

Foreign Aid Effectiveness in Korea: Bangladesh Could Learn about Economic Growth and Development

Doyananda Debnath
Senior Assistant Chief, Ministry of Planning, Dhaka, Bangladesh

Abstract

Lessons from Korea's miracle, such as its motivated work force, development strategy and aid utilization, aid allocation and performing, strong and closer bilateral relations, and cooperation and collaboration in diverse areas of interest could be the vital for economic development of Bangladesh. By effective utilization of aid especially allocating more aid in industrial sector and linking the performance with good policies, Korea proved that aid can work if it can be allocated effectively with specific focus and with appropriate policy tools. Notably, Bangladesh which has long history as an aid recipient, development is not remarkable. Thus, this paper is an attempt to build a consensus from the learning of Korea regarding effective utilization of aid and will assesses the potential implications from this notion for aid effectiveness and economic development in Bangladesh.

Keywords: Aid effectiveness, Korea, Bangladesh, Donor, Recipient.

1. Introduction

During the last decade, international policy debates on aid have focused on aid effectiveness, and the Civil Society Organizations (CSOs) and other development actors believe that it is time to re-think about the aid effectiveness. But, it is noted that Korea who has a unique history of transforming from a recipient to a donor country in 40 years has a prime development history on aid effectiveness, and in this continuation, it engaged himself as a member of the OECD-DAC member countries. But if we look at the development phenomena in the developing countries of the world, it could be drawn that the countries could not achieve desired development like Korea. Notably, Bangladesh is one of LDCs listed countries, which has long history as an aid recipient since its independence in 1971 but the development is not remarkable and it is still at an elementary stage of economic and social development (Quibria and Shafi, 2007).

Therefore, some important aspects of obstacles are examined by this research to achieve the optimal output from aid utilization of Bangladesh analyzing the issue of Korea's successful history regarding effective utilization of aid and will assesses the potential implications on: (a) How did Korea use aid effectively? What were the system tools of Korea's aid effectiveness? (b) Why did Bangladesh not get such achievement in economic development like Korea regarding aid uses? What were the limitations regarding aid effectiveness in Bangladesh? and (c) What could learn Bangladesh from Korea to ensure the effective utilization of aid for his economic development?

Thus the aim is finding the constraints of aid effectiveness in Bangladesh compare with a unique successful model for effective use of aid in the world in making relevant suggestions in order to pave ways to ensure effective use of aid for development.

2. Aid and Development

Foreign aid in different times and different places has been highly effective, totally in effective, and everything in between. The different scholars like Cassen et al. (1994), Cox et al. (1997), Lipton and Toye (1991), van de Waal and Johnston (1996), Lancaster (1999) etc. and World Bank as well revealed different views regarding aid's impact and effectiveness- aid has achieved much, especially with regard to improving the living conditions in many recipients (e.g. Asia); aid is failure because extreme human suffering continues (e.g. Sub-Sahara Africa, Africa and South Asia); aid works effectively in some sectors, countries and contexts, just as ineffective in other contexts, and neutrally in still other contexts; and aid is limited significance for both success and failure in development work.

If we look at Korea's development history, the empirical and historical evidence suggest that foreign aid played a central role in putting Korea on a path to sustainable growth (Mason, 1980; Krueger, 1982). The massive investments financed by aid raised the level of Korea's capital stock laid the basic foundations for economic growth. In a nutshell, the research found that aid's impact on economic growth and investment increased during the period when aid moved up to the macro level with the help of policy dialogue and structural adjustment programs (Hansen and Tarp, 2000). Mosley and Hudson (1997) concluded that aid's effectiveness in promoting growth and investments in developing countries improved from the period 1974-83 to the period 1984-92. They studied aid's effect on savings, investments, human capital and economic policy in developing countries, and through this, developing countries' economic growth rate.

However, development aid is given on the assumptions that it provides additional resources to recipient countries, the question is raised- Does aid work? The honest answer should be that we still do not know- not for

lack of trying, but due to the inherent difficulties of tracing its contributions. In one way necessity of aid has been understood is that 'aid is necessary for development' - especially for very poor countries with large numbers of poor people, insufficient resources to provide for core services, high levels of debt, ineffective institutions and little prospects of being able to achieve substantive structural changes in the short term, aid would appear to have an important gap-filling role to help meet the immediate basic needs of the poor people. In that sense, we could conclude that aid has great effectiveness and the justification for providing development aid will be considerably enhanced if it is used as effectively as possible. The more effectively aid is utilized, the more quickly it can contribute to long-term development outcomes.

2.1. Aid Recipient to Donor: Korea Experience

Looking the Korean development history, we can claim that it originates in 1945. It also is noted that between 1945 and the early 1990s, Korea received a total assistance of 12.69 billion USD from the international community. If we study the Korean development and aid uses, it could be opined that the enormous amount of foreign aid and its effective uses were the crucial one to Korea's sustained economic growth what was not seen before yet (Table I).

The empirical data showed that Korea given strategic focuses and allocated its aid in different sector by balancing agricultural development and industrial development. At the beginning, Korea encouraged in agriculture and textile and most aid allocation was made in that sectors. But in 1960s, Korea focused on targeting industry that drive HCI in 1970s by allocating his more resources in machinery, equipment, and petrochemical as well. It implies that more than 60% aid resources were allocated to the manufacturing and industry sector in 1960s and extended gradually (Figure 1) which was the most significant of Korea's economic development and catching up developed countries being an industrialization economy in the world. By achieving continuous development progress and enhancing contribution of its efforts, South Korea made its way out from the list of aid recipients and finally able to make a transition from an aid-receiving country to an emerging aid-donor country in 2000 and engaged himself as a member of the Organization for Economic Co-operation Development (OECD), a group of 34 advanced countries and later on, in 2010, is listed in OECD's Development Assistance Committee (OECD-DAC) member countries.

2.2. Foreign Aid Regime in Bangladesh

Bangladesh which has run a long distance in its journey of economic development since independence in 1971 following a bloody war, foreign aid has played an important role in the country's economic development and still continuing. However, the effectiveness of foreign assistance as a means to contribution to sustainable development in the country has, at times, been subject of debate. Although Bangladesh received almost 50 percent of its annual development program (ADP) over the past decade, made a significant economic development during the last three decades by maintaining an average 6 percent gross domestic product (GDP) growth per year for the past few years, and achieved considerable social improvements with respect to many MDG indicators, the country faces of low per capita incomes that is estimated around US\$ 640 in 2010 listed in LICs in the world (Table II).

3. Patterns of Development Aid Uses: Bangladesh 1972-2009

Over the past decade, although Bangladesh received a good average foreign assistance beginning with mostly grants in the form of food and commodity aid, accounting about 74 percent of total aid in the decade following independence, the country failed to attribute the aid affectivity what Korea showed. One of the major limitations is inadequate policies and strategies of aid management which is an important pre-requisite of aid effectiveness in recipient countries. The country policy should be focused on specific target oriented to ensure the best use and best outcome from aid uses what Korea did by focusing on specific targeted industrialization and made a success story. But Bangladesh, though unexpected, has no any such policy. However, the country has a long history as an aid recipient since 1971, is using the aid without any strategic focus. If we analyze the aid utilization of Bangladesh more specifically, we could sum up that the country used the aid just as food and commodity consumption at the beginning, and later on socio-infrastructure development (Figure 2). But the country never focuses on industrialization or critical sector development in capital accumulation. As the country exists in poor human capital and poor physical capital, the country will not be capable enough to get more output and the industrialization will not expand any more. But without expanding industrialization, higher rate of economic growth will not be possible and the country always seems to be in underdevelopment trap that ultimately reflects the inefficient in productive utilization of aid.

Aid and development effectiveness in Bangladesh is less than it could be due to number of interlinked and interdependent structural, procedural and capacity problems. As Sachs (2005, p. 14) notes, it has merely managed "to place its foot on the first rung of the ladder of development." As development theory and empirical experience from other countries, like Korea, suggest, external assistance can fill in for lacking resources by (a) augmenting limited domestic savings, (b) providing the additional foreign exchange required to finance critical

capital requirements and imports of raw materials, and (c) assisting with the development of human capital and the promotion of domestic capacity. However, as the distribution of aid in different sectors indicates, frequently these potential benefits of external assistance have not been realized, and most of aid is used on social sector support that is somehow accounted for more than 80%. That is why, despite the success in social achievements, the country is still at a rudimentary stage of economic and social transformation, and it shows- economic development still is quite insignificant and aid effectiveness on economic development is in questionable. If we look at the cross-country success on aid effectiveness, compare to Korea, the issue of aid effectiveness in Bangladesh is an ineffective and poor performance.

The country is still in relatively low income per capita, aid effectiveness has been mixed and challenging. As of 2000, to receive development assistance, Bangladesh is practicing poverty reduction strategy under the initiatives of WB's Poverty Reduction Strategy Papers (PRSP), and the country's, facing low levels of human capital and physical capital, initiative had a little impact on economic development and poverty reduction due to poor industrialization and capital accumulation. Bangladesh, time to time, that followed different strategies or development frameworks including PRSP to manage aid, are lacked from broad based outcome, however, it focused more on poverty elevation rather than industrial development with strategic focus.

3.1. Other Issues of Aid Effectiveness

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

(i) *Inappropriate Policy*: The country has no good instruments regarding prioritized, aid mobilization, mobilizing domestic resources, private sector development, and promoting export policy as well. Government, both at local and national levels, has not yet defined a proper enabling environment that can reduce transition costs and allowing entrepreneurships. The country is also required to enhance its project implementation capacity, because the performance of projects implementation is poor due to country's capacity constraints.

(ii) *Failure to link the Government Support with Performance*: The government of Bangladesh had received food aid like Korea, but they could not utilize it like Korea. Korea utilized the food aid in a very dynamic way and distributed this food aid among the poor people based on daily work performance linking with different government projects like erosion control projects, irrigation projects, forestation projects etc. This approach created motivation and self-independency in people that increased the productivity in agriculture sector and increased the income of rural people. But, the country, Bangladesh, did not take any program, which can achieved such a good performance what Korea achieved in 1950s.

(iii) *Absorptive Capacity Constraints*: From the literature review, it reveals that the developing countries still exist in poor infrastructure and poor human capital, and thus the countries are not capable enough to handle the aid efficiently, even the more aid is available, that is, the developing countries suffer from absorptive capacity constraints, and they are limited in terms of the amount of foreign assistance they can productively utilize (Chenery, 1966; Millikan, 1957; and Rosenstein-Rodan, 1961). For an instance, it is also widely believed that there are diminishing returns to aid, that is, as developing countries have low levels of human capital and limited physical infrastructure, the returns from foreign assistance decline as the flow of aid increases (Quibria, 2007). Bangladesh is not out of these scenes, and the country suffers from absorptive capacity constraints, that is, the country is limited in terms of the amount of foreign assistance it can productively utilize. The country has low levels of human capital and limited physical capital (both infrastructure and industry development), and thus Bangladesh shows low level portfolio performance which are reflected in achieving sufficient development impact.

(iv) *Physical Infrastructure Bottlenecks and Skills Shortages*: It is argued that 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 export competitiveness and real exchange rate overvaluation (Adam, 2006; McKinley, 2005), the factors that are responsible for aid effectiveness (Rajan, 2005). But the shortage of human capital and public infrastructure, the severe bottlenecks in Bangladesh, like other developing countries that are limiting their ability to absorb large amounts of aid, reflects that a large inflow of aid can help alleviate these constraints and become an important part of the solution strategy.

(v) *Governance and Corruption*: Some scholars suggest that foreign aid has a negative effect on economic growth through its adverse impact on governance (Rajan, 2007). They argue that manufacturing is highly dependent on the quality of governance, and that as the volume of aid increases, it reduces the government's accountability. In particular, the government slackens its efforts to maintain the rule of law, ensure predictable judicial outcomes and contract enforcement, and limit corruption. The country, like Bangladesh, is not out of this scenario, and namely, Bangladesh who is considered as high ranked in the most corrupted countries, where governance and corruption are clearly a serious problem to utilization the aid effectively. To the extent that foreign aid has indeed been a source of corruption, the culpability lies with both recipients and donors, as the aid delivery process—including

procuring materials and awarding contracts and consultancies—is under the dual control of both donors and recipients.

(vi) *Influence of Donors in Policy Matters*: The multilateral international financial institutions are the principal source of aid now a day, and the terms and conditions of the International Development Association have somewhat hardened, and in addition, paradoxically, while aid related to investment and economic development has waned, its significance as a catalyst for policy change has strengthened. In recent years, donor representatives have not only become ubiquitous, but also seemingly omniscient, lavishly dishing out wisdom on virtually everything, above and beyond their specific areas of economic assistance! This activity is actually hampering the economic development to establish the country himself as a self-sufficient.

(vii) *Policy Conditionality*: A common complaint is policy conditionality that is imposed by donors to the aid recipients while they provide aid, but a sizeable body of literature suggests that policy conditionality does not work and it is an ineffective approach (Rahman, 2008; Kanbur, 2006; Mosley, 1995). May be there are so many reason and the reasons may differ from country to country. However, remarkably notable that the donor and the recipient often have different views about the program, thus foreign aid would be offered to poorer countries based on evidence of progress, which would be measured in terms of outcomes, and not policies and other intermediate inputs. Therefore, the recipient countries should evolve their own development policy, and donors should shore up them to build up their capacity so that the recipients can grow and exercise the leadership and ownership as well by strengthening their institutions, expertise and management systems.

(viii) *Disproportionate Aid Allocation*: Bangladesh suffers from aid predictability and aid availability unlike Korea. In the early stage of foundation, Korea, as a recipient in 1950s, received almost 50% of its government expenditure as foreign assistance ($\approx 15\%$ of its GDP) where Bangladesh received a non-remarkable aid compared to Korea that could be another important reason for Korea in effectiveness of aid regarding development but not in Bangladesh.

3.2. Policy Implications: Bangladesh

The unique experience of Korea's aid effectiveness suggests that 'appropriate aid allocation' and 'opportunity to aid flexibility' are most important for the effective utilization of aid. There are so many pre-requisite issues are involved in aid effectiveness, however, but it is defined not only from the development policy of aid management view but also from a common vision and a shared set of priorities. The manner in which aid is provided to Bangladesh is inadequate and non-flexible that reflects aspects to fragmented vision and unrelated priorities. As a result, its contribution for a tangible outcomes and impacts on lead development has been failed to make a position with respect to the main longer-term determinant of aid effectiveness. On the other hand, with the enactment of the Foreign Investment Promotion Act (1960), Korea actively attracted foreign investment from developed countries and effectively utilized the foreign resources through the execution of its Five-Year Economic Development Plan. If we analyze the Korea's 30-year aid received data between 1945 and 1974, on average, Korea received more than 10 % of its total GDP and large portion was in non-project assistance (more than 90%) whereas Bangladesh received only less than 5% for the same period. From the late 1970s, the main form of development assistance to Korea changed from project-based loans to sector-based loans to figure out the development for a particular sector and structural adjustment loans to figure out the adjustment for economic structure as well.

(i) *Appropriate Aid Allocation*: Compare to any aid recipient developing countries in the world, the proportion of aid contribution in Korea was extremely high where Bangladesh is receiving very low proportionate amount of aid, and noted that the aid-GDP ratio at the beginning was only around 4% and, with a time being, it is declining dramatically (*Figure 3a*). So the huge allocation of aid in Korea, which provided critical resources for government capital, investment, industrial infrastructure and technological development, was a significant turning point for aid effectiveness and Korea's development that placed Korea in the achievement of milestone performance but may not be possible for Bangladesh with inadequate aid allocation.

(ii) *Opportunity to Aid Flexibility*: South Korea, in the history, had received large amount of aid and utilized this aid very efficiently and effectively where Bangladesh could not use the aid in efficient and effective way. One of the main reasons is limited flexibility of aid uses. The foreign assistance mobilization in Korea compare to Bangladesh revealed that Korea received aid mostly as non-project mode, where Bangladesh received aid as very rigid and specific project assistance (*Figure 3b*). The non-project aid- the aid that is granted with less conditionality or without conditionality is more suitable than the project aid- the aid that is very much rigid and not granted without comply the loan conditionality. So Bangladesh has no more flexibility or free room to use aid in the line of country context and what Korea did in 1960s and 1970s by allocating more aid in his focused industrial development.

(iii) *Aid to Planned Approach*: Korea used his aid to develop the country as a emerging industrialized country, and to do so, Korea used aid with equal emphasis in agriculture to increase its agriculture productivity, physical infrastructure development and machinery procurements to turns the country agrarian economy to industrial economy, and education and technology assistance purpose to build a human capital to keep sustainable development for the long run goal. Moreover, at the same time, Korea adopted industrial policy and trade policy

to promote international investment and exports and ensured a balance policy mechanism to increase the productivity in both agriculture and industrial sector as well. On the other hand, Bangladesh neither received adequate amount of aid nor have such policy like Korea, and even the country does not have any policy instruments so that it can create a balance mechanism between physical development, agricultural development and human development. The country just expends more aid in social sector project to reduce poverty level, but it does not have any planned approach like Korea. While Korea emphasized equal measure in agriculture and industry both with promoting human capital, Bangladesh emphasized more aid allocation on social sector development only, neither in industrialization nor in sectoral transformation, and nor in human development (*Figure 3c*).

4. Lesson Learned from Korea

Aid effectiveness is correlated with national policy efficiency. Korea had a good policy and thus they achieved a glorious result from aid which proved that aid can work if it is used effectively and efficiently. But if we see the present global aid scenario in terms of effectiveness, aid had largely remained unsuccessful in terms of achieving some of the major goals set by the Millennium Declaration, such as economic growth and poverty reduction, and the reasons behind this are poor economic policy in recipients countries, capacity constraints of recipients to implement the programs, lack of predictability of aid flows, increased conditionality by donors, lack of proportionate of aid allocation, and lack of coordination between both donors and partners, that have been recognized as responsible for such depressing performance of aid in the recipients countries, which are also true for Bangladesh. But the significant learning from Korea could be pointed out that aid should be allocated not only in social sector, it also should be allocated in both primary and secondary sector as well with specific focus and target. Bangladesh, to contribute towards real sustainable development through aid, must lead its own development policies and strategies linking with performance, should emphasis equal opportunity to all by policy implementation, and have to manage them with its own development work on the ground. Nevertheless, failure to formulate of own development policies, aid continued to impose policy agendas that were externally driven and to pull policymaking capacity out of government while at the same time initiating unpredictable flow of finance. Therefore, Bangladesh needs to accumulate good economic policy in its own system and donors need to use the existing country's system to manage and allocate aid. In this circumstance, the donors need to give aid recipients more flexibility and free room to use the aid where the country capable and providing more emphasis to link the development in efficient and effective way so that more outcome could be achieved from the aid uses.

The foregoing discussion highlights a number of issues that seem to have constrained the effectiveness of foreign assistance in Bangladesh. However, these issues are not in any sense unique to Bangladesh, but have a wider relevance. In light of the generic nature of these issues, the following recommendations to this end are drawn for Bangladesh to ensure the effective utilization of its aid resources:

First, aid effectiveness should be measured on the basis of economic outcomes, and thus aid mobilization must be shifted in favor of outcomes-based conditionality rather than policy-based conditionality, where the effectiveness focuses on impacts and outcomes rather than on inputs, activities, and outputs that can promotes greater ownership and accountability;

Second, the current practice of donors undertaking details assessments of a country's entire policy environment is unnecessary, and thus government should be given free rein to choose their policies, which would help promote ownership of policies and strengthen accountability, thereby enhancing private sector confidence;

Third, the recipient countries should be given complete autonomy in managing their aid resources without donor interference and on the basis of national plans;

Fourth, under the new international development compact, the principal basis for allocating aid should be national plans and MDG assessments, and thus according to this perspective, a country's development performance would be measured in terms of its progress towards achieving the MDGs over a given time frame and further scaling up of assistance would be linked to this progress; and

Fifth, maximizing the impact of aid on poverty reduction requires identifying and eliminating the major constraints to poverty reduction in a particular country, and this is where donor agencies can play an important supporting role to help the government for balancing the government policies to undertake positive policy actions.

5. Conclusion

The mixed success of foreign aid in Bangladesh can be traced to shared failures on the part of both the government and donors. Donors' current approach to aid suffers from some generic problems. The foregoing analysis highlights some measures, which are intended to (a) introduce greater flexibility in the delivery of aid, (b) provide recipient countries with more policy space, and (c) emphasize results, will be helpful to ensure aid effectiveness. But at the same time, Bangladesh should adopt complementary measures what Korea did in its development stage, and it could be the best learning for Bangladesh as an aid recipient. These measures include enhancing domestic capacity by improving human capital to implement sophisticated projects and creating an appropriate economic environment by focusing specific sectors for the economy to flourish economic growth and development.

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Table I: The Overview of Broad based Development in Korea (1962-2010).

	1962	1992	1997	2007	2010
Economic Development					
<i>Per Capita Income (in US\$)</i>	79.00	8,000	12,000	21,500	18,500
<i>Per Capita GDP(in US\$)</i>	87.00	7,527	11,176	20,014	20,500
<i>Investment (% of GDP)</i>	13.80	37.30	36.00	29.00	29.30
<i>Exports (% of GDP)</i>	5.10	26.60	32.40	45.60	51.50
<i>Imports (% of GDP)</i>	16.80	27.70	33.00	44.80	47.10
<i>Trade (% of GDP)</i>	21.90	54.30	65.40	90.40	98.60
Social Development					
<i>Life Expectancy at Birth</i>	55.00	72.00	74.00	79.00	80.50
<i>Infant (less than 5 years old) Mortality Rate (per 1000 birth)</i>	138.00	8.50	7.20	5.20	4.90

Source: Joon-Kyung Kim and Kwang Sung Kim (2011), From Aid to Development: The Korean Experience, OECD mimeo

Table II: Social Changes and Economic Development in Bangladesh (1972-2010).

	1972	1980	1990	2000	2010
Economic Development					
<i>Per Capita GDP(in US\$)</i>	125.00	216.00	280.00	358.00	640.00
<i>GDP Growth Rate (percent per year)</i>	2.10	3.39	3.40	5.90	5.85
Social Development					
<i>Life Expectancy at Birth</i>	45.00	58.00	60.00	61.50	63.90
<i>Infant (less than 5 years old) Mortality Rate (per 1000 birth)</i>	145.00	90.00	76.00	64.00	49.00
<i>Population Growth Rate (in percentage)</i>	4.50	2.50	2.00	1.50	1.36
<i>Literacy Rate (in percentage)</i>	25.00	28.00	32.00	40.00	60.00
<i>Poverty Declined (in percentage)</i>	55.00	50.00	57.00	49.00	36.00

Source: World bank. International Monetary Fund, OECD, and http://www.nationmaster.com/graph/eco_gdp-economy-gdp&data.

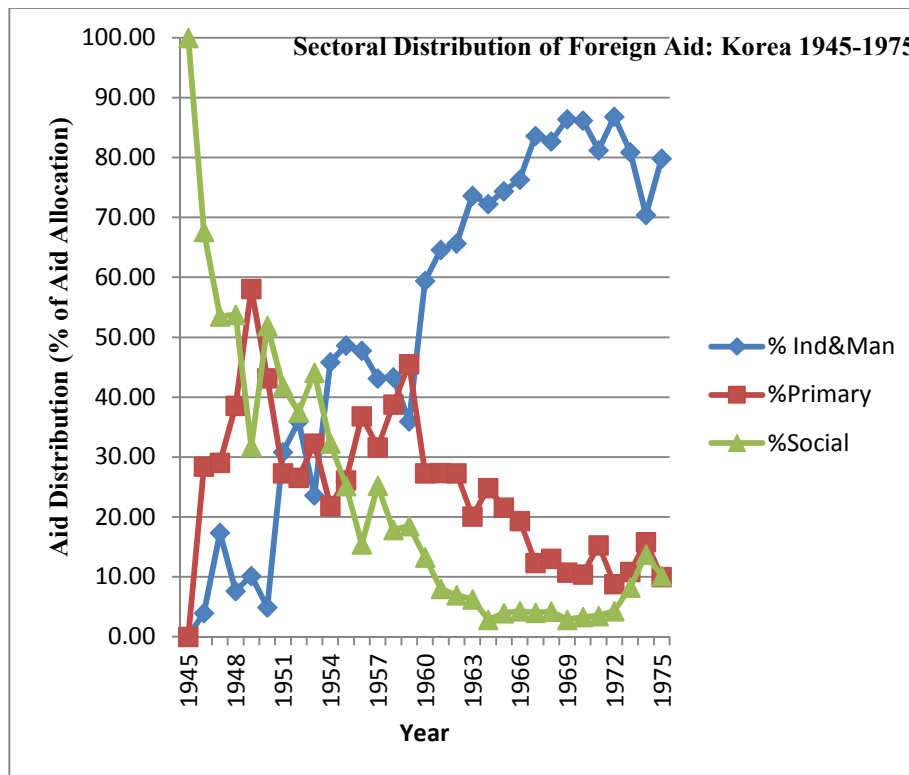


Figure 1: Sector Wise Foreign Assistance Distribution: Korea 1945-1975.

Source: The data is compiled from Anne O. Krueger (1982), The Development Role of the Foreign Sector and Aid, Studies in the Modernization of the Republic of Korea: 1945-1975.

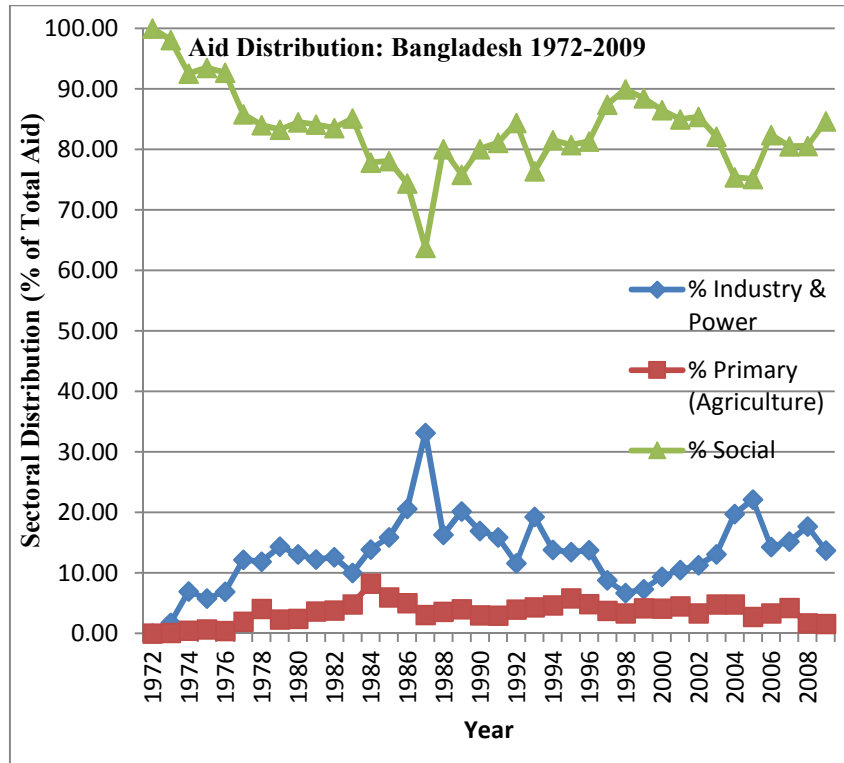


Figure 2: Foreign Assistance Utilization in Bangladesh (1972-2009).
 Source: The data is compiled from Economic Relation Division, www.erd.gov.bd (2011), Ministry of Finance, Bangladesh.

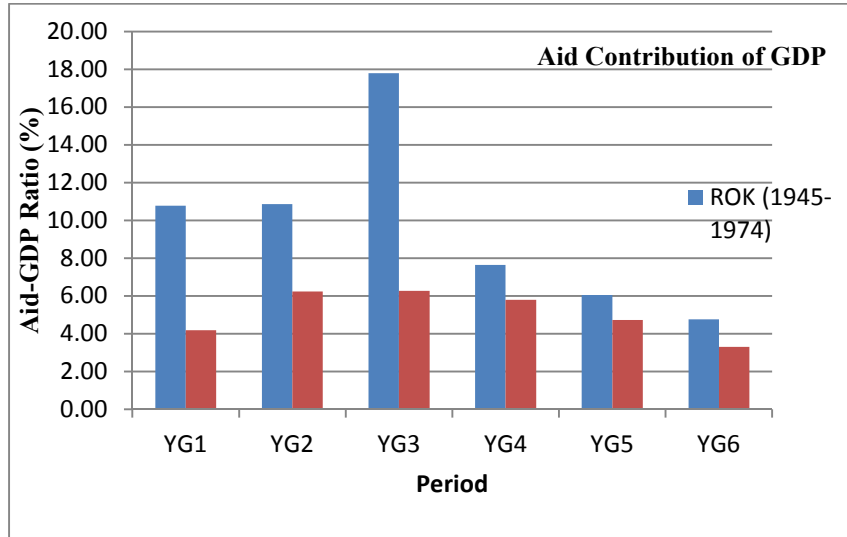


Figure 3a: Aid Assistance as percentage of GDP in Korea and Bangladesh.
 Note: Year Group YG1 is defined 1945-1949 for Korea (ROK) and 1971-1975 for Bangladesh (BD) respectively and so on. The period here is considered 1945-1974 for ROK and 1971-2000 for BD.

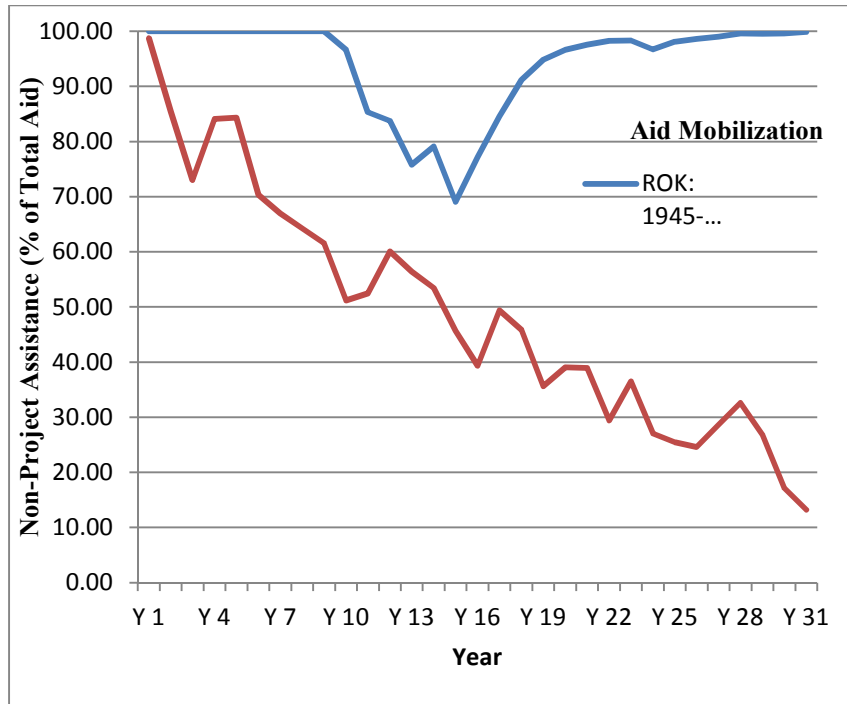


Figure 3b: Aid Assistance in Korea and Bangladesh by Type.
 Note: Year Y1 is defined 1945 for Korea (ROK) and 1972 for Bangladesh (BD) respectively and so on. The period here is considered 1945-1975 for ROK and 1972-2002 for BD.

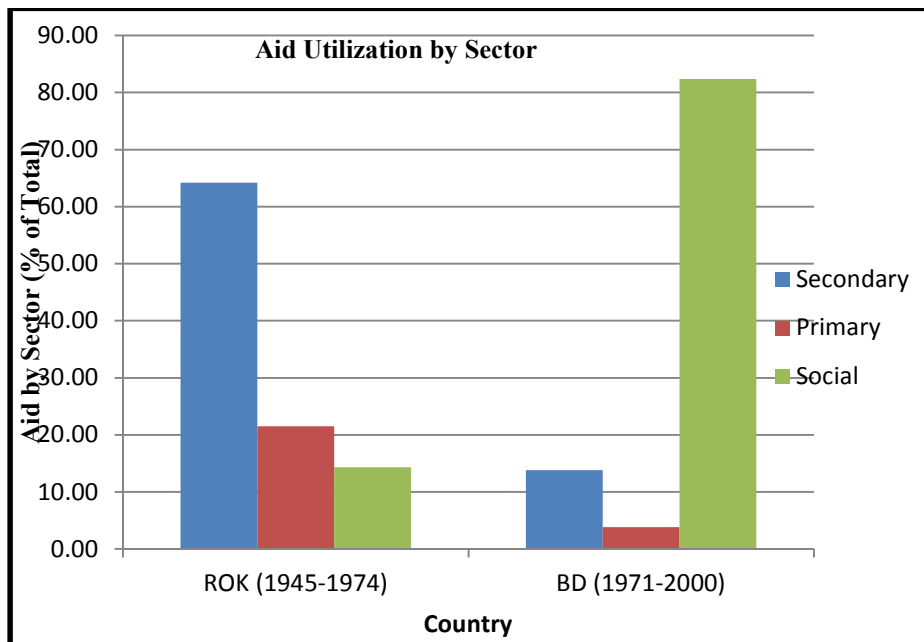


Figure 3c: Aid Assistance in Korea and Bangladesh by Sector.
 Source: Figure 3- The data is compiled from Anne O. Krueger (1982), *The Development Role of the Foreign Sector and Aid, Studies in the Modernization of the Republic of Korea: 1945-1975* and Economic Relation Division, www.erd.gov.bd (2011), Ministry of Finance, Bangladesh.