

Introduction

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It should not be called aid because it promotes an unquestioning attitude. It disarms criticism, obscures realities, and prejudges results. Who could be against aid to the less fortunate? The term has enabled aid supporters to claim a monopoly of compassion and to dismiss critics as lacking in understanding and sympathy.

— Peter Bauer, 1993

FOREIGN AID TO SOUTH ASIA: END, MEND, OR VOUCHERIZE?

The theme of the *Economic Freedom of the World Report 2006* is foreign aid, it would therefore be instructive to evaluate the aid experience of India, and broadly of South Asia. In this *Report*, William Easterly argues that aid is neither necessary nor sufficient for improving living standards in poor countries. It is not necessary because many countries, particularly the current donor countries, have developed without foreign aid. It is not sufficient because a large number of countries, particularly in Africa, have stagnated or even regressed despite very large doses of aid. His strident case against foreign aid calling it “a new farcical collectivist utopian fantasy,” is reminiscent of that by B. R. Shenoy and Peter Bauer. Both of them considered India as a classic case study on the harmful effects of foreign aid.

Mountains of Aid

In the developing world, India was the largest recipient of foreign aid from World War II until 1991 (Kamath, 1992). Table 1 contains figures of aid received in the form of government and non-government loans and grants since the inception of the First Five Year Plan (1951-1956). Even after the big bang liberalisation of 1991, India continues to map its economic progress in terms of Five Year Plans.

TABLE 1

Foreign Aid to India (in INR billion)

<i>Year</i>	<i>Loans</i>	<i>Grants</i>	<i>Total</i>
First Five Year Plan 1951-1956	1.22	.70	1.92
Second Five Year Plan 1956-1961	12.70	1.61	14.31
Third Five Year Plan 1961-1966	27.73	1.07	28.80
Yearly Plan 1966-1967	10.34	.97	11.31
Yearly Plan 1967-1968	11.35	.61	11.96
Yearly Plan 1968-1969	8.37	.65	9.02
Fourth Five Year Plan 1969-1974	40.31	1.53	41.84
Fifth Five Year Plan 1974-1978	48.41	8.84	57.25
Yearly Plan 1978-1979	9.04	2.73	11.77
Yearly Plan 1979-1980	10.49	3.04	13.53
Six Five Year Plan 1980-1985	91.23	17.80	109.03
Seventh Five Year Plan 1985-1990	201.22	25.72	226.94
Yearly Plan 1990-1991	61.70	5.34	67.04
Yearly Plan 1991-1992	106.96	9.19	116.15
Eighth Five Year Plan 1992-1997	518.73	48.30	567.03
Ninth Five Year Plan 1997-2002	661.12	52.80	713.92
Tenth Five Year Plan 2002-2007	438.79	61.43	500.22
Total	2259.70	242.35	2502.06

Source: *External Assistance 2004-2005*, Aid Accounts and Audit Division, Ministry of Finance, Government of India.

From 1951 to 2005, India has received total loans of INR 2259.70 billion, 242.36 billion in grants (almost 10 per cent of all aid), and has repaid 1669.15 billion as principal, 767.86 billion as interest. Table 2 gives details of disbursed and outstanding debts according to donors. The majority of aid to India has come from International Development Agency (IDA), the World Bank's concessional lending sub-agency. Semi-concessional lending has come through International Bank for Reconstruction and Development (IBRD), financed by the World Bank, and from Asian Development Bank. Among multilateral sources, which account for almost 60 per cent of total aid to India, the two World Bank agencies provide 90 per cent of the overall multilateral assistance. In the area of bilateral assistance, Japan has taken the lead role, accounting for 22.5 per cent of bilateral aid used by India.¹ Although Japan has been the largest Official Development Assistance (ODA) donor, Britain's aid has "comprised a much larger proportion of grants (as opposed to loans) than most other aid to India" (Lipton, 1996: 483).

1. <http://www.bostonapartments.com/loans/finance/foreign-aid-india-development.html> (Accessed on 7/8/2006 at 9:15).

TABLE 2
Disbursed and Outstanding Debts (from inception until August 8, 2006)

<i>Donor</i>	<i>DOD (INR Millions)</i>	<i>DOD (USD Millions)</i>	<i>Number of Loans</i>
IDA	11 02 306	23 670	328
Japan	473 704	10 172	157
IBRD	267 075	5 735	69
Germany	147 868	3 175	178
Asian Development Bank	146 409	3 144	41
Russian Federation	50 363	1 081	4
United States of America	30 823	662	58
France	29 400	631	93
International Fund for Agricultural Development (IFAD)	12 521	269	18
EEC (SAC)	1 956	42	1
OPEC	310	7	1
Switzerland	238	5	1
Norway	3	0.6	1
Grand Total	22 62 976	48 593	950

Source: External Assistance 2004-2005, Aid Accounts & Audit Division, Ministry of Finance, Government of India.

Table 3 shows the ODA flows to countries in South Asia and to the region as a whole. It is interesting to note that while the amount of ODA to individual countries has fluctuated during the decades—except for Pakistan, whose share has constantly progressed—the proportion of aid to South Asia compared to world ODA has progressively declined.

TABLE 3
External Resource Flows to South Asia

	<i>Official Development Assistance (ODA) Received^a</i>								
	<i>Total ODA (Millions of USD)</i>			<i>Per Capita ODA (USD)</i>		<i>ODA as % of GDP</i>		<i>Net Foreign Private flows as % of GDP^{b, c}</i>	
	<i>1980</i>	<i>1990</i>	<i>2001</i>	<i>1990</i>	<i>2001</i>	<i>1990</i>	<i>2001</i>	<i>1990</i>	<i>2001</i>
Bangladesh	1,282	2,103	1,023.9	19.7	7.3	7.0	2.2	0.2	0.7
Bhutan	8	47	59.2	32.7	27.9	16.5	11.1	0.3	0.0
India	2,147	1,586	1,705.4	1.9	1.7	0.4	0.4	0.6	0.7
Maldives	-	-	25.0	-	83.2	9.8	4.3	3.1	2.1
Nepal	163	429	388.1	22.7	16.1	11.7	7.0	0.2	0.3
Pakistan	1,130	1,152	1,938.2	10.3	13.2	2.8	3.3	0.4	- 0.5
Sri Lanka	390	665	330.2	39.1	17.6	9.1	2.1	0.6	1.5
South Asia	5,120	6,174	6,032.1	5.4	4.2	1.1	0.8	0.3	0.7
South Asia as % of total world ODA	18.50	12.58	11.73	-	-	-	-	-	-

Note: a: ODA receipts are total net ODA flows from DAC countries, other OECD countries, multilateral organisations and Arab countries as well as Estonia and Israel. Aggregates do not include net official aid.

b: A negative value indicates that the capital flowing out of the country exceeds that flowing in.

c: Private flows combine non-debt-creating portfolio equity investment flows, portfolio debt flows and trade-related lending.

Source: Sobhan, 2004.

Data for sector-wise disbursement of government loans and grants are available only from 1995-96 onwards. Among the major sectors where aid has been utilised are: Agriculture and Rural Development (from INR 7.26 in 1995-96 to 9.67 billion in 2004-05), Energy-Power (from 25.96 in 1995-96 to 30.18 in 2003-04, falling to 20.72 in 2004-05), Infrastructure-Road (from 5.19 to 24.65), Social (from 11.13 to 33.83), Urban Development (from 5.84 to 22.90), and Water Resources Management (from 6.06 in 1995-96 to 13.85 in 2002-03, to 9.28 in 2004-05).

Aid Flows and Private Flows: A Comparison

Table 4 gives figures for foreign aid in the form of ODA,² for FDI and remittances that have flown into South Asia between 2000 and 2004. Most of the aid has come from the Development Assistance Committee (DAC)³ sources bilaterally or multilaterally through DAC members' funding of multilateral agencies. The share of non-DAC bilateral donors is very small. While the aid stocks of Bangladesh, Maldives, Nepal and Sri Lanka have gone up, that of India have experienced substantial decline since 2002, while that of Pakistan has soared almost three times in 2001, later gradually declining to finally reach twice the amount in 2004 as in 2000. This exponential rise in 2001 and 2002 has been explained by Thomas Lum in his 2002 CRS report to the U.S. Congress: "Before the United States began its anti-terrorism war in Afghanistan in 2001, India and Bangladesh were the largest recipients of U.S. foreign assistance in South Asia. Following Pakistan's promise to cooperate with the United States in its military efforts in Afghanistan, it became the largest beneficiary of U.S. foreign assistance in the region ... " (Lum, 2002: 17). This is an example of foreign aid used to support foreign policy ends.

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2. According to OECD definition, ODA is defined as those flows to developing countries and to multilateral institutions for flows to developing country aid recipients which are: i) provided by official agencies, including state and local governments, or by their executing agencies; and ii) each transaction of which: a) is administered with the promotion of the economic development and welfare of developing countries as its main objective; and b) is concessional in character and conveys a grant element of at least 25 per cent (calculated at a discount rate of 10 per cent). Official aid (OA) consists of flows that meet all the tests of ODA, except that they are directed to countries in transition and to multilateral institutions which primarily benefit transition country aid recipients.
 3. Development Assistance Committee, the committee of the OECD, which deals with development co-operation. Its members are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Italy, Ireland, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, U.K., U.S. and EC.

<i>Year</i>		<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>Total</i>
<i>Recipient</i>	<i>Donor</i>						
Bangladesh	DAC	617	578	521	695	633	3043
	Non-DAC Bilateral	35	14	12	12	26	99
	Multilateral	519	438	380	689	745	2771
	All Donors	1171	1030	913	1396	1404	5914
	Grants	805	815	758	727	1036	4141
	Loans	367	214	155	670	367	1773
	FDI	280	79	52	268	449	1128
	Remittances	1968	2105	2858	3192	3584	13707
Bhutan	DAC	34	43	43	52	53	224
	Non-DAC Bilateral	0	-1	-1	0	-1	-4
	Multilateral	20	19	32	25	26	121
	All Donors	53	61	73	77	78	342
	Grants	43	47	52	65	64	270
	Loans	11	13	22	12	14	72
	FDI	0	0	0	1	1	3
	Remittances
India	DAC	650	905	785	384	15	2739
	Multilateral	847	824	680	555	667	3573
	Non-DAC Bilateral	-12	-4	-2	-26	3	-42
	All Donors	1485	1724	1463	913	685	6270
	Grants	775	890	1055	1038	1272	5031
	Loans	710	834	408	-126	-587	1239
	FDI	3584	5472	5626	4585	5335	24602
	Remittances	12890	14285	15754	21727	21727	86383
Maldives	DAC	13	15	13	9	9	59
	Multilateral	7	10	15	9	14	55
	Non-DAC Bilateral	-1	0	-1	3	5	6
	All Donors	19	25	27	21	28	120
	Grants	18	20	17	12	14	80
	Loans	2	5	11	8	14	40
	FDI	13	12	12	14	15	66
	Remittances	2	2	2	2	3	11
Nepal	DAC	231	270	279	320	318	1420
	Multilateral	155	118	65	145	106	589
	Non-DAC Bilateral	3	6	21	1	3	34
	All Donors	390	394	365	465	427	2042
	Grants	252	306	337	367	382	1643
	Loans	138	88	29	98	45	398
	FDI	0	0	-6	15	0	9
	Remittances	111	147	678	771	823	2530
	DAC	475	1110	702	536	382	3206
	Multilateral	227	824	1392	531	1025	3997
	Non-DAC Bilateral	1	15	44	-2	14	72

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Year		2000	2001	2002	2003	2004	Total
Recipient	Donor						
Pakistan	All Donors	703	1948	2138	1066	1421	7275
	Grants	206	968	494	1464	424	3557
	Loans	496	980	1645	-398	997	3719
	FDI	308	383	823	534	1118	3166
	Remittances	1075	1461	3554	3964	3945	13999
	DAC	240	280	188	271	337	1317
	Multilateral	25	20	136	386	161	727
	Non-DAC Bilateral	11	13	20	18	21	82
Sri Lanka	All Donors	276	313	344	674	519	2126
	Grants	187	177	194	235	268	1062
	Loans	89	135	150	439	251	1064
	FDI	173	172	197	229	233	1004
	Remittances	1166	1185	1309	1438	1590	6688
	Total Aid	4098	5494	5325	4612	4561	24089
	Grants	2285	3224	2906	3908	3461	15784
South Asia	Loans	1812	2270	2419	703	1101	8305
	FDI	4358	6118	6704	5646	7151	29977
	Remittances	17212	19185	24155	31094	31671	123317

Sources: For aid figures, OECD; for FDI and remittances, World Development Indicators Database.

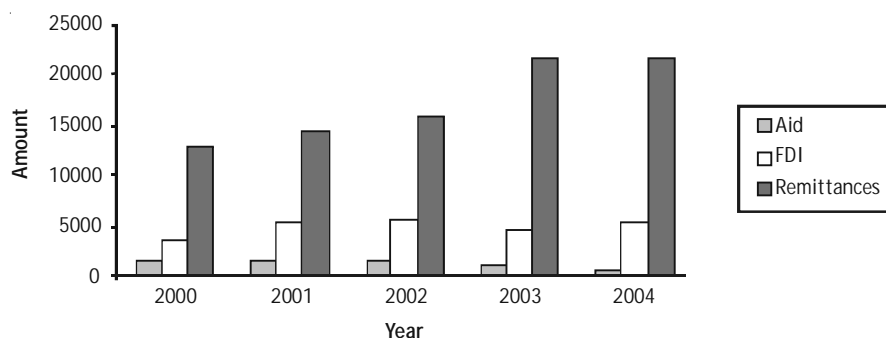
Aid however is not the only or the primary form of capital flow to South Asian countries at the present. "Private capital flows to South Asia reached a record USD 23.6 billion in 2005, up from USD 9.7 billion in 2000. This growth was largely driven by India, which received the majority of capital flows to the region. Foreign Direct Investment (FDI) in South Asia rose to USD 8.4 billion in 2005, an increase of USD 1.2 billion [from] 2004. In India, investment rose in industries such as cement, sugar, plastics and rubber, and hotels. In Pakistan, privatisation and resource-related FDI led to a doubling of foreign investment from USD 1.1 billion in 2004 to USD 2.2 billion in 2005" (World Bank, 2006). At the same time, the migration of South Asians in search of high-paying jobs in North America, Europe and the Middle East has brought in huge remittances.

If we compare the figures of ODA (OA) flows in South Asian countries with flows of FDI and remittances, we get some idea of the financial role aid plays at the moment in these countries. India receives about eight times more FDI than aid, and nearly thirty-two times more workers' remittances and compensation of employees. For Bangladesh, although the FDI was almost three times lower than aid flows in 2004, the remittances were almost two and a half times higher than the latter. Bhutan receives negligible FDI and remittances. Maldives is availing flows from all the three sources but in rather low amounts. Nepal receives almost nothing in FDI, but got greater amounts of remittances than aid since 2002. The Maoist

rebellion and the royal coup have not only created inner insecurity, but have prevented foreign investors from reaching the Himalayan kingdom. Save 2001, Pakistan has received much higher amount of remittances as compared to its aid receipts.

GRAPH 1

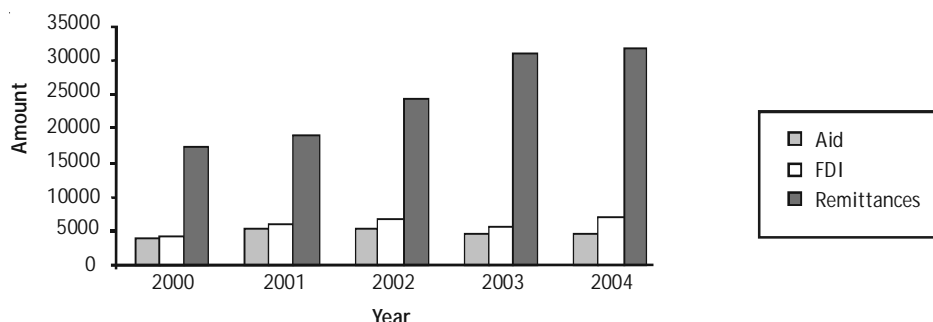
ODA (OA), FDI and Remittance Flows to India (in USD millions)



Source: Table 4.

GRAPH 2

ODA (OA), FDI and Remittance Flows to South Asia (in USD millions)



Source: Table 4.

It is common knowledge that substantial amounts of remittances to these countries come through unofficial routes, and if that amount is included then the total amount of remittances could be at least twice as high. A similar pattern is observed in Sri Lanka, where LTTE violence keeps foreign investments away from the country. Serious security issues in four of the seven South Asian countries continue to hinder the region from attracting FDI to its true potential. FDI and remittances have the potential to offset foreign aid as important engines of growth and development in South Asia, and these countries need to develop conditions that bring in more FDI and other forms of private flows.

Is Aid Effective?

Foreign aid perhaps is one of those rare issues that have invited the ire of both the champions of the state as well as the market, albeit for very

different reasons. The former believe that aid spreads and perpetuates the dominance of capitalism, rather than to help reduce poverty or promote growth. It is a means in the service of neo-colonialism. First, rich nations exploit developing countries, and later transfer a share of their plunder as an aid to pacify the revolutionary anger. Their classic example is the Marshall Plan for the Western Europe, offered to contain the 'specter of communism' from spreading inside the lands devastated by the World War II. They also draw a correlation between aid flows and the Cold War, claiming that aid levels have declined with the fall of the Soviet Union.

On the other hand, liberal economists view aid as the continuation of the old follies of socialism and central planning. Easterly calls it "the new farcical collectivism" that is an impediment in the path of economic freedom and development. B.R. Shenoy, a prescient observer of the Indian economy, concludes:

Given correct policies, the same quantum of domestic savings and foreign aid may take us strikingly fast on the road to prosperity. If, on the other hand, our policies are misconceived, no amount of foreign aid, as Indian experience has so conclusively demonstrated, can save us from economic chaos and social and political instabilities. The way out of this chaos is in our own hands. What we need most, today, is basic policy changes, not massive foreign aid. (Amin and Shah, 2004: 100)

The aid leads to burgeoning of government bureaucracy with increasing interference, inefficiency, lack of accountability, corruption. The aid is more commonly used for consumption than investment, to serve political purposes rather than achieve development. The accountability and evaluation mechanisms for assessing the real impact are weak, and there are weak feedback and improvement systems.

Liberals argue that expansion of economic freedom rather than aid would lead to genuine economic development and empowerment of the individual.

Individual freedom is worth having not only for its own sake. Economic development is apt to be in proportion to the freedom which the individual has in the choice of his occupation, in the disposal of his income, and investment of his savings. If the individual is deprived of these economic freedoms—and we have been engaged in this nefarious business under the guise of planning—how different would such an individual be from a slave? (B.R. Shenoy in Amin and Shah, 2004: 100)

The economic freedom as measured in this *Report* support the contention that higher degrees of freedom assure higher levels of economic development. India has experienced the largest increase in her economic freedom in the last 15 years or so compared to all other South Asian countries (Table 5). At 53, India has the highest ranking among the South Asian countries, and at 118, Nepal has the worst. And Indian economy is growing at a rate higher than any of her neighbours. Moreover

the focus on economic freedom also suggests areas of direct improvement (Table 6). This provides unambiguous advice to policy makers for further action. India has the worst rank in credit market regulations (114), suggesting clearly the need to denationalise the banking system and open up the financial markets. Despite opening up the international trade substantially, India still has a long way to go as indicated by its rank of 82 under the freedom to trade internationally. Similar policy prescriptions can be put together for other countries of South Asia by considering the components of the Economic Freedom Index.

TABLE 5

Summary Economic Freedom Ratings (Rank) for South Asian Countries

Country	1985	1990	1995	2000	2001	2002	2003	2004
Bangladesh	4.0 (95)	4.7 (90)	5.5 (79)	5.7 (93)	5.8 (87)	5.9 (85)	5.7 (96)	5.7 (95)
India	4.9 (75)	4.9 (80)	5.6 (75)	6.2 (71)	6.2 (70)	6.4 (60)	6.4 (65)	6.7 (53)
Nepal	5.4 (55)	5.3 (62)	5.3 (84)	5.8 (85)	5.8 (87)	5.7 (93)	5.2 (114)	5.2 (118)
Pakistan	5.1 (66)	5.0 (75)	5.6 (75)	5.4 (101)	5.5 (99)	5.8 (89)	5.6 (99)	5.7 (95)
Sri Lanka	5.1 (66)	5.0 (75)	6.1 (60)	6.1 (75)	6.2 (70)	6.0 (80)	6.2 (73)	6.0 (83)

Source: *Economic Freedom of the World: 2006 Annual Report* (data for Bhutan and Maldives not available).

TABLE 6

Area Economic Freedom Ratings (and Rankings), 2004: South Asia

Country	Size of Government	Legal Structure & Security of Property Rights	Access to Sound Money	Freedom to Trade Internationally	Regulation of Credit, Labor & Business	Credit Market Regulations	Labor Market Regulations	Business Regulations
Bangladesh (95)	8.1 (11)	2.7 (115)	7.0 (99)	5.4 (121)	5.4 (100)	5.7 (116)	6.7 (25)	3.7 (101)
India (53)	8.2 (7)	6.3 (44)	7.0 (98)	6.4 (82)	5.4 (97)	5.9 (114)	5.7 (48)	4.7 (69)
Nepal (118)	5.2 (93)	2.5 (118)	6.9 (103)	5.4 (119)	5.7 (83)	6.8 (91)
Pakistan (95)	7.2 (30)	2.5 (119)	6.4 (117)	5.8 (106)	6.5 (38)	7.6 (61)	7.8 (10)	4.2 (88)
Sri Lanka (83)	7.4 (24)	3.8 (92)	6.5 (115)	6.5 (78)	5.7 (82)	6.9 (89)	6.4 (35)	3.9 (93)

Source: *Economic Freedom of the World: 2006 Annual Report* (data for Bhutan and Maldives not available; countries ranked 130).

Critics may dismiss both the left and the right (statists and liberals) for relying too much on philosophical/theoretical arguments, anecdotal evidence or broad empirical generalisations. What then is direct empirical evidence on the effectiveness of aid?

From Philosophy to Empirics

Any empirical estimation of aid's effectiveness raises two fundamental problems: what type of aid be included in the analysis, and what parameter/yardstick to use to judge its effectiveness. Should the aid data

include only the developmental assistance or also humanitarian aid, and then there is military aid which is a sizable proportion of global aid. Often the data does not separate the types of aid. How to account also for the differential impact of grants and loans? The second problem is of deciding the yardstick of effectiveness: Should it be the level of poverty, social and human development indicators, or economic freedom and growth?

Determining what role, if any, foreign aid has played in promoting growth and development is difficult for many reasons. First, the dynamics propelling material and social progress are extremely complex historical processes and are influenced by many factors—some possibly remaining unidentified—only one of which is foreign assistance. Second, a great many social and economic trends may occur together with the flow of international aid, which makes determining causality elusive. Third, there is no clear and universally accepted framework for evaluating the impact of various sorts of aid activities. Finally, the data for a research effort designed to determine the role of foreign aid or any other factor are problematic; for example, less than a tenth of the low-income populations of Asia, Africa, and Latin America live in countries with reasonably complete vital statistics, much less economic accounts (O'Neill, 1997: xi).

There is no surprise then that the empirical evidence is all over the place. Radelet *et al.* (2005) say: "Throughout this debate, however, most analysts have missed a critical point by treating all aid as if it were alike in its impact on growth. In [our] study, we try to rectify this gap by exploring the impact on growth of aid flows that actually are aimed at growth. ... On substance, almost all studies look at the relationship between total aid and growth, even though large portions of aid are not primarily directed at growth." Their study finds "a positive, causal relationship between growth-oriented aid and growth. At the same time, no one should conclude that aid has always worked or that it cannot work better."

Easterly (2001) on the other hand claims: "There is a huge empirical literature on foreign aid and growth, with the latest verdict being that foreign aid does not have any measurable impact on growth." Rajan and Subramanian (2005) in a cross-country analysis, "find little robust evidence of a positive (or negative) relationship between aid inflows into a country and its economic growth... [that is] regardless of the situation—for example, in countries that have adopted sound economic policies or improved government institutions—or the type of assistance involved, aid does not appear to stimulate growth over the short or long term." Very damning indictment indeed, or one can take heart that at least there is no clearly negative relationship between aid and growth.

It is not the quantity of aid, but its quality, and the quality of macroeconomic policy and governance that leads to economic growth, argues one group of experts. East Asia is presented as an example of such fortunate confluence of policies and aid. O'Neill maintains that, "aid given to countries that are well governed and have adopted market-oriented

economic policies may provide a boost to their development. Conversely, aid given to countries that have been governed poorly or have employed restrictive economic policies is less likely to make a positive contribution to their development" (1997: xi). So, if aid is tied to the adoption of macroeconomic reforms, it has the potential of leading to economic growth. Durbarry *et al.* have tried to explain the differential impact of aid in the pre- and post-liberalisation phases. According to them, "studies using data up until the mid-1980s have mostly found evidence of an insignificant impact of foreign aid on growth, while the evidence ... of Hadjimichael *et al.* (1996) and Burnside and Dollar (1997), using more recent data, suggest stronger aid impacts. One possible interpretation is that in pre-trade liberalisation phases aid was less effective at generating faster growth, but post-liberalisation aid, linked as it is to policy reform, has been much more effective" (Durbarry *et al.*, 1998: 18). But a recent Asian Development Bank (ADB) study (2006), using cross-country data, found that "while the macro policy environment and the quality of governance have a significant bearing on poverty reduction, aid effectiveness is not critically contingent on them."

Radelet *et al.* (2005) further say that "those who argue that aid works only in countries with good institutions overstate their case. It would be more accurate to say that aid works better in countries with strong institutions, but at times can be effective in other situations. Aid has helped support growth in Mozambique and Uganda over the past decade, even though policies and institutions were far from ideal, and aid has played an important role in stabilising Sierra Leone since its cease-fire. Aid helped to support sustained growth and poverty reduction in Indonesia during the Suharto regime—even in the 1970s and 1980s when institutions were weak, corruption was problematic, and policies were less than ideal."

With the liberalisation wave around the world, many argue that macro and micro-economic reforms be the yardstick. "Of course, there are cases of aid recipients that have adopted reforms. But it's hard to find any instance where there is convincing evidence that they did so because of such assistance. Take three of the most dramatic examples: China, India and the Soviet Union. All chose a reform path over the last two decades, but foreign aid had nothing to do with that decision. Rather, all three changed course for the same reason: the old statist strategy had failed, and failed disastrously. The only alternative was reform" (Bandow, 2002: 34-35).

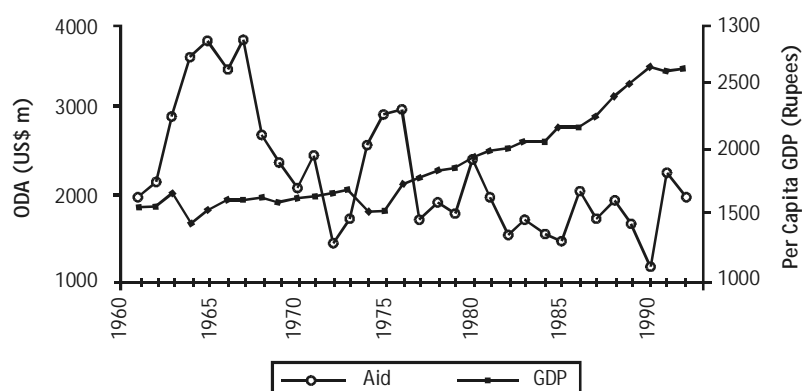
Another point of debate is the 'micro-macro paradox', that aid works at the micro level—at the project level—while evaluations at the macro level—at the programme level—have led to an unclear picture (Durbarry *et al.*, 1998: 1). However, others argue that micro analysis understates the

impact of aid: "Benefit cost analyses of projects often do not consider effects on behavior elsewhere in the economy or fail to account for positive or negative externalities. Thus it is desirable to consider the wider sectoral or economy wide effects of aid" (Norton *et al.*, 1992: 777). Though it does become more difficult to claim that the impact in this or that sector, or in a wider sphere, has been caused by aid or something else.

India being one of the biggest recipients of foreign aid, several studies have looked at her experience. The results are as inconclusive as for the rest of the countries. A research conducted by Dawson and Tiffin concerning a possible relationship between India's ODA and its GDP using annual data for 1961-1992 revealed that: "ODA is stationary while GDP has a unit root. Hence, a long-run relationship cannot exist. Thus, aid neither promotes economic growth and hence development at the macroeconomic level, nor adversely affects it. A corollary is that aid is not responsive to changes in India's income" (1999: 276). Their analysis is captured in the following chart:

FIGURE 1

ODA and Per Capita GDP in Real Values



Source: Dawson and Tiffin, 1999.

Lipton has looked at particularly the impact of British aid on India: "Much aid worldwide, including much *British* aid, has supported large commercial and/or defense-oriented projects, which are often claimed to do nothing, or less, for development or poverty reduction. Many Indian policy decisions—on technology policy, primary education, trade, the macro-economy—also appear to have militated against the poor. These two problems intersect in the concentration of much British (and other) aid to India ... " (Lipton, 1996: 483).

Jha and Swaroop (1999) point to a problem of fungibility of aid. Donor money that finances state projects frees up resources that could be used

for other projects and schemes. The authors obviously find that the money is indeed fungible. "For the donor community, however, the results indicate that successful execution of their projects in the country could be providing an incomplete picture; the marginal use of their money and its overall development impact could be very different from that intended. Perhaps a more effective way of disbursing aid would be to provide direct budgetary support [as opposed to project driven support] based on mutually agreed development outcomes with monitorable indicators."

What is most striking about this debate on the empirical measurement of the impact of aid is that the donor agencies have yet to evolve any agreeable methods of assessment. Even after more than 50 years of running the aid industry, only recently there are internal demands to assess the effectiveness of aid. Many of these donor agencies have a large and reputed research staff that would probably be hard to find anywhere else. One cannot help but feel that their conscious reluctance to be held accountable for their work is by far the strongest indication for general ineffectiveness of aid. With all the resources at their command and access to national and project data, it is difficult to accept that the paucity of evaluative work has simply been an oversight.

New Avatars of Aid

Since it is increasingly difficult to demonstrate economy-wide effectiveness of aid, one way to avoid accountability is to keep changing the purpose or the ultimate objective of aid itself. In the early heydays, aid was almost synonymous with industrial development, particularly of the 'commanding heights of the economy'. Then the objective shifted from just industrial to more overarching economic development. In the 1980s, the *mantra* was the overall quality of life as measured in the Human Development Indicators, with a specific focus on health and education. With continued emphasis on HDI, an added target of physical infrastructure, electricity, water and roads, came into focus. Now the World Bank envisions "a world free of poverty!" And the Millennium Development Goals are the rage. Grand new promises, manifestoes, and visions seem to keep the aid industry energised and help the public forget the failure of the last promises and manifestoes. With no serious attempt to publicly discuss or debate the past promises and their failures, it is difficult not to be cynical about the new promises. The emperor keeps changing into new clothes at every washout.

World Bank's new President, Paul Wolfowitz, emphasised the issue of governance in his recent speech. "Commitments like the ones made at Gleneagles mean that aid is increasingly being allocated to countries that

show that they have good governance, that they have good policies, but also the countries that have more severe needs. ...Good governance also builds the confidence of investors in the business climate. ...And the donor community is also taking governance seriously. We now use something called the performance-based allocation system to put more weight on the quality of governance when we allocate aid across low-income countries. And we're pursuing efforts along several fronts to strengthen governance, first to strengthen anti-corruption efforts in our own projects, secondly, and perhaps most importantly, to help developing countries strengthen their own institutions, and third, to expand cooperation with the other multilateral development banks and other international partners so that we all put an appropriate priority and we can cooperate, for example, a company that misbehaves on an Asian Development Bank project can't easily turn around and bid on a World Bank project or vice-versa" (Wolfowitz, 2006). New phrase is EDA (Effective Development Assistance) and not just ODA (Official Development Assistance).

An extension of EDA is the idea of 'aid for trade', which emerged in the Doha Round. It is considered as, "an essential element of a successful, pro-development Doha package" (IMF and World Bank, 2005: point 23). Developing countries can achieve growth and reach the targets set in the Millennium Development Goals (MDGs) by lowering barriers to free trade and actively participating in the international economy through liberalisation, rather than asking for concessions. Countries with a higher share of trade in their GDP have grown, while those that have maintained barriers have hampered their progress. However, growth might not naturally follow from undertaking such policy reforms, and some countries could face difficulties during transition. So in order to help such countries adjust to the new economic policy, with reduced trade barriers and liberalisation, there is a need for technical assistance, capacity building, institutional reforms, investments in trade-related infrastructure, and assistance to take care of transition/adjustment costs. More international aid will now flow to support countries to participate and benefit from the expanding international trade. The World Bank's aid for trade increased from USD 0.8 billion in 1998-2000 to USD 1.4 billion in 2001-2003. For 2004-2006, the projected figure was USD 3 billion, with trade facilitation component accounting for one-third of it. On its part, the IMF has introduced the idea of Trade Integration Mechanism (TIM) to help member countries meet balance of payments problems resulting from trade liberalisation. In South Asia, Bangladesh has taken advantage of it by receiving USD 78.03 million, equivalent to 10 per cent of its IMF quota.

Alternatives to Aid

For most countries in South Asia, private capital flow is far higher than the official aid. Countries need to fundamentally shift their focus from attracting aid to attracting FDI, because the impact of the latter is incomparably higher than that of the former. "Indeed the magnitude of the growth impact of private inflows appears to be higher than for any other sources of capital ..." (Durberry, *et al.*, 1998: 19). They recommend that governments in South Asia should ease restriction placed on the flow of private capital, learning from the example of South-East Asian countries where FDI has been a significant source for availing capital as well as technology for exports and economic growth (Husain, 1992: 24). "Beyond its role as a source of risk capital for investment, FDI can play an important role in development by transferring new technology and business practice, by stimulating innovation and investment in the host country through its linkage to domestic firms, and by securing access to international goods and capital markets. ...Considering the comparative advantage of South Asian economies—an ample supply of low wage skilled and educated labour—countries in this region must pursue more actively policies that would attract FDI inflows" (Husain, 1992: 29). The Asian Development Outlook 2006 report emphasises that India "needs to improve the investment environment by lowering the cost of doing business" (ADB 2006: 158). This discussion on FDI as the engine of economic growth leads us towards significance of economic freedom, a central argument of the present *Report*, which is the precondition for attracting FDI flow.

If You Must, Voucherize Aid

Despite the emphasis on sound macroeconomic policies, transparent and accountable governance, and private capital flows, it is hard to see the aid industry disappearing any time soon. If aid is going to gush, then what form should it take?

There is growing evidence across several different sectors that the direct transfers of cash or vouchers is far more effective in targeting the affected population and in achieving the targets set for the programme. Food stamps have been long used in many countries. India has announced a pilot programme of food stamps, though it is yet to come into existence. Several experiments in Africa and India have used health vouchers in different denominations to enable the poor to access proper health services. In some cases, the vouchers are given even to government dispensaries, which gain extra money for providing the service to voucher holders. Government dispensaries that hardly saw any doctors, suddenly found polite and attentive doctors present throughout the day. Mexico's PROGRESA scheme gives cash to parents for sending their children to school

and getting regular health checkups. This has been one of the most successful programmes of the Mexican government in increasing enrolments as well as the quality of education for the poor. Education vouchers are now commonly seen as an effective instrument to break the monopoly of state schools on the education of the poor. Giving poor the same choice would not only increase enrolments but also achieve higher quality education.

Eugene Steuerel *et al.* (2000) is a wonderful volume that addresses the economics, politics, and legal issues of voucher use and explores how vouchers are currently employed in the United States and abroad for education, child care, job training, housing, and healthcare. Indonesia has launched a programme to help the poor cope with the sudden and sharp increase in oil prices, where eligible families get about USD 150 per year but payable in monthly installments.

The Bangladesh Female Secondary School (FSS) Stipend Programme paid school fees and transferred an incentive payment direct into girls' bank accounts on condition of at least 85 per cent school attendance, remaining unmarried until at least 18 years old, and passing exams. This has increased enrolment rates by 12 percentage points per year in rural areas. Brazil's *Bolsa Escola* is a national programme that transfers \$6-19 a month to an estimated 5 million families. It targets cash transfers—paid directly to mothers—to poor families with school-age children on condition that each child attends school at least 90 per cent of the time. Studies show a sharp fall in school dropout rates and higher enrolments in post-primary education (DFID, 2006).

Ideally the issue of aid should be decided by individuals, communities, and voluntary associations—by the civil society. Government to government aid should stop. India has already limited her aid take and is determined to reduce its dependence on official aid, though for rather different reasons. Nonetheless, with continued economic growth of 8 per cent and higher, she can put enough resources in the hands of individuals and communities that before the Indian state monopolises compassion, Indian civil society would be able to build mechanisms, associations, and institutions to reach out to those who need help. This will be the most effective way to provide genuine support and aid, and if achieved, it would be a real triumph of liberalism.

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