

Towards Achieving the MDGs: Addressing Absorptive Capacity Constraints

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II. Building Absorptive Capacity

- What do we mean by absorptive capacity?
 - Distinguish aid effectiveness vs absorptive capacity.
 - § AE differs considerably between countries
 - § AC affects the returns to aid – the ‘slope’. As AC is lower, the incremental returns are lower.
 - § Every country runs up against diminishing returns
- Determinants of Absorptive Capacity:
 - Multidimensional concept -
 - § Macro (Dutch disease, price distortions – e.g. food aid)
 - § Institutional—administrative factors, (additional burden from lack of coordination)
 - § Governance – part of ODA does not reach intended beneficiaries,tivene

- § High ODA flows to meet social MDG requirements are likely to have bigger impact on the exchange rate
- § This is likely to shift resources away from export sectors, hurt the trade balance.
- § But this can be offset by productivity dynamic – key parameter that depends on using aid to improve business climate, infrastructure connectivity, and realize growth potential.

- **Governance**

- § Difficulty modeling or quantifying. Consider low rate of improvement in institutions and governance (eg. 2% annual efficiency gains).
- § Illustrate with U-shaped curve showing frontloading and total cost (PDV terms). U curve shifts downwards and flattens –productivity growth and substitution effects.

III. Conclusions:

- Importance of addressing AC in country PRSPs. Linked with medium term expenditure programs and capacity building efforts.
- Sequencing is key element – infrastructure → education → other MDG services with externalities.
- Macro imbalances very important– need for offsetting potential damage to the export sector.
- Role of donors to improve aid effectiveness through greater predictability of ODA flows, harmonization and alignment measures, and central importance of the Doha trade agenda.