012 and demanded that the government take actions against officials involved in the high level corruption it had uncovered.

As a precondition for resuming lending, the World Bank suggested a number of actions: (i) place all public officials suspected of involvement in the corruption scheme on leave from government employment until the enquiry is completed; (ii) appoint a special prosecution team within the ACC to conduct the enquiry; and (iii) grant access to all information to a panel of international experts appointed by the World Bank that would advise on the credibility of the investigation. The World Bank agreed to work with the government and the ACC to ensure that all actions requested were in conformity with Bangladeshi laws and procedures.

In light of allegations of corruption, the World Bank also proposed that the financing decision of the Bank and its co-financiers would be made when the first bids are launched, based on the panel's assessment that a full and fair investigation was under way and progressing appropriately. In June 2012, because of the unsatisfactory response by the government, the World Bank decided to cancel its $1.2 billion IDA loan for the Padma Bridge project. With the World Bank, other co-financers followed suit.

4.4. Conditionality and Ownership

A common complaint among donors is that policy conditionality has not worked in Bangladesh.[19] 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.

Policy conditionality is ineffective for many reasons.[20] 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 following the disbursement of aid (as incentives change). Indeed the issue of conditionality goes beyond designing an incentive-compatible contract in a principal-agent framework. The interactions between donor and recipient are dynamic and asymmetric, much more complex than envisioned in the standard static principal-agent problem. Third, the incentive structure of donor agencies and the so-called Samaritan's dilemma can also adversely affect the attainment of conditionality. Existing incentive systems in donor agencies place a high value on aid disbursement, the incentive that encourages aid officials to maximize disbursements and neglect conditionality. Similar failures may also result from compassion to help the poor in aid-recipient countries. The poor may benefit from such noncompliance of conditionality in the short run, a concern that might lead aid agencies to overlook non-fulfillment of policy actions in poor countries (Kanbur 2006). However for the poor, there is often a trade-off between relatively small short-term gains and potentially much larger long-term benefits.

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. Country ownership has been defined in different ways,[21] 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.[22]The World Bank, the IMF, 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.[23]

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;[24] 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 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 stymied 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 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; in those areas where there is little consensus on what constitutes good policies, there is often disagreement, leading to 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, now commonly used in conjunction with process conditionality, has also not proved to be as fruitful as originally anticipated. In view of this to enhance aid effectiveness further, 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, measured in terms of outcomes… and not policies and other intermediate inputs. They argue that this would give local institutions the flexibility and autonomy required for policy and institutional experimentation, while at the same time ensuring that aid pays only for real and measurable progress.

4.5. MEASUREMENT OF AID EFFECTIVENESS

The choice of metric matters. Currently, the implicit metric of aid effectiveness used by the international community is an assessment 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 four 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.[25] The European Commission has recently introduced a form of outcome-based conditionality for its adjustment aid to African, Caribbean, and Pacific countries (Adam et al. 2004).

The main arguments advanced in favor of policy-based conditionality, rather than outcome-based conditionality, are that the former entails policy changes that are easier to observe and monitor and have greater incentive effects. Governments can control policies, rather than outcome more directly; and their implementation can be more easily monitored. 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, be it economic growth or 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.

5. 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, much of the current effort to ensure aid effectiveness is anchored in the notion of "good" institutions and policies that aid agencies strive to foster across the developing world. However what is "good" is not necessarily always "appropriate". If the objective of the aid agencies is to enhance the effectiveness of aid, they should abandon this cookie-cutter approach, recognize the diversity among countries, and allow the countries the space to experiment and design their own policies and institutions (Easterly 2006a, UNCTAD 2006).

Second, donors presently allocate aid based on some notion of selectivity. However the basis for such selectivity should be actual economic and social outcomes; that is, it should be decided by concrete and measurable results, and not by subjective assessments of policies and institutions, as seems to be the current practice.

Third, policy-lending based on *ex ante* policy conditionality has proved to be largely ineffective. One way to improve conditionality is to promote country ownership of the policies. The concept of ownership has been formalized in the PRSP process of the international donor agencies; when a country is genuinely in charge of its development process, it formulates its own policies and strategies. It also brings local knowledge to work. Thus some have suggested that to foster ownership, recipient countries be given complete autonomy in managing their aid resources without donor interference.

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

Fifth, maximizing the impact of aid on poverty reduction requires identifying and eliminating major constraints to poverty reduction in a particular country. This is where donor agencies can play an important role through supportive analytical work that is informed by global experience of other nations.

6. CONCLUDING REMARKS

Foreign aid has had a mixed performance in Bangladesh. The blame for the failure accrues with both the government and donors. Donors' current approaches to aid delivery are fraught with many generic issues highlighted earlier. Addressing those issues would require changes in the current donor approach, changes that (a) allow for greater flexibility in the delivery of aid; (b) provide recipient countries with more policy space; and (c) emphasize results. These steps by themselves will be insufficient, unless accompanied by complementary measures by recipient countries. These measures include enhancing domestic capacity to implement sophisticated projects and creating an economic environment conducive to growth.

In the past Bangladesh has achieved considerable success in many areas of the economy, despite infrastructural constraints, policy deficiencies, and weak governance. This success is a testament to people's entrepreneurial abilities, which are reflected in exports of garments and textiles, remittances from overseas workers and breakthroughs in agricultural production, and in the dynamism of nongovernmental organizations in addressing social issues. If the country can maintain its current growth momentum, it would soon join the ranks of middle-income countries. However, the path to sustained economic development is paved with many obstacles. Besides policy and infrastructure bottlenecks, the country is faced with serious governance issues.

Even though Bangladesh made a transition from authoritarianism to democracy more than two decades ago, it has the flaws and weaknesses of an illiberal democracy (Zakaria 1997). Although the system allows for institutions of representations, such as elections and parliament, it lacks the institutions of restraints of a liberal democracy, enshrined in the independence of the judiciary, and in the separation of powers to maintain law and order and ensure rule of law.

However representation without restraint, elections without the rule of law, is a recipe for the "tyranny of the majority" (de Tocqueville 1969). Such an illiberal democracy can preclude the development of a level playing field, breed corruption, and foster crony capitalism.

The governance problem has been compounded further by the absence of enlightened leadership with a grand vision and a sophisticated understanding of the economic development process, leadership traits particularly important for a country trying to be part of the global production system.

Governance problems notwithstanding, the economy has made great strides in recent years. However it would be wrong to extrapolate the past success into the future. In the process of economic development, the role of the institutions vary from one stage to another; many aspects of governance that were less central in the past will become more critical in the future, as the economy makes a transition from the stage of being predominantly rural and agricultural to one that is urban and industrial. The hope is that the political leadership will rise to the occasion to initiate changes in policies and institutions in synchrony with the evolving exigencies of the economy. If that happens, foreign aid could be an enormous catalyst for economic development, and poverty may become an issue of the past much sooner than the early prognosticators of doom had ever imagined.

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END NOTES

[1] At the onset of the Bangladesh liberation war, Henry Kissinger, then United States Secretary of State, is said to have famously remarked that Bangladesh was going to be an economic "basket case", which would be perennially dependent on foreign aid.

[2] The MDGs are a set of development targets, adopted by the United Nations in its millennium session in 2000, 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 are to be achieved by 2015.

[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 overtime, so has the meaning of aid effectiveness: the goals that the international community seeks to achieve through foreign assistance. These goals have varied over time, 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 increasingly equated aid effectiveness with attaining the MDG goals.

[4] Triangulation is a qualitative method of arriving at robust and credible conclusions by studying the problem from more than one standpoint— through cross verification of data and information from multiple sources. It seeks to offer a more balanced and detailed picture—in its full richness and complexity—than what is captured in standard econometric studies.

[5] The method of randomization has various shortcomings that Deaton (2009, p2) succinctly summarized:

> In ideal circumstances, randomized evaluations of projects are useful for obtaining a convincing estimate of the average effect of a program or project. The price for this success is a focus that is too narrow to tell us 'what works' in development, to design policy, or to advance scientific

knowledge about development processes. Project evaluation using randomized controlled trials is unlikely to discover the elusive keys to development, nor to be the basis for a cumulative research program that might progressively lead to a better understanding of development.

[6] In 2008, Bangladesh was faced with an acute shortage of food due to an adverse weather shock, a scarcity that required the country to import food. However this situation represented a mere short-term blip rather than a long-term trend. Indeed in 2009, with improved weather and smooth access to farm inputs, agriculture output rebounded sharply.

[7] Even with a recent slight uptick in the volume of aid, the role of the United States as a source of bilateral aid has declined over the years: in the earlier years till the late nineties, it was a major source of aid, particularly, food and commodity aid; it is now a marginal contributor to the country's development process. Much of the American assistance is grants but tied, channeled through preselected nongovernmental organizations, rather than the government. Despite serious efforts by the government, Bangladesh has so far failed to obtain funding from the United States Millennium Challenge Account. If that happens, it would improve the performance of the United States as a bilateral supplier of aid to the country.

In recent years the United Kingdom has emerged as the second most important bilateral donor after Japan. Its assistance, which is mostly grants, is concentrated in activities related to poverty reduction, private sector development, and improving governance.

[8] It is widely believed that in contrast with bilateral aid, multilateral aid is more influenced by economic than political considerations; however this argument does not necessarily stand up to scrutiny, since the same set of countries dominate both multilateral and bilateral aid. As data clearly indicates, the ownership of multilateral financial institutions remains concentrated in a few countries, which are also major bilaterals, with similar perspectives on aid.

[9] The IMF was excluded from this review because its direct contribution to economic development and poverty reduction is all but marginal, because its mandate limits its lending activities to maintaining macroeconomic stability (a role

that is important, but does not have a direct and immediate bearing on economic development).

[10] The lending data of the donors are based on data reported on the respective donors' websites, unless otherwise stated.

[11] International aid agencies have recently recognized that the implementation problem stems, to some measure, from donors' diverse procedures and standards; they are working toward harmonizing these procedures and standards and aligning them with countries' own systems. To date, some progress has been made, but much remains to be done.

[12] The Partnership Agreement on Poverty Reduction was the ADB equivalent of the World Bank's Poverty Reduction Strategy Papers (PRSPs). ADB subsequently discarded this initiative at the behest of the World Bank and the IMF, which introduced the PRSP process in 2000. This process obliges the low-income countries—though some exceptions were made for large countries, such as India—to prepare national poverty reduction strategies as a condition to receive aid. These national strategy documents include 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, five core principles guide these papers: (i) they should be country driven, involving the participation of civil society and the private sector in all operational steps; (ii) they should be results oriented, focusing on outcomes that benefit the poor; (iii) they should be comprehensive in recognizing the multidimensional nature of poverty; (iv) they should be partnership oriented, which involves the coordinated participation by development partners (bilateral, multilateral, and nongovernmental); and (v) they should be based on a long-term perspective for poverty reduction. For details see World Bank and IMF (2005).

[13] India did not go along with this process. It insisted on linking the assistance program to the country's Five-Year Plan. In the case of Bangladesh, the PRSP virtually replaced the Five Year Plan, which became practically defunct at some stage. In the absence of such a plan, the medium-term budgetary framework reported in the budget provided "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).

[14] Some of the donor-introduced institutional mechanisms to circumvent the absorptive capacity issues come with their own drawbacks. One such institutional mechanism is the project implementation unit to coordinate, manage, and fast-track the implementation process. While such a unit is helpful in many ways, it has its own shortcomings—it creates new vested interests with competing incentives, and thwarts local institutional development.

[15] In recent years, a number of authors, such as Adenauer and Vagassky (1998), Nyoni (1998), Vos (1998), Vos and Johansson (1994), and White and Wignaraja (1992), analyzed the Dutch disease effects of aid inflows. However these studies differ considerably in their conclusions.

[16] One can also make an opposite argument that foreign aid provides a country with the wherewithal to pay greater attention to governance issues, as many aspects of good governance entail significant investments of resources in physical and social infrastructure. This may be the reason why governance indicators and per capita income move in sympathy.

[17] 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 skew the relationship between governance and development.

[18] For a short summary of events, see Rubenfeld (2012). However the incident was extensively covered in international and local media.

[19] Conditionality, in the traditional sense, refers to policy conditionality. In recent years however, the emphasis has shifted from policy conditionality to process conditionality; the latter links lending to the participation of various stakeholders, particularly, the representatives of the poor, of the society in the design and delivery of aid. The putative purpose of process conditionality is to minimize corruption, foster respect for human rights, and promote greater accountability of the government. Process conditionality, however, is not without its flaws. It

requires donors to make the difficult and intrusive judgment about the quality and inclusiveness of democracy in recipient countries: how the poor are represented in the political process. In addition, process conditionality may undermine indigenous institutions of accountability, such as local government and civil society organizations, and overemphasize internationally visible nongovernmental organizations.

[20] The reasons may differ from country to country. Rahman (2008) provided an interesting personal account, based on his experience as the top civil servant, of coordinating foreign aid resources of the country. He noted that while Bangladesh government officials collaborated with donors in the design of programs, its reform agenda in such diverse sectors as jute, energy, railways, industries, telecommunication, health and education, the role and participation of the Bangladesh officials varied considerably across sectors. He also noted that though donors and recipients always agreed, at the general level, on the desirability reforms, they often differed significantly on specifics; but at the end, the donors always prevailed. He concluded that while government participation enhances the probability, but does not guarantee the success of a reform agenda.

[21] The World Bank's Independent Evaluation Group 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, requires extensive government consultations with other segments of society, including civil society and the private sector. The purpose of such consultation is to elicit new ideas, knowledge, and opinions, and to promote consensus on the strategy. Given the large elements of subjectivity involved in this definition, assessing ownership remains largely subjective

[22] Stiglitz (1999) suggests that the role of donors in the design and implementation of reforms should be drastically limited; this should be no more than that of economic advisers who make countries aware of prevailing, alternative views on reforms.

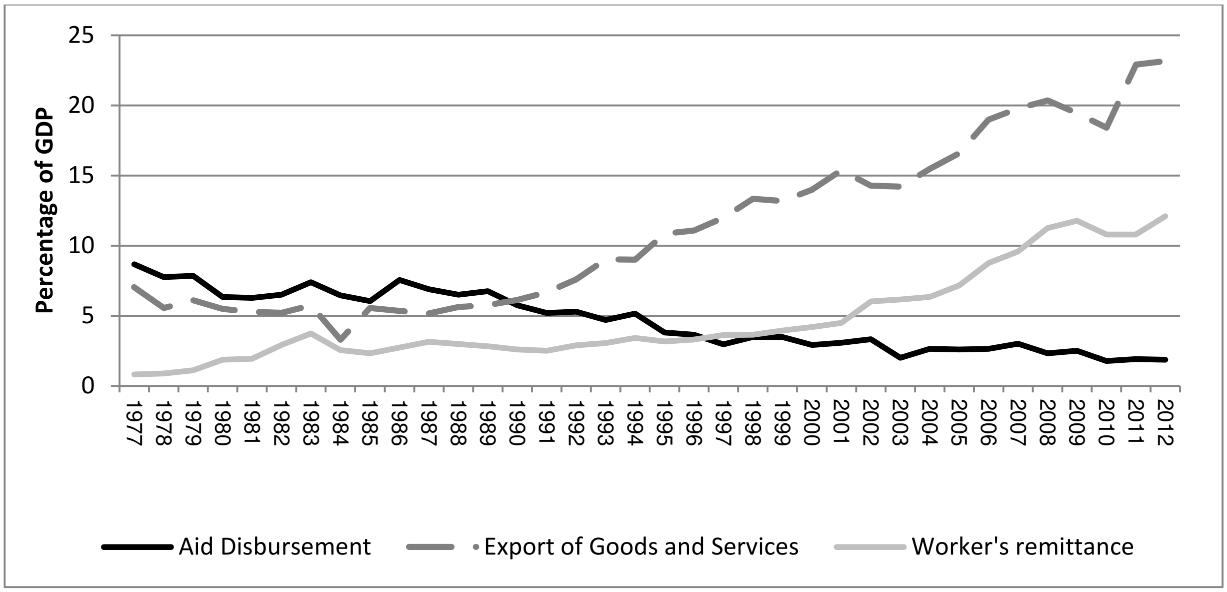
[23] However this attempt to confer greater ownership has at best achieved only limited success. First, PRSPs continue to be mostly donor, rather than country, driven, particularly where domestic capacity to formulate such a strategy is lacking (Easterly 2006b). Second, even where such capacity exists,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

[24] Conditionality, in its traditional sense, requires a country to pledge a stipulated set of policy actions before it receives aid. In other words, conditionality involves prior actions before the loan is disbursed, 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, however, selectivity is usually combined with process conditionality.

[25] 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.

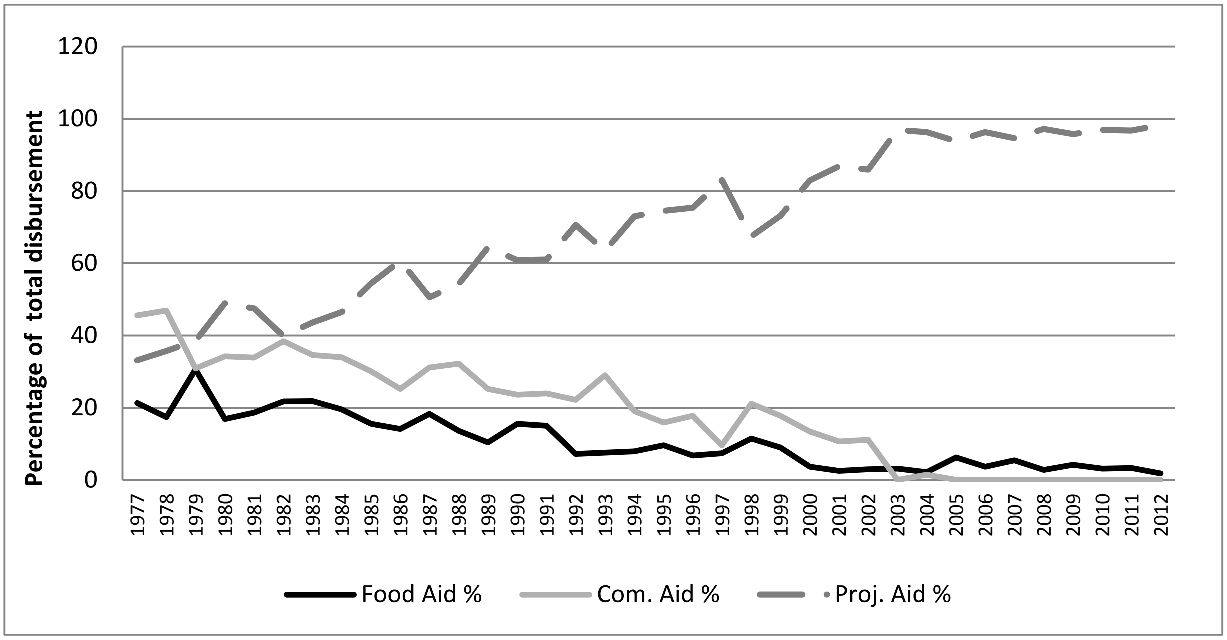
Figures:

Figure1. Trend of Aid Dependency



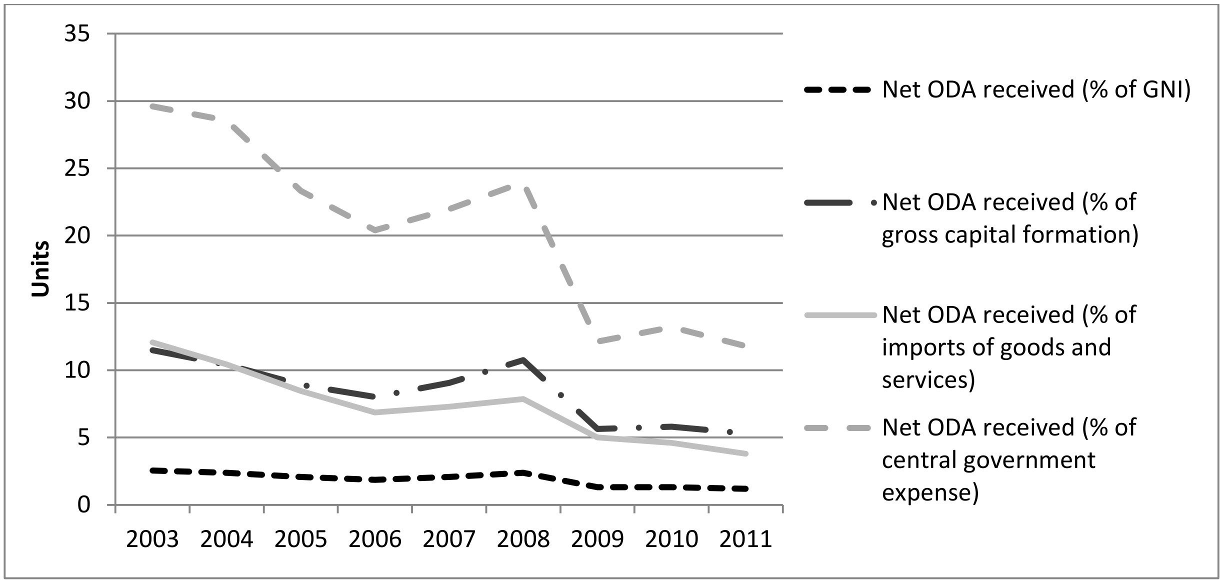
Source: World Development Indicators online database

Figure 2. Changing Composition of Aid



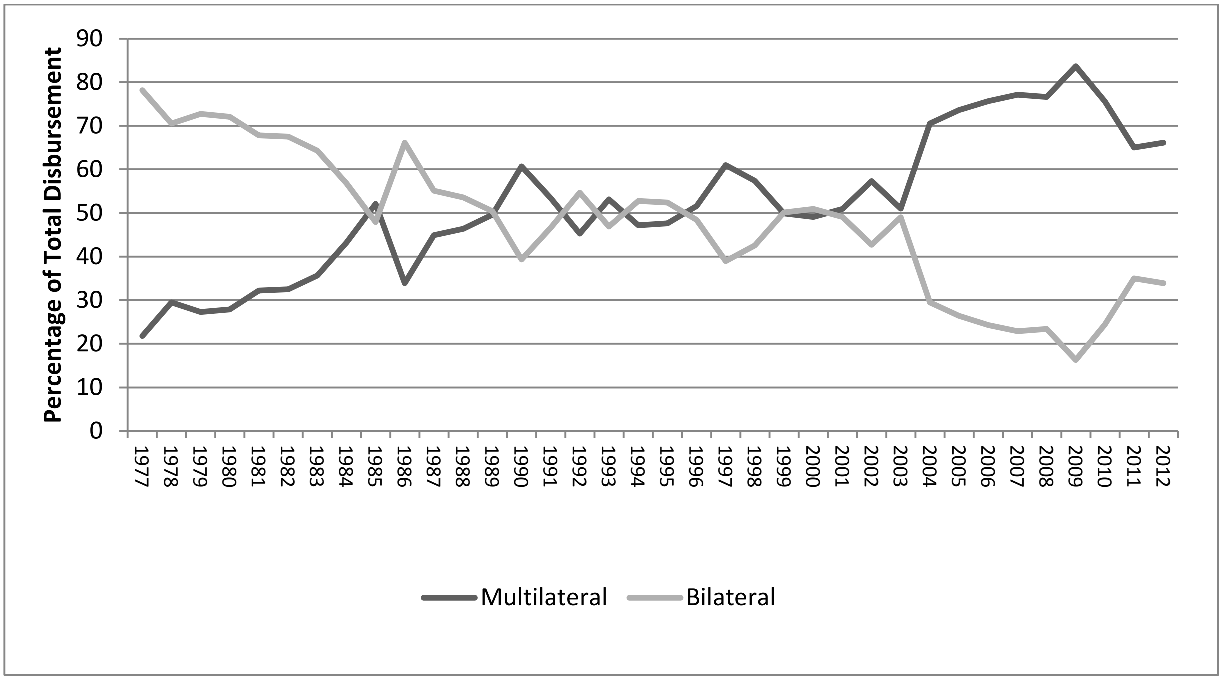
Source: GOB (2013), available at http://www.erd.gov.bd/images/FlowBook/Tbl-3.10.pdf (accessed 7 July 2014).

*Figure 3.*Foreign Aid as a percentage of Government Expenditure, per capita Income, Imports and Investment



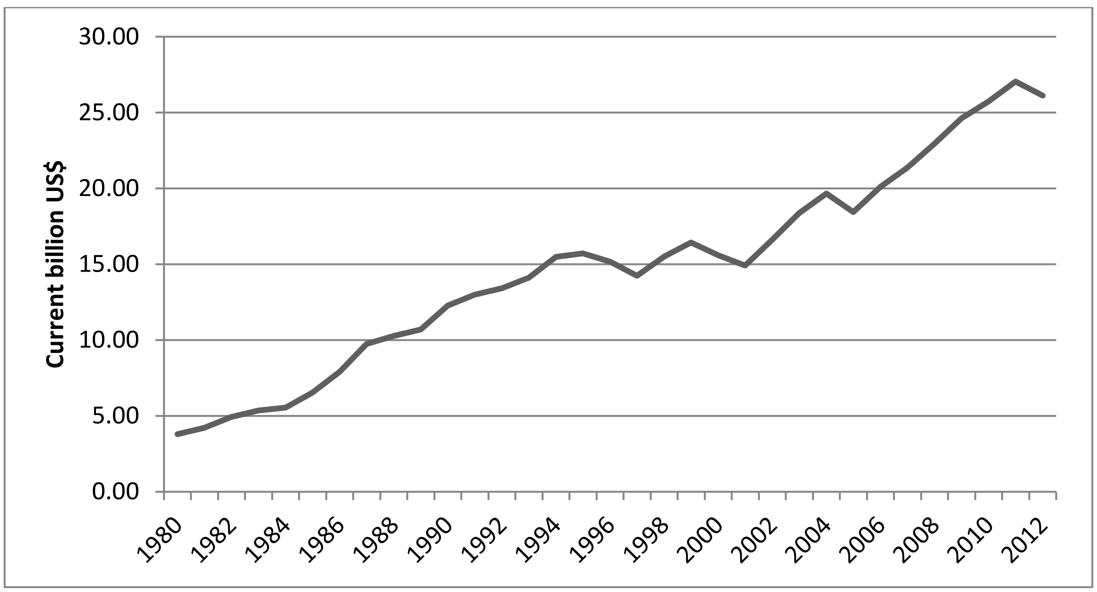
Source: World Bank, International Debt Statistics. World Development Indicators online database

*Figure 4.*Changing Role of Bilateral versus Multilaterals



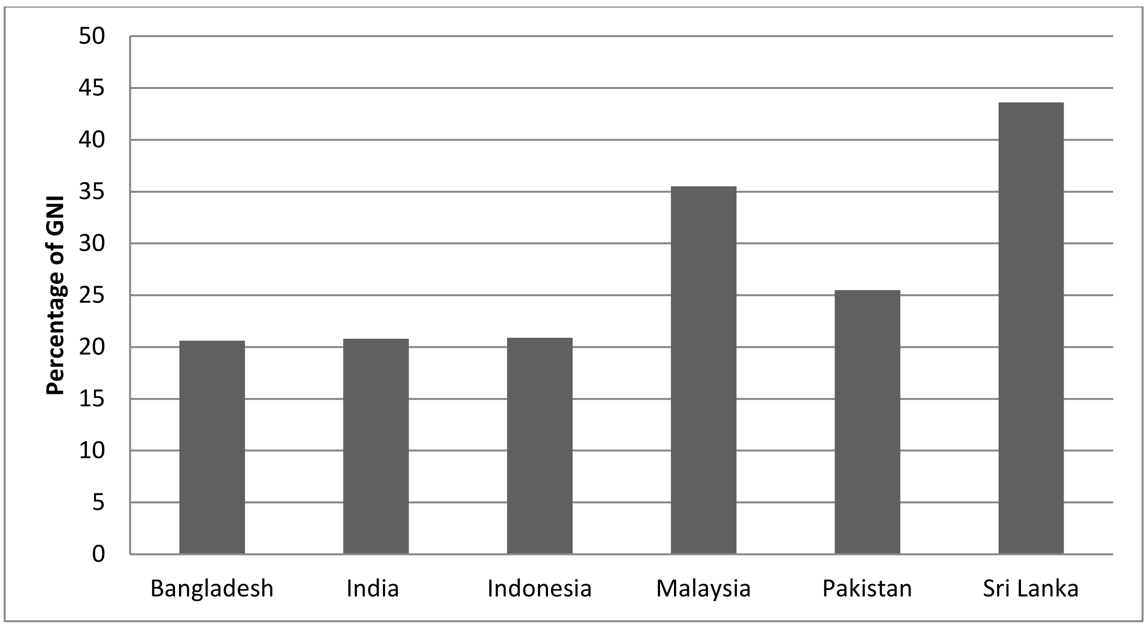
Source: GOB (2013), available at http://www.erd.gov.bd/images/FlowBook/Tbl-3.10.pdf (accessed 7 July 2014).

Figure 5: Total external Debt from 1980-2012



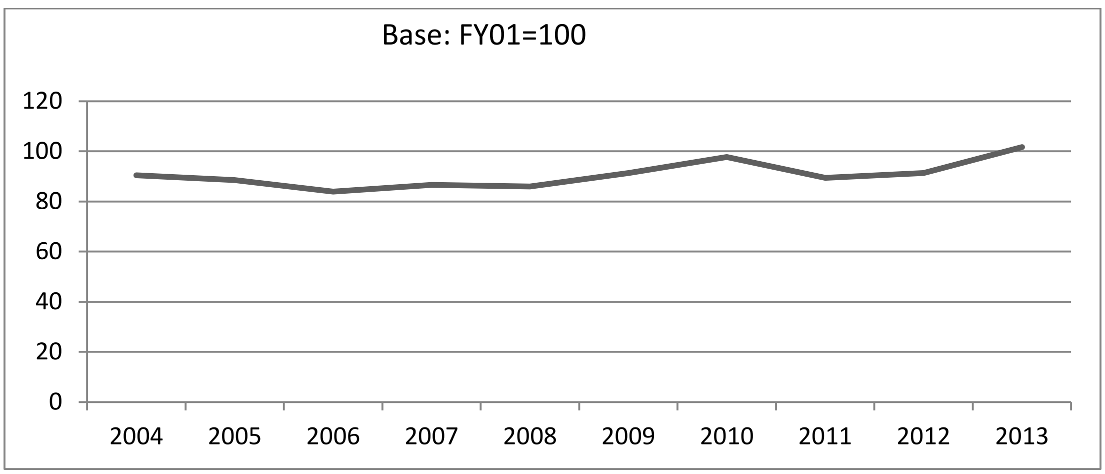
Source: World Development Indicators online database

Figure 6: Total external Debt as a percentage of GNI for selected countries in FY 2012



Source: World Development Indicators(2014), available at http://wdi.worldbank.org/table/6.8 (accessed 11 July 2014)

Figure 7. Trend of Bangladesh's real effective exchange rate



Source: Bangladesh Bank(2013) available at http://www.bangladesh-bank.org/pub/annual/anreport/ar1213/app03.pdf (accessed 21 July 2014)