

ASIA'S JOURNEY TO PROSPERITY

Policy, Market, and Technology over 50 Years

Chapter 14: The Role of Bilateral and Multilateral Development Finance



Outline

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- 02** Bilateral official development finance flows
- 03** Multilateral development banks
- 04** Experience of recipient countries
- 05** Experience of providers
- 06** Looking ahead
- 07** Questions and further readings



1. Development assistance in Asia: An overview

- In the early years after World War II, development finance flows to Asia had been critical to the region's development.

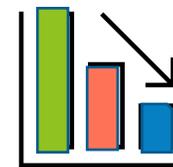


- ❖ In the early years, countries in the region had shortages of domestic savings and foreign exchange. They were less creditworthy to borrow from abroad, and domestic capital markets were not developed.



- ❖ At that moment, external development finance from bilateral aid agencies of developed countries as official development assistance (ODA) was critical. Large amounts of development finance were also provided by multilateral development banks (MDBs) as:
 - ✓ concessional funds (including grants)
 - ✓ and non-concessional flows

- Since the mid-1970s in developing Asia, the share of bilateral and multilateral development finance has gradually declined as other modes of external finance expanded significantly.



1. Development assistance: An overview

- In general, there are three instruments of bilateral and multilateral assistance.

01



The first is **loan financing** to bridge gaps in necessary funding resources for development, including for infrastructure.

Also, large loans from bilateral and multilateral development partners often come with the transfer of knowledge, ideas, governance, and policies.

02



The second instrument is **grant assistance**, especially for social infrastructure such as health and education, humanitarian assistance, and other social programs.

Grant aid is a form of financial assistance without repayment obligations. Grant is effective to support the poorest or debt-distressed countries, or for those in fragile and conflict-affected situations.

03



The third instrument is **technical assistance**. It is used to deliver technical and managerial skills in health, education, agriculture, forestry, and others.

Technical assistance helps design and prepare projects. It also supports effective policies and structural reforms in such areas as public finance, social security, the financial sector, the education system, health service delivery, and environmental protection.

In general, the use of resource inflows from abroad for development evolves in relative importance depending on the stage of development: initially, grant aid for less-developed countries, moving to concessional loans, and then non-concessional finance from bilateral partners (including export credit agencies) and MDBs (including loans and equity investments to private companies). As countries become more developed, private capital inflows, including foreign direct investments (FDI), commercial loans, portfolio bonds, and equity investments, increase their importance.

1. Development assistance: An overview



There is a **large and growing** volume of literature **on aid effectiveness**.



Findings and conclusions **on aggregated, macroeconomic impacts** tend to differ and diverge depending on the context, situation, and type of aid because the complexity of the overall economic development process makes it difficult to generalize and precisely attribute development results to development finance.



An emerging alternative research direction is to deviate from quantification of macroeconomic impacts and to aim at identification of **micro-level impacts** of each intervention using rigorous methods such as randomized controlled trials (Banerjee and Duflo, “Poor Economics”).



But in **Asia**, it is generally agreed that **development finance** played an **important role** in supporting country development.

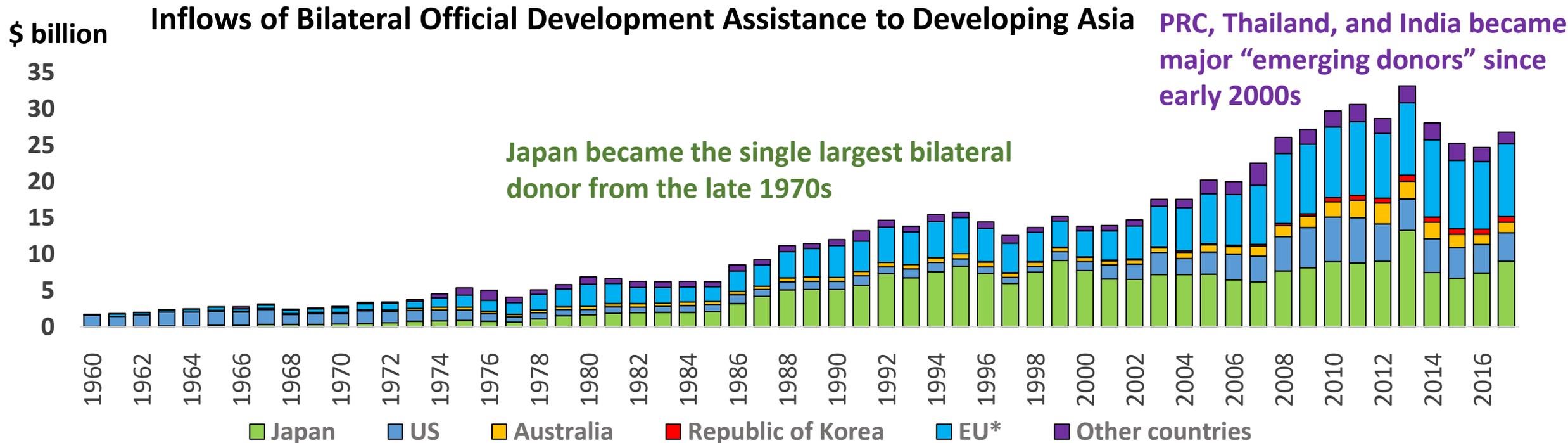


Recipients of development finance—through programs and projects—**benefited** from **finance** combined with the **transfer of technology** and **ideas**. Countries worked to enhance their absorptive capacities, aligning external finance with country strategies, and maintaining “ownership.” Bilateral and multilateral development finance remains important today, especially for supporting such areas as persistent poverty, gender equality, climate change, and quality infrastructure.



2. Bilateral official development finance flows

- In developing Asia, the United States (US) was the largest aid provider before the 1970s. Japan became the single largest bilateral donor from the late 1970s. The People's Republic of China (PRC), Thailand, and India became major emerging donors since the early 2000s. European countries have been important aid providers throughout.



EU = European Union, PRC=People's Republic of China, US = United States.

Notes: EU* includes Development Assistance Committee (DAC) EU member countries and EU institutions. Other countries include non-DAC countries such as Thailand, which reports to DAC.

Source: Organisation for Economic Co-operation and Development (OECD). *OECD Data*. <https://data.oecd.org/> (accessed 22 July 2019).



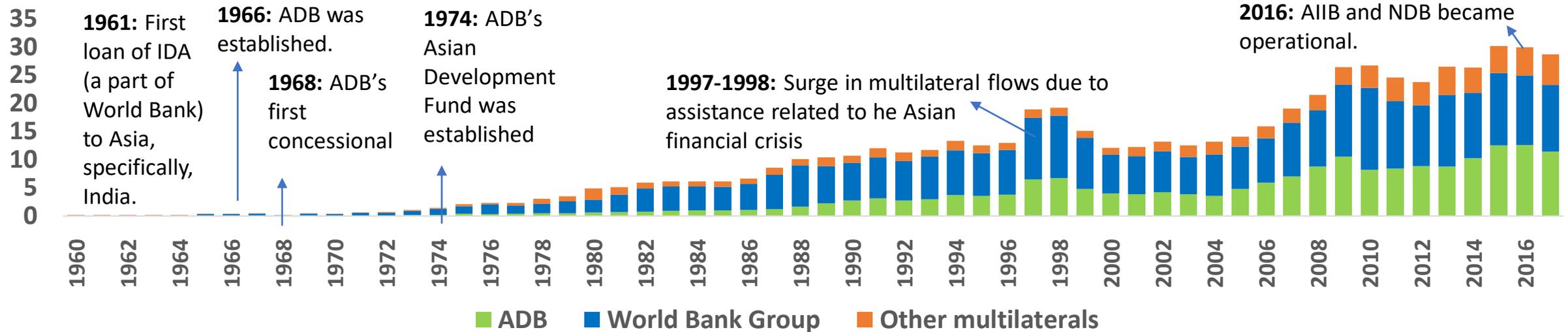
3. Multilateral development banks

- Post-war multilateral development assistance began with the establishment of the World Bank and the International Monetary Fund (IMF). Early emphasis was on reconstruction of economies, and later the focus shifted to development.

Inflows of Multilateral Development Finance to Developing Asia (\$ billion)

1942-1944: Formation of UN, World Bank, and IBRD
1944: Bretton Woods Conference
1948: IBRD's first loan to Asia (India)

In recent years, multilaterals broadened the scope of their assistance to new areas such as governance, fragility, and post-conflict assistance.



ADB = Asian Development Bank, AIIB = Asian Infrastructure Investment Bank, IBRD = International Bank for Reconstruction and Development, International Development Association, New Development Bank, UN = United Nations.

Note: European Union institutions are not included in this figure.

Sources: Organisation for Economic Co-operation and Development (OECD). *OECD Data*. <https://data.oecd.org/> (accessed 22 July 2019); and for flows from ADB: ADB, Controller's Department. *Disbursements Data*. Manila.



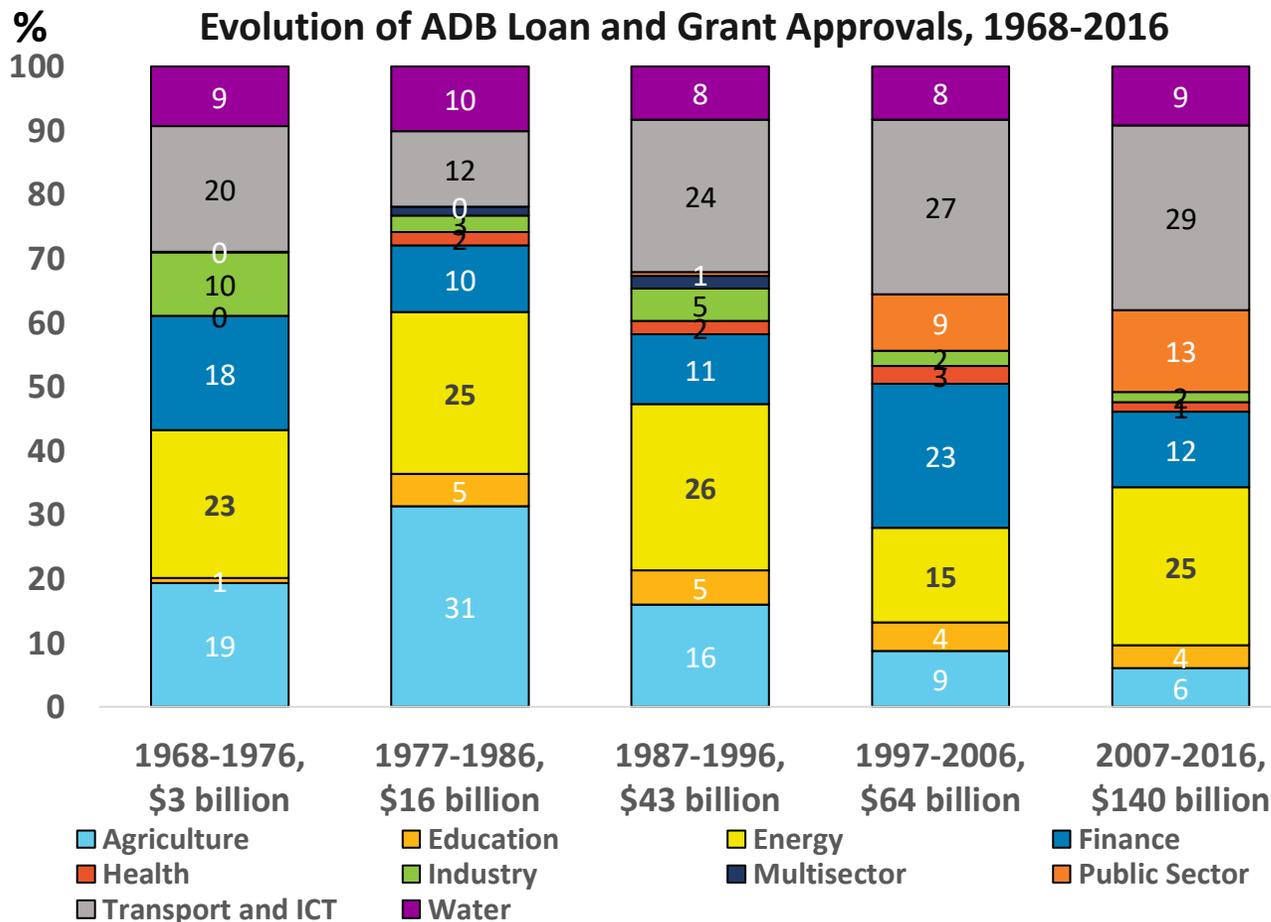
3. Multilateral development banks

- Multilateral institutions have broadened their scope of assistance, improved coordination among them, and promoted internal reforms to improve governance and aid effectiveness.
 - ❖ Reflecting the changing needs and priorities of developing member countries, MDBs broadened the scope of their assistance to new areas such as governance, fragility, and post-conflict assistance.
 - ❖ They developed new modalities such as policy-based financing (budget support finance based on certain reform measures), results-based-financing (disbursements linked to performance indicators such as in education and health), and contingency disaster risk financing. They are also increasing climate finance to support climate change mitigation and adaptation.
 - ❖ Non-sovereign operations (lending to and equity investment in private companies) have been expanded to increase sources of financing and to adopt the best practices of the private sector.
 - ❖ MDBs have extended their country presence by opening field offices. They have also continued to enhance the quality of engagement by aligning country strategies with those of recipient countries.
 - ❖ Cooperation and coordination among MDBs and bilateral donors have also strengthened.
 - ❖ Several internal reforms have also been instituted in MDBs, including streamlining business operations, mainstreaming the managing for development results framework, reinforcing knowledge management, and enhancing accountability and transparency.



3. Multilateral development banks

- To meet the region's changing needs, the Asian Development Bank (ADB)'s development assistance—as with other MDBs —has continuously evolved in terms of instruments, scope, and target sectors.



In early years, ADB's focus was on food production and rural development.



Over time, lending and technical assistance increasingly expanded to power, transport, and urban development, environmental protection, and social sectors.



ADB also provided policy-based lending to support reforms, grants for the poorest countries, and finance for private sector operations

ADB = Asian Development Bank, ICT = information and communication technology.
 Notes: Amounts in bars are sector shares (%) of the total. Figures below years are total loans and grants for the period. Data from 1997 onward follow ADB's new project classification system, so subsector data across time may not be strictly comparable.
 Source: McCawley, P. 2017. *Banking on the Future of Asia and the Pacific: 50 Years of the Asian Development Bank*. Manila: Asian Development Bank (based on ADB data).

4. Experience of recipient countries

- **Recipients.** Countries gained more from aid when they worked to build their absorptive capacity to carry out projects and have policies that maximize the impact of external support.

01 **Japan** received humanitarian and economic aid from the US and nongovernment organizations after World War II. From 1951 to 1966, Japan received loans from the IBRD, which provided much-needed foreign exchange financial resources, and transfer of knowledge and new technology.

03 Following the 1978 reforms and move toward opening its economy, **the PRC** began receiving significant bilateral and, from 1986, multilateral development finance together with the transfer of knowledge and technology.

After the breakup of the Soviet Union, **Central Asia** received technical assistance on policy analysis and capacity building, including price liberalization and reforming state-owned enterprises. It also received special assistance to ensure imports of essential goods and help mitigate the adverse impacts from the sudden disruption of trade and financial flows.

02 Overall, foreign aid was an important source of investment financing in the **Republic of Korea's** early economic development. Foreign aid during the 1950s was used (i) for reconstruction and rehabilitation of infrastructure; (ii) funding of imports; (iii) higher education; and (iv) capacity building that supported industrialization.

04 ODA has played a critical role in facilitating economic growth and development in **Thailand**. Bilateral and multilateral development finance together contributed to attracting FDI through “an infrastructure effect” and “a vanguard effect.”

06 Australia, New Zealand, and multilateral agencies provided assistance tailored to **Pacific** island country needs, including building infrastructure and improving education and health, small and medium-sized enterprise finance, digital connectivity, disaster risk management and adaptation to climate change, and seasonal worker schemes.

5. Experience of providers

- **Providers.** As providers, Japan and the Republic of Korea (ROK) emphasize economic infrastructure, loans, and self-reliance.

Japan

During mid-1950s to mid-1970s, Japan started reparations and joined the Colombo Plan in 1954. Through the 1960s, Japan provided grant aid, concessional loans, technical assistance, and contributions to international organizations. Japan also established the Overseas Economic Cooperation Fund (OECF) in 1961 to manage ODA loans (yen credit) and the Japan International Cooperation Agency in 1974.

Japan's economic vitality and yen appreciation led to increases in its ODA to other countries. By the 1990s, Japan's position on ODA has changed. Japan's ODA policy in 2003 shifted from the goal of high quantity to ensuring its effectiveness and in cooperation with the international community.

Republic of Korea

ROK had early experience hosting technical training for other developing countries. In the 1980s, its economic assistance broadened to include sending out volunteers and providing concessional loans.

In the 1990s, the current structure of its ODA system began to take shape. The ROK joined the OECD in 1996.

After joining the OECD Development Assistance Committee in 2010, the ROK hosted a forum on aid effectiveness. The meeting formally acknowledged the important role of emerging donors.

5. Experience of providers

- **Providers.** Australia and New Zealand support Pacific economies. Emerging donors are increasingly becoming important players.

Australia

Australian aid increased rapidly after World War II as bilateral aid to Pacific countries or as big contributions to multilateral agencies. In 1951, Australia helped found the Colombo Plan, which provided scholarships in developing countries. In 2013, Australia integrated the Australian Agency for International Development into the Department of Foreign Affairs and Trade to more closely align aid with diplomacy.

New Zealand

Since the 1960s, official aid has mostly provided budget support for newly independent states, especially in the Pacific. In the 1970s and 1980s, the New Zealand official assistance program started providing project aid and humanitarian support. Later, New Zealand has become more focused on sustainable development and reducing poverty. Geographically, New Zealand focuses its ODA on the Pacific island countries, with the Pacific receiving 60% of New Zealand's annual ODA budget.

Emerging donors

Emerging donors in Asia include the PRC, India, and Thailand, which are increasingly active in providing development finance to other Asian countries. The PRC sees South–South cooperation as an important external policy. The PRC took the initiative of founding the Asian Infrastructure Investment Bank, which began operations in early 2016. India's development cooperation consists of Exim Bank lines of credit, grant assistance, small development projects, technical consultancy, disaster relief and humanitarian aid, and capacity building programs. Thailand also provides aid, especially to developing neighboring countries.

6. Looking ahead

- Bilateral and multilateral financing partners and recipient countries must work together, focusing on the following priorities.



First, more effort is needed to address remaining and emerging challenges—including persistent poverty, increasing inequality, climate change mitigation and adaptation, disaster resilience as well as environmental sustainability, gender equality, rapid urbanization, demographic aging, rural development, and food security.



Second, quality infrastructure should be promoted using new technologies. Countries should aim to incorporate advanced technologies and knowhow, pay attention to infrastructure maintenance, integrate environmental and social considerations, build resilience against natural hazards, and strengthen governance for debt sustainability.



Third, developing country support should pursue policy and institutional reform. Policy-based MDB financing, technical assistance, and capacity-building are usual channels of support for these reforms.



Fourth, continued attention must be given to aid effectiveness. It is necessary to enhance coordination and cooperation among recipient countries and bilateral and multilateral donors.



Fifth, private sector resources must be mobilized for development finance. MDBs should help crowd-in private sector development finance by improving the investment climate, identifying bankable projects, and advising on well-designed public–private partnerships.



7. Questions and further readings

- Questions

- 01** How has the role of development assistance evolved over the past 50 years? How has this evolution affected the volume, nature, and purpose of ODA?
- 02** What are the three instruments of development assistance? How are they used for development?
- 03** When is aid effective? How can recipient countries effectively benefit from aid? What have been some successful country examples in Asia?
- 04** Which countries have been major providers of aid in the region? How do their assistance differ in agenda and priorities?
- 05** Looking ahead, what are priority areas that bilateral donors, multilateral agencies, and recipient countries should work on together, for development assistance to be effective and relevant?



7. Questions and further readings (cont.)

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7. Questions and further readings (cont.)

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Thank you!

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