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ALL ROADS DO NOT LEAD TO DEVELOPMENT: THE DIVERGENT OUTCOMES OF DONOR ASSISTANCE AND AID IN BANGLADESH AND PAKISTAN

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A B S T R A C T

Bangladesh and Pakistan share a long common history since both were part of British India and Bangladesh was East Pakistan after the 1947 Partition before gaining independence in 1971. For both countries, aid has been an integral part of their economy. However, despite their common history, donor aid and assistance have witnessed divergent trajectories in Pakistan and Bangladesh primarily due to the composition of aid and socio-political factors in both countries. This paper attempts to examine the patterns and consequences of aid in both countries as well as explore the reasons for such effects and will finally conclude by providing some recommendations to the problems created by donor assistance and the aid structure.

Keywords: Assistance and Aid, Bangladesh, Development, Donor, Economy, Pakistan.

INTRODUCTION AND LITERATURE REVIEW

Donor assistance and foreign aid have been controversial concepts since post World War II. The first United States aid initiative was the Marshall Plan which involved disbursing economic aid for the reconstruction of Western Europe after World War II. In recent years, foreign aid was viewed as a means for the Least Developed Countries (LDCs) to close their savings gap and attain the take-off stage of economic growth. The Harrod-Domar growth model expresses growth as a function of the savings rate in an economy and the capital-output ratio. Aid proponents such as Chenery and Strout (1966) believed that capital injected by foreign aid would improve domestic savings and would trigger a self-sustaining cycle of economic growth in LDCs. However, this view rests on several assumptions: robust institutions to absorb and channel foreign aid, low levels of corruption, good governance and macroeconomic stability among others. When applied to the context of developing countries, many of these factors are missing. For instance, Burnside and Dollar (2000) posit that foreign aid is beneficial for growth in developing countries only when it is coupled with strong fiscal, monetary and trade policies.

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One of the biggest criticisms of foreign aid to LDCs came from Andre Gunder Frank, a leading scholar of the dependency theory. In his book, “The Development of Underdevelopment”, Frank introduces the “metropolis-satellite relations” phenomenon which states that the satellite states or the LDCs will never be able to develop as long as they are part of the global capitalist system led by the metropolis or the developed states like United States and Europe. The LDCs are trapped into this vicious cycle of underdevelopment by the developed countries who exploit them for cheap labor and raw materials as well as by the international trading system where poor nations have very little voice and experience deteriorating terms of trade. Currently, donor countries or international institutions offer assistance with a lot of strings attached and are accused of using a “cookie-cutter” approach when imposing aid conditions which in turn forces LDCs into greater debt and a plunging economy.

This paper looks at two aid dependent countries, Pakistan and Bangladesh, with shared history yet very different donor assistance outcomes. The central research question is what accounts for the divergent consequences of foreign aid and donor assistance in Pakistan and Bangladesh? The paper will first provide the donor assistance and aid landscape in both countries and then explore the consequences and underlying causes of divergences and conclude by providing a few recommendations.

OVERVIEW OF DONOR ASSISTANCE AND AID PATTERN IN BANGLADESH AND PAKISTAN

During the liberation war of Bangladesh, Henry Kissinger, the then US Secretary of State famously classified Bangladesh as a “basket case” and a country which would always be dependent on foreign aid. From 1971-2008, Bangladesh received about $48 billion in aid, with the annual flow of aid ranging between $1billion and $1.5 billion (Quibria, 2010). However, the composition of aid has largely evolved throughout these years (Wahab, 2013). Whereas in 1970s, the majority of aid consisted of food aid, followed by commodity aid and project aid, in 2011-2012, project aid was much more than food aid. The 1972-1973 period also had more aid in form of grants rather than loans but in 2011-2012 the situation was reversed. Another change was that the sources of aid shifted from bilateral to multilateral aid. The World Bank remains the biggest and most important lender to Bangladesh, followed by Asian Development Bank, IMF, UNDP, Japan and some Western European countries (Obaydullah, 2007). Over the years, Bangladesh has received less aid as a percentage of GDP partially explained by its high GDP growth rates and its transition from an aid dependent to a trade dependent economy. From 1970s till the early 1990s, the net flow of aid was more than 6% of GDP whereas in 2005, net flow of aid was only about 2% of GDP (Quibria, 2014). Despite this declining importance of aid for the country’s economy, aid remains an integral part in many sectors of the economy.

Turning to Pakistan, the pattern of donor assistance and foreign aid in the country can be viewed as a roller coaster ride with highly erratic and unpredictable aid flows. Pakistan has been receiving aid since its independence in 1947; in fact during the years 1960s and 1970s, Pakistan was the largest aid recipient in South Asia. Pakistan’s major donor is United States of America and consequently, changes in US policy regarding aid to Pakistan are largely synonymous to a change in the pattern of total aid received by Pakistan. According to the Center for Global Development, between 1951 and 2011, Pakistan has received nearly $67 billion in aid from the US in 2011 dollar value. Most of the aid in 1950s and 1960s was developmental aid with military aid composing less than 9% of the aid basket. However, shifts in the geopolitical dynamics of the region and changes in US policies on aid caused many disruptions to US aid flows to Pakistan as well as altered the composition of the aid. In 1965, as Pakistan entered into a war with India, US suspended all military aid; in 1979, when Pakistan adopted its nuclear enrichment program, President Carter suspended all aid except food aid. Aid flows started again in 1980s when the country played a frontline role during the Soviet invasion of Afghanistan. The Pressler Amendment in 1990s ended aid flows to Pakistan since it had nuclear weapons but massive influx of aid resumed post 9/11 where Pakistan was considered a critical ally in the War Against Terror. Between 2002 and 2009, 70% of US assistance has been security and military related with a meagre 30% for economic development purposes. In 2008, Congress authorized the Kerry-Lugar-Berman (KLB) bill which would triple economic assistance to Pakistan meant for increasing economic growth, governance and investment in the population. $7.5 billion is expected to be disbursed between 2010 and 2014 with the KLB significantly changing the proportion of economic assistance to 41% of total US assistance to Pakistan (Center for Global Development, 2014). Apart from the United States, the World Bank’s International Development Association provides 21% of total Overseas Development Assistance (ODA) to Pakistan, followed by Japan, United Kingdom and European Union institutions.

CONSEQUENCES OF DONOR ASSISTANCE AND AID IN PAKISTAN AND BANGLADESH

In both Pakistan and Bangladesh, foreign aid has had very little impact on economic growth or poverty alleviation; in fact Kelegama (2012) points to a negative causal relationship between aid and growth. The reasons behind these consequences of aid vary between both countries since they have a different political landscape and a different aid composition.

In the past two decades, as Obaydullah (2007) explains, Bangladesh has made some very impressive strides in its economic and social performance by attaining near self-sufficiency in food grains, by having an improved life expectancy ratio due to lower infant mortality rate, by boosting primary education coverage with a spike in girl attendance, by curbing its population growth, by sustaining a growth rate of 5% over the years and so on. Unfortunately, little of these improvements can be attributed to foreign assistance. A mere 25% of foreign aid reaches the poor. The groups that benefit from aid are often the ones who need it the least such as foreign consultants, local consultants, local politicians and bureaucrats, foreign equipment suppliers, local commission agents, local contractors, NGOs and the urban and rural elite. Although foreign aid has made some positive impact on Bangladesh, the negative consequences of aid far outweigh the benefits the society has been able to reap.

The principal reason behind this failure is donor conditionality. Bangladesh's major donors such as the World Bank and IMF have long been accused of adopting a cookie-cutter approach and a one size fits all mentality when it comes to giving out aid, without taking into account the economic and political realities of the recipient country. This leads to the principal-agent problem where the donors' interests and the recipient country's priorities are not aligned. Consequently, the vast majority of aid was tied to the features of the Washington consensus namely privatization, liberalization and stabilization. Obaydullah (2007) thoroughly analyzes the aid landscape in Bangladesh. He claims that from 1987-1989, aid was conditional on sectoral and macroeconomic aspects which the Bangladeshi government accept despite knowing that these policies would be terrible for the economy and hence are unfeasible. The Structural Adjustment Program (SAP) on whose implementation World Bank aid was conditional broadly consisted on privatization, liberalization, withdrawal of agricultural subsidies and so on and these proved counterproductive and disastrous for the Bangladeshi economy as it increased the number of unemployed and poor people.

The main problem with these adjustment policies was the pace of change. A rapid reduction in import tariffs had an immediate effect of reducing revenue and adversely affecting local industries coupled with the fact that the Bangladeshi government did not have the capacity to increase income from direct taxes to make up for the loss in tariff revenue. In addition, World Bank's demand to devaluate the Bangladeshi currency resulted in a higher budget deficit, a higher cost of foreign debt and debt servicing charges and inflation brought about by increased import costs. In the late 1970s, the budget had to be balanced by repeatedly cutting back on development expenditure because of the requirements of the adjustment programs. Privatization as advocated by the World Bank and the IMF was not devoid of problems either. Private sector credit ballooned to 130% in the mid-eighties without any simultaneous increase in production creating a huge debt default problem and giving rise to a default culture. To correct this situation, when the government attempted a restrictive credit policy, there was a significant decline in industrial investment, demand and production.

Furthermore, withdrawing agricultural subsidies has definitely hit the farmers, especially the subsistence farmers very severely. Without considering Bangladesh's on ground realities, the World Bank suggested a higher procurement price to compensate farmers for the absence of subsidies. However, the poor institutional capacity of the government cannot guarantee that a high procurement price would reach farmers at the lowest rung of the production chain since corrupt middlemen might appropriate it instead. Another factor is that most of the farmers are subsistence farmers and hence higher procurement prices are of little benefit to them whereas input subsidies were much more relevant and helpful in their case.

Due to a vulnerable political system with two feuding begums and a very weak institutional framework, donors have resorted to using NGOs as a channel of aid distribution claiming that NGOs are more effective in reducing poverty. Foreign aid comprises 34% of total NGO expenditure including microfinance and 88% of non-microfinance projects (Obaydullah, 2007). In 1990-1991, 10.5% of total aid passed through NGOs; the figure increased to 30% in 2005 (Khan, 2013). While NGOs such as BRAC were more efficient in aid delivery, reaching out to women and remote areas, the focus on NGOs as vehicles of aid delivery has sparked a few concerns. Firstly, despite their superior performance in the fields of health, education and microcredit, there exists the age old problem of power and wealth concentration in the hands of a few big corporate NGOs like BRAC, ASA, Proshika where transparency and accountability become problematic. There is also a principal-agent problem here where NGOs may very well divert aid funds to support their own economic and political agenda. Finally, this trend where NGOs are seen as substitutes to the Bangladeshi government by the donors weakens and challenges the legitimacy and institutional framework of the already fragile governmental system. The Bangladeshi government resents NGOs as competitors for foreign aid and feels the state is being bypassed, undermined and sidelined in the developmental process where traditionally the onus of development lay with the state.

In spite of these dismal facts, Obaydullah (2007) asserts that foreign aid has had some beneficial effects on the Bangladeshi society. Liberalization and dismantling of import controls have empowered small farmers by giving them access to more sophisticated input equipment from abroad. A new class of working women in the garment industry has emerged as a consequence of trade and industry policy reforms and population planning. The sector which has perhaps benefitted the most from foreign aid is microfinance which received IDA aid flows with minimal or no strings attached; a great contrast from the conditional aid Bangladesh normally receives. However, the overall picture of foreign aid and donor assistance effectiveness in Bangladesh remains bleak and unsatisfactory despite these positive effects.

Moving on to Pakistan, foreign aid has been unsuccessful in poverty alleviation or spurring economic growth in the country. Khan et al (2007) present a comprehensive snapshot of Pakistan's aid patterns and consequences. Foreign aid has instead benefitted the vested interests of a small circle of elite in politics and society. During the 1960s and 1970s when Pakistan was the largest Asian aid recipient country, average percentage of the population living below the poverty line declined minimally from 43% to 39%. Foreign aid did not help improve other socio-economic indicators either with literacy rates remaining almost unchanged over the last thirty years. At the same time, during the same time period, the Pakistani government used economic assistance aid to increase the level of private investment and the level of physical infrastructure, power and irrigation related projects. Terbala and Mangla dams were constructed and there was a lot of investment in roads, electric power and projects like the Indus Super Highway and Pakistan Steel Mills. The 1960s and the 1970s could be termed as the golden era of foreign aid effectiveness in Pakistan.

During the later years, as the geopolitical and strategic interests of donors, especially the United States changed, the composition of aid evolved and so did its effectiveness. Post 9/11, 70% of aid given by the United States to Pakistan was security related and there were very few conditions attached or close monitoring of how the aid money was spent (Center for Global Development, 2014). The idea was to retain Pakistan as a critical ally in its War against Terrorism with little attention to the consequences of aid. Pakistan has a long history of the military in politics and consequently, a highly centralized governance structure. Foreign aid has actually helped strengthen the military even more and weaken the nascent signs of democracy in the country. The access to centralized rents enabled the military to continue pursuing its top-down policies, exclusionary politics and limiting political access (Khan, 2013). This in turn has given rise to sectarianism, internal violence and waning legitimacy of the ruling coalition. Unlike Pakistan, in Bangladesh, since the structure of aid was not security based and given the fragmentation of political organization, a small circle of political elite could not reap rents from the development aid. There was also immense competition to grab the rents for coordinating delivery of aid by a much larger group of organizations in Bangladesh. The purpose of aid has been defeated since Pakistan has diverted the aid money in stocking up conventional military equipment rather than combating terrorism (Zaidi, 2011). The inefficient use of security aid money is perhaps best highlighted when on 2nd May 2011, Osama Bin Laden was found and killed in Pakistan with the Pakistani military being apparently oblivious to his presence on Pakistani territory.

To mark a change in the pattern of aid given out to Pakistan, the Kerry-Lugar-Berman (KLB) bill approved by Congress in 2008, separated security and development issues. Its goal was to shield economic development aid from uncertain military changes and enable a long-term agenda and long-term planning. This bill marks a substantial shift from previous aid trends by introducing conditionality. Although this is a step in the right direction, expecting conditions to be fulfilled by the civilian government is highly unrealistic given the primordial dominance of the military in Pakistani politics and the subservience of the civilian government to military interests. Furthermore, the KLB does not consider Pakistan's absorptive capacity which might imply that there is more money than projects to fund. Foreign aid has also been wanting in altering the flawed structural incentives as it has failed to improve regional integration or revenue collection (Zaidi, 2011).

Another problem that Pakistan is experiencing from donor assistance and aid is an aggravated foreign debt problem. There has been a stark shift in Pakistan's debt profile with external financing taking the form of multilateral and non-concessional flows instead of the previous bilateral and concessional trend (Mubarak, 2008). Moreover, foreign aid has given birth to an inelastic revenue structure, low volume of developmental expenditure, poor infrastructure and poor quality of social services and a dearth of public investment (Khan et al., 2007). On the whole, like Bangladesh, the Pakistani case shows little effect on foreign aid on economic growth or poverty alleviation; at the same time, it has left minimal if at all positive footprint whereas in Bangladesh, there were at least a few albeit minor bright points of aid influx.

CONCLUSION

This paper studies the impact of donor assistance and aid in two developing countries, Pakistan and Bangladesh. The main conclusion of this paper is that foreign aid has had no impact on economic growth or has even had a negative relationship with economic growth and a minimal effect on poverty alleviation in both countries. In case of Bangladesh, the reasons are mainly unrealistic donor conditions that come with aid, low absorptive capacity and a political system riddled with corruption and inefficiency. Foreign aid ineffectiveness in Pakistan can be attributed to a high proportion of military or security aid which undermined development goals, an erratic pattern of aid inflow, a corrupt, centralized and powerful military, further strengthened by aid inflows, which siphoned off much of the aid or diverted aid money to serve their own selfish interests, low absorptive capacity and more of the aid being increasingly in the form of loans instead of grants.

Some recommendations which might improve aid effectiveness for both countries might be to customize donor conditions by studying the ground realities of both countries and choosing those conditions which can be implemented without adverse consequences for the economy. Strong institutions, more accountable governments, higher transparency in transactions involving aid money, more mechanisms to monitor the use of aid by donor countries and tools such as websites accessible to the public where it can actively see details on aid disbursement and transactions might all boost aid benefits in Bangladesh and Pakistan. Moreover, cash on delivery aid could be considered as an alternative for certain projects and to improve accountability, the numerous civil society organizations in Bangladesh could implement a citizen report card system which would periodically evaluate programs using the public's inputs and would help determine the future aid inflows.

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