

Role of Aid Politics on Its Effectiveness for Global Development Purposes

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Abstract

Foreign aid has been distributed for many decades with the 'theoretical' expectation that it will work as a catalyst for development by boosting domestic savings, investment and economic activities. But in 'practice', foreign aid has been debated for its performance. Particularly in the 1990s, this debate has peaked when the scholars had sufficient amount of evidence to spot aid as 'partly' successful. Despite multiple views and several disagreements persist regarding the success of aid; still, poor performance is more or less evident. Many reasons have come forth so far to explain this ineffectiveness of aid. This paper based on the literature review- tries to indicate the role of politics in making the foreign aid ineffective. It is evident from the review, the main reasons associated to 'politics' for aid ineffectiveness are, irrational selection of aid recipients, excessive conditionality of foreign aid, lack of coordination among donors and the divisive role of political elites in recipient countries. Although, in recent decades, donors have changed their ways of aid allocation, which improves, aid performance in compare to pre-cold-war period, nevertheless many miles to go. Performance driven and altruistic allocation of aid should be the most desirable way that could save the taxpayers' money from misuse.

Keywords: Foreign Aid, Aid Conditionality, Aid Selectivity, Altruistic aid Allocation, Rent Seeking Behaviour, Inflated Aid.

Introduction

Foreign aid had started to flow to developing countries from developed world long before there was very compelling theory or evidence about its effectiveness (Boone, 1996). Classical wisdom about external financing was that aid would boost domestic savings, investment and fiscal budget that eventually lead to higher economic activity and alleviate poverty. Though the large number of aid programs have started in post-world war II period,

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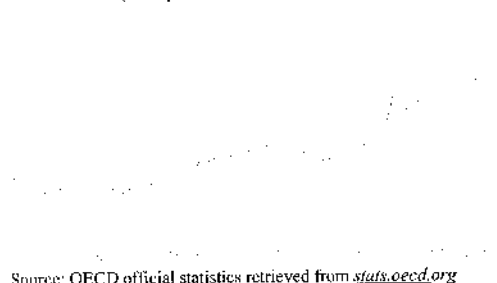
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only since the 1960s economic experiments have been underway to scrutinize their impact. Early literature was very inconclusive due to limited data availability. From the 1990s, notable evidence about the impact of foreign aid has started to come where substantial confusion regarding aid effectiveness was evident (Easterly, 2003). Despite the debate and doubt of aid effectiveness, quantity of aid flow has grown considerably in the past two decades. In 2015, a record high amount of \$146.68 billion has distributed as official development assistance (ODA) by the member countries of Development Assistance Committee (DAC) to the poorer countries and refugees living in OECD countries of the world (OECD, 2015).

However, it is commonly argued that these transfers are highly volatile, fungible and sometimes motivated by political interest of donors rather humanitarian or development perspectives. In this paper, we will discuss the role of politics on the quantum and direction of foreign aid, as well as the plausible influence on economic development based on the available literature. The focus of this paper is to examine why aid flowed and how it was used

in the recipient countries rather direct impact analysis of aid. But we will refer to the impact repeatedly as the limited success of aid is the key motivation of this paper. The rest of the paper is organized as scope of political factors in the foreign aid sphere, discussion regarding politics and aid effectiveness and concluding remarks.

Figure 1.1: Trend of ODA by DAC countries
In USD Billion (2014 prices & exchange rates)



Source: OECD official statistics retrieved from stats.oecd.org

Scope of 'Political' Factors Affecting Foreign Aid

Foreign aid could improve the recipients' economy by several structural adjustments namely capital mobilization, fiscal expansion, focused intervention etc. It is commonly presumed aid have a strong positive correlation with economic growth. However, correlation always doesn't necessarily mean causality. Over last two decades, aid benefits have highly scrutinized by scholars to find out the causal relationship with recipients' economic and social development. Lack of causal evidence, in many cases, convince them to explore the reasons and ended up with never ending list of factors. Boone (1996) was one of the earliest notable researchers who incorporate political factors (with statistical rigor) in explaining reverse causality of aid. Since then, many scholars (e.g. Easterly, Burnside, Dollar, Svensson etc.) stretch the topic further. In this section, we are presenting a brief discussion about 'which political factor affecting the quantum and effectiveness of aid'.

In generic view, participatory government is the most preferred form of government and should get more aid to improve the life of the people effectively. In a notable study Boone (1996) test aid effectiveness based on the political regime and found that in both forms of government, government i.e. democratic or repressive (weak-form dictatorship), political

elites got benefited from the aid programs mostly. Moreover, they showed aid doesn't increase investment and improve the life of the poor but it does increase the size of the government. That indicates a conflict of interest between political elites and the target recipients of aid. However, Easterly (2003) has argued that increasing size of the government is not always bad in poor country's context. On the contrary, Islam (2003) has found that aid has a statistically significant influence on growth in totalitarian economies compared to the tin pot countries. Probably this difference exists due to rational decision choice of totalitarian instead of a popular choice of tinpot countries. Though, on an average impact of aid was very little in both forms of economics. He also conforms to Boone (1996) that political elites benefited more from aid programs. In another more recent work, Bjørnskov (2010) has found that aid in conjunction with democracy in recipient countries leads to a more right-skewed distribution of income. Interestingly, he reports less skewed income distribution in autocratic countries. Furthermore, in many instances, aid led to higher level of corruption due to rent-seeking activities of political elites (Svensson, 2000). However, Tavares (2003) found complete opposite result regarding the level of corruption. Overall, recipients' political structure and efficiency haven't played a crucial role in the quantum of aid as well as the distribution of aid benefits.

Another viewpoint of looking into politics of aid quantum and effectiveness might be the macroeconomic policy environment of recipient countries. In general, the good policy indicates good politics and both are very essential for growth. So to achieve aid effectiveness, aid should be given to the countries with good policy or at least to those who is improving their policies. Burnside and Dollar (2000) have a prominent research based on cross-country aid database that incorporates recipients' economic policies into aid effectiveness research. They have found that aid catapult is the economic growth and growth effectiveness of aid varies depending on the quality of fiscal, monetary and trade policy while these policies have very little role in donors' aid allocation decision. This paper has started a series of academic debate, which produces a number of research papers. Dalgaard and Hansen (2001) have conducted a research using Burnside and Dollar framework and concluded that robustness of aid effectiveness found by Burnside-Dollar is only due to the deletion of some outlier sample. Using the same framework with an extension in the period and sample size, Easterly et al. (2003) have also found that Burnside-Dollar's research result was not robust and conclusive. Both papers suggest the interplay between policy, economic growth and aid is ambiguous. However, though Easterly et al. (2003) have not found any significant effect of aid on growth, they report positive marginal growth effect of policy, that actually indicate the policy relevance (as claimed by Burnside and Dollar 2004b). Importantly all these authors agreed that recipient countries' policy environment play insignificant role in aid flow.

Afterward, Burnside and Dollar (2004a) have revisited their earlier model and again found a robust positive relationship between aid effectiveness and quality of institutional policy. This debate might be explained by two weakness of the Burnside-Dollar framework. First, the inclusion of outlier samples in original Burnside-Dollar framework has changed the robustness in later research (Hansen and Tarp, 2001); second, negative terms of trade has

an adverse effect on growth which Burnside-Dollar didn't consider (Guillaumont and Chauvet, 2001). Despite some disagreement with Burnside-Dollar, Guillaumont and Chauvet (2001) have also confirmed that donors are not responsive to good policies in deciding the recipients of aid. Again, it is not very conclusive; recipients' macroeconomic policies have played a major role in quantum and flow of foreign aid.

Moving from recipients' side to donors' side, in many instance donors' distribute aid based on their own selection criteria and strategies rather than rational choice or altruistic view. Alesina and Dollar (2000) have found that UN voting pattern explains aid flow and direction more strongly than the political institutions and economic policies. Furthermore, the authors conclude that aid flow and quantum does depend on the colonial status of the recipients and strikingly, does not depend on poverty in some cases, especially in the case of French aid. Additionally, multilateral donors are more selective to rule of law in compare to bilateral donors (Dollar and Levin, 2006). Bilateral donors tend to depend more heavily on their own selection principles. In another classic study, Schraeder et al. (1998) have empirically compared American, Japanese, French, and Swedish aid flows and shown that foreign aid is not serving altruistic view of humanitarian causes and heavily influenced by the strategic and ideological factors related to cold war. Even in the post-cold war era, political and strategic goals played a strong determinative role in foreign aid allocation (Younas, 2008).

It is not unfair if donors have some strategic position beside the humanitarian consideration. But strategic position should not dominate the policy environment, rule of law, and altruistic view of foreign aid. As aid is a scarce resource and comes from tax payers' money, it should be distributed efficiently. Moreover, in practice, effectiveness of aid has a strong negative relationship with the level of strategic goals of donor government (Beece and Tironi, 2010). Nevertheless, aid allocation criteria cannot be generalized and vary significantly among donors. Most of the Nordic countries, Ireland, Switzerland and Austria are very responsive to altruistic humanitarian view, while Australia, France, Italy, Japan and United States are very egoistic in allocating aid (Berthélemy, 2006). Irrespective of the significant differences in strategic decision criteria between bilateral and multilateral institutions, by and large, aid have failed to meet the expected level of poverty alleviation and economic growth (Maizels and Nissanke, 1984; Lumsdaine, 1993; Agénor et al., 2008; Bjørnskov, 2010; Burnside and Dollar, 2004a). Nevertheless, these authors have a disagreement about the reasons for aid ineffectiveness. Numerous reasons come into play along with multidimensional political factors. Here we have present a few of them. In the next section, we discuss 'how aid politics playing a crucial role in aid ineffectiveness for development purpose'.

Discussion: Politics and Effectiveness of Aid

The role of politics in aid has several dimensions, namely, politics in the recipients' country, politics in the donor country, inter-country politics among donors and recipients, politics in multilateral institutions etc. From the literature, it is quite evident that recipients 'have very little to do with the direction and quantum of foreign aid but have a crucial role in using aid efficiently. By maintaining a high level of policy standard, political stability, governance and meaningful democracy, recipient countries could effectively reduce poverty and achieve superior economic growth through aid support (McGillivray, 2003). Then these factors mostly remain absent in many developing countries. Thus the effectiveness of aid diminishes

and leads to skewed distribution of wealth. However, recipients are not always responsible for aid programs' failure. Sometimes donors themselves make it difficult to achieve aid effectiveness by tying political conditionality, strategic goals and geopolitical interest with aid e.g. American aid relationship with Pakistan. Moreover, donors among themselves have some conflict of interest regarding market control and domination in international institutions such as United Nations, Security Council etc. (Bandyopadhyay and Vermann, 2013). In recent decades, private aid has grown significantly that demand much attention from a political viewpoint. But in this current study, we have mainly focused on the effect of politics on public funded conventional aid flow and their performance.

Irrational Selectivity: Corrupt Autocratic vs. Poor Recipients

In general, aid performs the worst in alleviating poverty when it goes to corrupt dictators or relatively higher income countries. It is quite surprising that non-democratic countries with colonial legacy got twice as much as aid in compare to democratic non-colonies (Alesina and Dollar, 2000). Even though democracy is the well-acclaimed form of government, the majority of donors are rhetoric about promoting democracy. Donors were historically unresponsive to the political context of recipient countries (Easterly and Pfütze, 2008). In South Asian countries, similar trend prevailed in the aid flow. Pakistan and Afghanistan are the two countries with more volatile and fragile political past among all South Asian countries. However, Pakistan has managed to receive consistently higher level of ODA in this region (table 1). More surprisingly, under military regimes Pakistan got higher aid compare to civil administration. Similarly, Afghanistan in recent years is getting huge amount of aid, mostly due to so called Global War on Terrorism (GWOT), not for solely development purpose. Whereas, being more successful in political practice India is getting lower level of aid. This statistics support that political structure in the recipient countries of South Asia didn't play any substantial role in aid flow. In the following table aid flow towards Pakistan is compared with other neighbouring countries to exhibit the irrational selectivity.

Table 1: Aid Inflows during Various Political Regimes of Pakistan between 1958-2007 and Comparison with Afghanistan, Bangladesh and India

Regime	From-To	Per capita aid (current US\$)	Total aid (US\$ million)	Average Per capita aid (current US\$) during the same period		
				Afghanistan	Bangladesh	India
Ayub Khan (military)	1958-69	7.6 (109.20)	5,717	3.68 (96.60)	---	2.04 (99.68)
Yahya Khan (military)	1969-71	6.4 (162.64)	1,770	2.50 (143.56)	---	1.58 (112.21)
Zulfiqar Ali Bhutto (civil)	1971-77	7.5 (163.10)	4,861	4.98 (175.61)	7.09 (151.77)	1.86 (153.58)
Zia-ul-Haq (military)	1977-88	9.5 (327.06)	14,792	2.98 (267.82)	14.40 (221.59)	2.31 (288.50)
Various (civil)	1988-98	9.4 (442.46)	24,829	15.09	13.65 (322.20)	2.04 (365.76)
Pervez Musharraf (military)	1999-07	10.3 (641.77)	21,895	76.70 (236.92)	9.00 (447.91)	1.26 (626.58)

Note: Average GDP per capita (current US\$) during the corresponding period in the parentheses.

Source: Authors' calculation and adaptation from a book chapter written by Ahmed and Wahab (2012) published in '*Foreign Aid in South Asia: The Emerging Scenario*', edited by Kelegama, S.

Even donors were not very focused towards least developed countries until 2004 since when least developed countries getting more aid in comparison with rest of the countries. However, this increase comes at the cost of a decrease in low-income countries' portion rather cutting the relatively higher income countries' share. This irrational distribution is mainly motivated by the political interest. For instance, historically, Israel and Egypt got almost one-third of the total aid disbursed by the USA mainly due to the donor's keen interest on Middle East's geo-politics (Alesina and Dollar, 2000). Though the trend is dropping, a significant portion of aid is going to corrupt, non-democratic, or relatively well-off countries. Table 2 exhibits some facts regarding the irrational selectivity of donors in disbursing aid.

Table 2: Some Facts of Donor's Selectivity

Scenario A	Scenario B
In 1991, Israel's GDP per capita was 44.2 times higher than Ethiopia.	In 1991, Ethiopia got 16.1 times lower net ODA per capita than Israel.
In 2011, Afghanistan got 12.31 times higher Net ODA per capita in compare to 2001.	With comparable GDP, in 2001, Egypt got \$19.5 and Iran got \$1.73 as Net ODA per Capita.
In 1991, Malawi got high amount of net ODA per capita (\$56.91), which was 25% of their per capita GDP.	In 2001, Malawi's Per capita GDP has reduced by 35% in compare to 1991 and got 24% of it as Net ODA per capita. (Aid Fatigue)

Source: Authors' calculation based on World Development Indicator (WDI) 2016 published by World Bank Group.

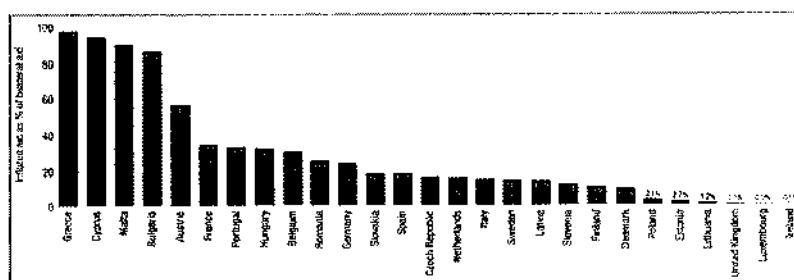
Obviously, poor countries are also prone to corruption but donors have the opportunity to use aid as an incentive to reduce the level of corruption (Tavares, 2003). Besides corruption and autocracy, some other indicators show the negative selectivity of foreign aid. Bilateral donors are not responsive to human rights violators in making their aid allocation, while multilateral agencies, especially World Bank, shows somewhat responsive allocation (Lebovic and Voeten, 2009). Some bilateral donors are not also very responsive towards basic human need issues relate to. For instance, USA traditionally has used PL480 to distort their food aid policy (Ball and Johnson, 1996). Overall, these selectivity issues are actually shifting aid from its development purpose.

Conditionality of Foreign Aid: Strategic/Political Goals vs. Credibility

Donors usually give a long list of covenants with the aid to poorer countries to ensure the economic reform, which is very crucial to ensure the objectivity of aid program. But, in many cases, donors fail to maintain their credibility in executing and monitoring those suggested economic reform due to the high level of their own strategic or political goals. Bearce and Tirone (2010) have statistically shown that aid programs are more efficient in post-cold war period mainly due to the reduction of political goals of donors. Authors mainly point out enhancement in credibility as the reason for this improvement. Though this research has several limitations like deficiency of control variable, general equilibrium issue etc. still it is quite an eloquent finding. Dunning (2004) also has confirmed that end on cold war reduces the tension and shift much of the US foreign aid from security type investment to more ideological, economic and more efficient allocation. Wright and Winters (2010)

have reported similar findings that cold war reduces the inclusiveness of politics in aid. However, they have viewed politics as both exogenous constraint (causal link with aid and growth) and endogenous factor (politics affected by aid). Largely, strategic goals of aid are reducing but still exist. This high degree of strategic goals resulted in inefficiency, as donors were reluctant to maintain strict conditionality and performance-based aid issuance and maintenance.

Figure 1: Inflated aid as a percentage of total bilateral aid of EU countries



Source: CONCORD Aid Watch 2013, www.aidwatch.concordeurope.org.

Figure 1 exhibit level of inflated debt as percentage of total bilateral aid provided by the EU states in 2013. It is evident that many of the big contributors of ODA including France and Germany have distributed a quarter or more bilateral aid as inflated aid. The definition of “inflated aid” include debt relief, tied aid, spending on students and refugees in the donor country, and repayments of interest on concessional loans and future interest on cancelled debt which is not genuinely contributed to the development of developing countries. Conditionality and strategic goals of foreign aid thus hindering the aid effectiveness.

Lack of Coordination among Donors: Fight for the Market

It is well researched and evident that effectiveness of aid largely constrained by the lack of coordination among the donors. In the search for the reasons behind this problem, Fuchs et al. (2015) have found that there is a strong competition exists among the donors for capturing the recipients’ market (the export market for the donors). Besides that, donors usually compete with each other for political support. These competitions for export market and political support has been deriving aid from social infrastructural investment and altruistic spirit. Öhler (2013) has also confirmed this egocentric attitude of the donors, especially for bilateral donors. He extended the topic further by the inclusion of NGO and found that NGOs have coordinated aid in sectoral (i.e. regional, similar in type etc.) level. But they failed to bring coordination among donors and inter-sectoral level. Another reason for this lack of coordination has posed by Rahman and Sawada (2012). They have argued that self-interest of donors bringing more donors in the play and creating proliferation or fragmentation problem. Obviously, coordination is tougher when there are larger numbers of donors with self-interest. It is also evident that higher fragmentation or proliferation makes the donors more inefficient (Knack and Smets, 2013). For instance, even after

performing poorly, Malawi had received significant amount of aid in the last decade due to the large number donors and lack of donors' coordination. This lack of coordination mainly creates a misallocation of the fund, free riding activity of recipients and increase the overhead cost of aid.

Divisive Role of Political Elites in Recipient Countries

Political elites in the recipient countries have played an important role in aid effectiveness. Interaction between policy and aid effectiveness is obvious. Alongside, political elites also play a crucial role in policymaking process. Several decades after large aid disbursement, it is evident that aid exerts an inequality increasing effect in recipient countries (Herzer and Nunnenkamp, 2012). Several other convincing researches confirm the prevalence rent-seeking activities in aid programs (Bjørnskov, 2010; Angeles and Neanidis, 2009). This rent-seeking activity is hampering the objectivity and causing fungibility in aid programs. Furthermore, in some cases, political elites simply believe that they have given a sufficient effort in poverty alleviation (Hossain, 2005). This reluctant attitude of recipients is also resulting into the low aid performance. Furthermore, political elite - especially in democratic countries- commonly show high pledge towards popular choice. Thus, they usually go for those aid-funded programs, which help them to get re-elected and extend their time in the office rather taking socially, environmentally and economically sustainable projects. As a result, probably, aid does not lead to a virtuous circle of development and recipients fail to move out from the poverty trap (Carter and Temple, 2014). Using their political influence and higher capitalization, political elites creates an obstacle between the justified recipients of aid and aid program, thus reap the benefit of foreign aid. However, donors could reduce the rent-seeking activities of political elites by getting into a binding policy commitment i.e. donors will give aid only in the existence of good policy environment in the recipient country (Svensson, 2000).

Interplay between politics and aid is quite vast and multifaceted and it is tough to explore every layer of it. Some of the political dimensions that are greatly verified and contemporary in nature are presented in previous few paragraphs. However, foreign aid is only a component of the large system that controls the international foreign policy; still, it has quite significance and diverse use. Elements like trade market control, international resource control, dominance in international forums, regional geopolitics etc. have simultaneous interaction with foreign aid. Moreover, recipients' own country level politics has also have some role in defining donor patron relationship, fungibility of aid fund, structural adjustment, economic reforms and changing social groups' characteristics. These diverse interfaces of aid don't really make aid completely worthless but less effective in many cases e.g. Afghanistan, Pakistan etc.

Concluding Remarks

Professionals of foreign aid arena have accused politics as one of the key reasons for less than expected aid performance. Due to political interest, sometimes core politics or

sometimes peripheral politics, donors have shown their reluctance in maintaining strict conditionality, lack of coordination among themselves and irrational policy in selecting recipients which eventually lead to ineffectiveness of aid. In recent decades, with more informed impact assessment, donors have changed their ways of aid allocation. As a result, aid performance in post-cold-war period is better than previous. However, the question still remains, do donor agencies have changed enough? Political economy is still playing a significant role in donors' sphere. Donors are still not performing as a welfare maximizer rather they are more motivated by self-interest while keep welfare as only one goal [...secondary goal] (Easterly, 2007). Furthermore, *power* relationship between donor and recipient plays an important role, where normally donors dictate as they have more power. However, in the recipient countries, there are lots of heterogeneity exist in objective and power relationship among various social and political groups. Overall, reality of political economy is deviating the goal of aid far from its perceived one. Nevertheless, for a better liveable world and make good use of taxpayer's money aid policy should be revisited based on functionality and objectivity.

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