

Towards Achieving the MDGs: Addressing Absorptive Capacity Constraints

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by

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Achieving the MDGs – key talking points

- The Millennium Project Report is proving a very valuable tool in helping to focus world attention on resource requirement, donor commitments, and strengthening aid effectiveness.
- There is widespread agreement that serious progress towards meeting the MDGs in low income countries requires moving away from ‘business as usual’. The key elements of this are
 - MDG-based Poverty Reduction Strategies – they must be more ambitious, have *strong country ownership*, and place Governments and civil society at the center.
 - Growth strategies must be a core component of the PRS. Without sustainable growth income-poverty targets will not be met. Should include:
 - Improving the business climate at center of PRS.
 - International trade liberalization agenda – Doha—critical measures by both OECD and developing countries.
 - Revisiting debt burden and mechanisms for debt relief.
 - Make aid more effective:
 - Key role of donors in harmonization and alignment to minimize ‘compliance costs’, align practices with recipient needs and strategies.
 - Key role of recipients in ensuring broad commitment to PRS strategy, and being publicly ‘accountable’ through strengthening governance and institutions.
 - Building absorptive capacity to use ODA effectively in countries where capacity constraints remain binding.
- The issue of absorptive capacity is a central question to highlight today.

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, accountability mechanisms weak, information flows back from end-users / recipients weaken delivery mechanisms
 - socio-cultural factors
 - AC is dynamic not static.
 - Key to have AC in place [2003 Development Committee report suggests many already do have sufficient capacity for a major increase in ODA] or to build it in tandem with ODA flows.
- Illustrating Absorptive Capacity -- examples from Ethiopia
 - **The Bank is working with GoE authorities** to provide analytic inputs for the national Needs Assessment and their strategic framework (SDPRP), to help clarify future MDG path and tradeoffs.
 - **Maquette for MDG Simulation (MAMS)** focuses on micro (sectoral) strategy linked to the national economy. Emphasis is on labor markets, infrastructure, and macro balances considered as the most important AC constraints in Ethiopia.
 - **Infrastructure**
 - Key to ‘network effects’, growth, and to meeting MDG 1
 - There is a strong case for front loading infrastructure to capture productivity effects.
 - **Labor market constraints**
 - Meeting the MDG2 requires trained teachers, but capacity to delivery is constrained in short run.
 - Consequence of accelerating (front-loading) is opportunity cost of skilled labor in other uses (private sector), bids up real wages, slows growth, reduces incomes.
 - Consequence of moving too slowly is will not have skilled labor to deploy through economy over time.
 - **Macro-economic**

- 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.