PART III

Chapter 14

Making international development co-operation “smart” enough to end poverty

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In the fast-evolving landscape of development financing, this chapter asks “What role now for official development assistance?” For many years, it has made a difference for millions of people all over the world – will this continue to be the case in the future given the economic crisis in Europe, the rise in private sector development finance, the growing reliance on domestic taxes to fuel development, and the strengthening role of co-operation among countries of the South? The answer to the question is yes, but only if aid gets “smart”: in other words if it’s effective, well-targeted (to the poorest countries and communities) and well co-ordinated. The author outlines key steps for making aid (official development assistance or ODA) smart enough to help the global community end poverty. These include ensuring that development assistance adapts nimbly and effectively to the needs, challenges and priorities that will define the post-2015 development framework; establishing a new development finance framework that brings together all the options provided by OECD countries – not only ODA; and holding each other accountable through an internationally recognised, open and transparent system to report on and publicise development financing efforts and the resources that actually flow to developing countries.
As the development community prepares for 2015 and the expiry of the Millennium Development Goals, we can look back at some impressive achievements over the past two decades. Foremost among these is our success in halving absolute poverty. Yet as we look forward, a new set of global challenges – security, climate change, health and migration, to mention a few – is clearly defining the horizon.

Above and beyond this, there is the remaining challenge of the 1 billion people who continue to live in extreme income poverty. Yet the locus of global poverty has shifted from low-income to middle-income countries (Chapter 1), and this creates new challenges for targeting and reaching the poor, and for maintaining political support in donor countries for doing so.

As the centre of economic growth shifts east and Africa aspires to make this century Africa’s century, domestic resource mobilisation – or tax – is becoming widely acknowledged as the foundation for financing national development. Concessional development finance is no longer the key instrument for national development; non-concessional lending from both public and private sources has increased significantly over recent years and is now playing an important role. Southern countries who provide resources, technology and knowledge to other Southern countries (a process known as South-South co-operation, see Chapter 16, Global approach 3) are becoming major economic powers, as well as players in the development financing arena.

Does all this mean that public concessional finance has become irrelevant, or does it still have a role to play? For many years it has made a difference for millions of people all over the world in the fight to eradicate poverty, disease and hunger and to address development challenges such as conflicts, disasters, good governance and equality. Will this continue to be the case in the future?

Official development assistance (ODA) – concessional public financial flows that have development as their main objective – is under threat as it is becoming increasingly challenging to sustain the political support it needs. The past two years have seen a small, yet significant, decline in ODA. This is primarily the effect of the continuing economic crisis in Europe, which has also fuelled deepening questions about the continued justification for ODA in the changing global environment. All of this has translated into growing pressure for these funds to be ever-more effective – for smart aid.

All in all, this is a healthy move: from seeing ODA as the main solution to global development challenges to today’s more realistic assessment of it as one of several tools in the development toolkit. Yet it should not prematurely be written off as a tool of the past. What’s needed is a facts-based discussion about where ODA will still be useful, and what it will take to make it more effective.

What has been learned over time? Has ODA adapted to continuously changing development challenges – has it shown itself to be “fit for purpose”? What has made ODA effective? What are the factors that will characterise smart aid in the future? These questions are ever-more pertinent as the world prepares to reshape the scope and thrust of a renewed global partnership for development beyond 2015.
Smart aid adjusts to changing needs, opportunities and challenges

Though the basic concept of ODA has remained largely unchanged since 1972, its use has changed substantially, responding flexibly to emerging needs and priorities. As new challenges have emerged – such as devastating famines, war and conflicts, debt crises, debilitating diseases, sudden geopolitical transformations, and now the effects of climate change – OECD Development Assistance Committee (DAC) members – the countries who provide the majority of ODA – have adapted their support accordingly. As we look to the future, it is possible to identify critical areas where ODA can continue to make a difference. Having an impact on all of the areas identified below will be essential if the world is to end poverty.

A great deal more money will be needed to deal with climate change

By 2020, USD 100 billion a year must be found from public and private sources to tackle climate change

The impact of climate change on health, food security, infrastructure and livelihoods will be felt strongly in the developing world, particularly in the poorest countries. At the 2009 United Nations Climate Change Conference in Copenhagen, developed countries committed to mobilising USD 100 billion a year from public and private sources by 2020. Figure 14.1 shows a major increase in funding for climate change, which peaked in 2010 – just after the Copenhagen Accord – at USD 22 billion. Statistics for 2010 indicate that more than two-thirds of climate change ODA in that year was targeted at reducing greenhouse gas emissions (mitigation), driven by Rio Convention commitments in the energy, transport, water, forestry and environmental sectors. The People’s Republic of China, India, Indonesia, Turkey and Viet Nam have been important partners for this support over the past decade, accounting for 35% of the total. Support for climate change adaptation is growing quickly, reaching approximately USD 8 billion in 2010 spread over a larger share of partner countries.

Figure 14.1. Trends in ODA for climate change, 2002-11
Biannual averages for bilateral commitments, USD billion constant 2010 prices

Mitigation/adaptation – upper bound estimate (principal+significant objective)
Mitigation/adaptation – principal objective
Share of upper bound estimate in total ODA (right axis)

Note: DAC countries only started reporting data on ODA for climate change adaptation in 2010.
StatLink http://dx.doi.org/10.1787/888932895729
To meet the challenges of climate change, substantial new financial resources will be required – from private investments to new forms of taxation. ODA for climate change will also continue to be important, but it will need to be smart – using innovative mechanisms to attract other finance and to create the systems and capacity for monitoring and assimilating these resources in diverse developing country settings.

**Support to fragile states is fundamental for eradicating poverty**

In 2010, nearly 40% of all government-to-government ODA went to fragile states.

The past two decades have seen the rise of conflict and fragility as major global concerns, with serious implications for poverty eradication (Chapter 16, Global approach 4). Between 2000 and 2010, support from DAC members to fragile states more than doubled – from USD 20 billion to USD 50 billion – reaching 38% of all ODA given by DAC countries (Figure 14.2). This support is fundamental for addressing global poverty: in 2010, these countries accounted for one-third of the world’s poor and by 2015 they are projected to be home to half of them, particularly in sub-Saharan Africa (OECD, 2013). Many argue that this is where the main future use of ODA should be. The OECD-DAC is working with the New Deal for Engagement in Fragile States (International Dialogue on Peacebuilding and Statebuilding, 2011) to ensure that ODA is used effectively in the particularly challenging conditions that prevail in these countries.

![Figure 14.2. ODA to fragile states and as a share of total ODA, 1980-2010](http://dx.doi.org/10.1787/888932895748)

1. Countries classified as fragile states in 2012.

**Poverty eradication means balancing social and economic policies**

Over the past 20 years, ODA allocations have shifted notably between the economic and social sectors in response to changing political priorities. A strong and sustained upswing in donor support for health, education and other social issues was powered by growing international concern about these spheres after the 1995 World Summit for Social Development and, subsequently, the launch of the Millennium Development Goals.
parallel, support to agriculture, infrastructure and the productive sectors fell – from 44% to 20% of total ODA – between 1990 and 2007. This was prompted by a range of factors, including mixed experience with previous investments in these sectors and questions about the role of public investments in productive activities. Over the last few years, a growing recognition of the importance of economic growth and food security for poverty reduction and development progress has led to a welcome rebalancing (Figure 14.3). In the future, careful consideration needs to be given to the long-term nature of social sector development when allocating development finance, focusing on needs such as developing the core state capacity for delivering public goods.

It is important to target the neediest

Providers of ODA have historically given priority to the poorest of the poor. Figure 14.4 shows that the share of ODA going to low-income countries rose from the mid-1980s to the mid-1990s, when it peaked at approximately 55% of total ODA. Since then, however, it has followed a variable but declining trend. This reflects the fact that a large number of countries have “graduated” from the status of low to middle-income country; most of the ODA to middle-income countries has been targeted to the poorest segment of these countries.

Figure 14.4 shows that since 2008, ODA to low-income countries (which today comprise 36 countries) has been around 30% of total ODA. Within this group, however, there are some countries which are not receiving enough ODA to meet their needs. The existence of under-aided countries – or “aid orphans” – results largely from donors’ uncoordinated allocation practices: one donor rarely takes into consideration how other donors allocate their ODA when making their own decisions.

Nine countries – from Bangladesh to Togo – are “under-aided”, receiving too little ODA to meet their needs

To address this vacuum, the OECD-DAC has developed a methodology for identifying potentially under-aided countries and monitoring assistance to them. The most recent analysis (using 2010 data) finds that nine countries – Bangladesh, Burkina Faso, Gambia, Guinea,
Madagascar, Malawi, Nepal, Niger and Togo – are under-aided according to allocation criteria that look both at a country’s needs and at its performance in managing its economic policies (OECD, 2012). This analytical tool will help us better target ODA, making it smarter still.

**Smart aid can tap new resources**

While traditional development finance, notably ODA, will continue to be important, there is now agreement that extra financing will be needed for sustained development in the majority of poor countries. The challenge for smart aid is to provide ODA in ways that will stimulate additional resources for development. Using aid to strengthen tax collection systems, for example, can capture home-grown resources for development (Box 14.1). ODA can also be used to encourage foreign investment, engage the private sector and encourage the types of innovative financing mechanisms described below.

For example, through the advance market commitment, public concessional finance has been used to encourage pharmaceutical companies to engage in the development, production and distribution of specialised vaccines. By issuing bonds against legally binding future ODA commitments, the International Finance Facility for Immunisation has been able to “frontload” development assistance for immediate investments in global immunisation campaigns. A range of other innovative approaches for catalysing additional resources for development – such as lotteries, international levies, international taxes on carbon and others – offer promising options for financing development in the future (OECD, 2011a).

As financing mechanisms for development diversify, however, there is a growing need to understand how flows and types of finance relate to each other and how synergies can be enhanced. The development community also needs to understand more about how public financing instruments can encourage additional resources. Can smart aid catalyse more private investment that is good for development? Can it bring on board additional money when combined in an overall financing package? The OECD DAC is looking closely at how various financial instruments interact – and how to make them work more effectively, separately or in tandem.
III.14. MAKING INTERNATIONAL DEVELOPMENT CO-OPERATION “SMART” ENOUGH TO END POVERTY

Smart aid partnerships have more impact and value for money

Smart aid is quality aid. The question of how to ensure value for money is not new. From experience, the development community knows a lot about how to deliver development assistance so that it has the greatest possible positive impact on poverty. Yet putting this knowledge into practice often calls for politically challenging reforms which development assistance agencies and ministries may be reluctant to implement for fear of undermining public support. For example, when DAC members committed to the Paris Declaration on Aid Effectiveness in 2005, they agreed to provide aid directly to developing countries’ own financial and budgeting systems, rather than setting up separate programmes and structures. The idea – grounded in evidence – was that channelling funds through a country’s own system helps to build administrative and financial management capacity. Despite this knowledge and commitment, however, the 2011 Survey on Monitoring the Paris Declaration (OECD, 2011b) showed that donors are still not systematically making greater use of these systems, even when countries have taken steps to improve them and make them more reliable.

Box 14.1. How smart aid can help developing countries claim taxes from multinationals

Multinational companies use a technique known as transfer pricing to reduce their overall tax burden by positioning their profits in low-tax countries. This deprives the host country of essential tax revenues. But it can also have much wider implications: tax avoidance by high-profile corporate taxpayers can be perceived as unfair by citizens, undermining the legitimacy and credibility of the tax system; this, in turn, can discourage compliance among all taxpayers.

To help address this problem in Colombia, the OECD Tax and Development Programme implemented a capacity development project for tax administrators at a cost of approximately USD 15 000.

The increased tax revenues collected by the local authorities led to a 76% increase in tax revenues – from USD 3.3 million in 2011 to USD 5.83 million in 2012. This represents a rate of return of approximately USD 170 of revenue for every dollar spent. A similar capacity development project in Kenya enabled the local tax authorities to negotiate a transfer pricing adjustment resulting in additional tax revenues of USD 12.9 million – a rate of return of approximately USD 1 290 of revenue for every dollar spent.

Partnerships can strengthen public institutions

People in developing countries need to play a central and systematic role in making policy decisions and setting priorities. Their governments, likewise, must have strong public financial systems and ensure that agreed activities are implemented. Effective public institutions and systems not only improve the contribution of development assistance; they also help to ensure that all resources have a positive, sustainable impact on people’s lives. The OECD DAC has been instrumental in facilitating progress and understanding in the use of country systems, which has led to the Effective Institutions Partnership. It has also been monitoring the quality of procurement.

Donors are still not using partner countries’ own systems despite the many benefits of doing so
Predictable and well-targeted aid is essential for productive partnerships

The focus of the post-2015 development framework needs to be squarely on the benefits aid actually generates for partner countries, especially the poor. More predictable ODA brings greater benefits because it enables partner governments to plan ahead for key public expenditures – for example on health care, education, and infrastructure such as roads and railways – that take some time to implement. To help with this, the DAC has developed a tool for monitoring how predictable ODA is. Known as the Survey on Donors’ Forward Spending Plans, it has encouraged DAC donor countries to reform how they manage their aid (see Part IV).

Clarity about the magnitude of ODA that actually reaches a partner country and is readily available for investing in development priorities is also essential for better results. The forward spending survey makes it possible for development countries to readily see the resources they receive because it tracks a subset of ODA – “country programmable aid” (CPA)⁴ – rather than what donors spend on aggregate ODA (this latter figure includes administrative and other costs in the donor’s own country).

Partnerships based on trust and transparency work best

When developing countries obtain detailed and timely information on development financing and activities, development efforts can be made more effective and efficient. The recent trend for open data has shown that free, public, easily accessible and usable data improves the performance of local governments and implementing agencies, resulting in better policies and decision making. Transparency is also fundamental for building trust among partners. While the OECD DAC has long been recognised as the major provider of measurable, comparable and high quality statistics on ODA and other flows of development finance, there is still room for improvement. The OECD DAC is working to improve the frequency, timeliness and detail of reported data, and expand the number of donor countries and agencies that are included in its databases.

Partnerships with no strings are transparent and provide value for money

In 2001, the OECD DAC recommended that donor countries “untie” ODA to least developed countries (OECD, 2001). Untied aid is money that does not tie or oblige the partner country to procure services from companies based in the donor country. Why is this important and what does it mean for poverty eradication? Aside from improving transparency, untied aid ensures greater value for money – it has been shown to lower the cost of goods, services and works by 15% to 30% on average. Untied aid also improves countries’ ownership of their own development plans and objectives. Between 2001 and 2010, total untied aid as a portion of total ODA rose from 45% to 75% (Figure 14.5 and see Part IV).

Conclusions

To end extreme poverty in the next generation, development assistance needs to adapt to emerging challenges and priorities. To do that, it needs to be smart. What steps can the international community take to ensure high-quality, smart aid?

● In the post-2015 framework, development assistance will need to renew its focus on eliminating extreme poverty and reducing inequality both within and between countries. It will also need to respond to new challenges linked to sustainable development and delivery of global public goods. It will be important that in the post-2015 era a single,
unified financing structure is agreed by the international community to fund global
development, sustainable development and the environmental challenge (Chapter 11).

- Strategic and collaborative work with a range of development partners is needed to
  identify and develop new, innovative mechanisms to leverage, mobilise and catalyse
  additional resources for development. It is also fundamental to ensure that taxpayers in
  OECD countries remain willing to provide “smart aid” to those who need it most.

- Prioritise ODA to the poorest countries – where it is most difficult to mobilise other sources
  of finance – in particular to “under-aided” countries. As countries develop, ODA can be
  phased out – but in a predictable and gradual manner linked to the country’s ability to
  mobilise resources domestically, for example through higher growth and improved tax
  collection systems.

- Encourage dialogue and partnership among “old” and “new” providers of development
  assistance to learn from each other’s experience and respond effectively to the changing
  needs of developing countries.

- Develop a new development finance framework – one that takes account of the broad array
  of publicly-supported instruments and approaches provided by OECD countries that go
  beyond ODA. Understand better how these tools and mechanisms operate and how they can
  be improved, combined and enhanced – and this learning should be done in broad
  collaboration with others. It will be important to understand what the new development
  finance landscape means from partner countries’ perspectives and their motivations and
  strategies to manage the diversity of development finance options they can access.

- Hold each other accountable for commitments already made through an internationally
  recognised, open and transparent system to report on and publicise the development
  financing efforts that countries are making, and the resources that actually flow to
  partner countries.
Notes

1. Concessional loans are provided at far lower than market rates for countries of the South, for longer terms, and with conditions which allow grace periods for payments. Concessional financing is part of the responsibilities normally given to development agencies of various industrialised countries and to local and regional development banks (Blackwell Reference Online).

2. The United Nations Framework Convention on Climate Change (UNFCCC or FCCC) is an international environmental treaty negotiated at the United Nations Conference on Environment and Development (UNCED), informally known as the Earth Summit, held in Rio de Janeiro from 3 to 14 June 1992. The industrialised countries that signed the three Rio Conventions in 1992 committed themselves to assist poorer countries to tackle challenges they face in the areas of biodiversity loss, desertification and climate change (Source: Wikipedia).

3. An advance market commitment is a binding contract, typically offered by a government or other financial entity, used to guarantee a viable market if a vaccine or other medicine is successfully developed. As a result of such a commitment, the market for vaccines or drugs for neglected diseases would be comparable in size and certainty to the market for medicines for rich countries, enabling biotech and pharmaceutical companies to invest in the development of new vaccines to tackle the world’s most pressing health problems, such as pneumonia, diarrheal disease, HIV/AIDS, and malaria (source: Wikipedia).

4. CPA, or “core aid”, is much closer than ODA to capturing the flows of aid that actually go to partner countries and over which they could have a significant say. It excludes aid that is unpredictable by nature (such as debt forgiveness and emergency aid); entails no cross-border flows (such as research and student exchanges), and does not form part of co-operation agreements between governments (such as food aid or core funding to NGOs).

References


