Open Society Forum
Initiative for Policy Dialogue
Press Institute of Mongolia

DEVELOPMENT AID
IN THE 21st CENTURY

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Covering Economic Development
Ulanbataar, July 5-7 2005

Session objectives:

- Understanding background
- Limited development resources
- Increased bilateralism and the lack of a common global agenda
- Who benefits? Tied aid
- Investment priorities
- Instruments of development assistance – Familiarize with new concepts DBS, SAWps

= things to watch out

Background: Interest groups in development

Different interest groups/actors may not share the same goals in development:

- **GOVERNMENTS** *(good governance? Often pressed by interest groups)*
  - Ministry of Finance (de facto Ministry of Planning)
  - Other Ministries and Sector Agencies *(fight for budget)*
- **DONOR AGENCIES**
  - IMF, Development Banks *(Powerful since the 1980s - Respond to their Boards - Ministries of Economy/Finance/Central Banks – often not best for issues such as poverty, environment, etc)*
  - UN agencies
  - Bilateral donors
- **PARLIAMENT**
- **CIVIL SOCIETY (and NGOs)**
- **PRIVATE SECTOR**

⇒ The general objective of public policies is to defend the common public good, to serve the majority of citizens with attention to those in need

- Not serving institutions o vested interests (ie. influential groups/elites)

Development Aid in Perspective

- At the beginning of the 20th century, development aid still linked to the colonial system
  - Example - UK's 1929 Colonial Development Act which stated that the British Parliament should approve ten-year budgets on annual basis
- Development assistance not new idea – all empires invested in their colonies, benefiting more "developed" capitals than colonies
- **Bretton Woods Agreement: New post-war order,** UN international organizations (as we know them today) created
- **Marshall Plan:** In 1948 the US Congress approved the use of 2% to 3% of US Gross National Product (GNP) per annum to finance grants for the reconstruction of Europe, until 1953. It disbursed US$13 billion (or $87 billion in 1997 dollars) to 16 beneficiary countries => Good legacy of development aid being effective.

Development Aid in Perspective

1950s: Cold war

- Aid remained bilateral, linked to the commercial or political interests of the donor country.
- 1955: Non-Aligned Movement
- Latin American inward-development - Prebisch

1960s: Independence Colonies (1955-65) – need of Aid Assistance

- "Marshall Plan for the South" adopted by the General Assembly of the UN in 1960: 1% of the GNP of rich countries should be devoted to aiding the South
- "Green Revolution" to support the food needs of a growing population
- But weak results. Expenditure target (1% GNP) never reached. Problems of accountability (what are development expenditures?)

Development Aid in Perspective

1970s: "Second development decade"

- In 1969, a Commission led by the Canadian Prime Minister called for 0.7% of rich countries' GNP to be given in aid, excluding commercial loans and military expenditure => Adopted by all countries at UN General Assembly in 1970.
- But oil crisis led to even lower levels of aid, decreasing to an average of 0.29% of GNP
- However 1970s prolific from an intellectual point of view: critical assessments, new ideas for development aid. Major advances occurred in environment, social development, gender, income distribution/ redistribution, employment, human rights, basic needs approaches, among others.

1980s-90s: "The lost decades"

- 1982: Debt crisis – Interest rates up, commodity prices down
- "Washington Consensus"

"Washington Consensus"

A formula that proposed structural adjustments requiring:

- Anti-inflationary measures
- Cuts in public expenditures
- Privatization of public assets and services
- Financial and trade liberalization

Problems:

- Paying loans, containing inflation and building reserves (mostly in US$ bonds) – Are these the main development priorities of affected countries?
- Privatization – better affordable services?
- Human cost – UN Jolly: *"Adjustment with a human face"*
- Financial liberalization: Opening of current accounts causes increased vulnerability => Asian crisis 1997-98
- Trade liberalization – Promotes development?
- Most of the countries that developed after 2WW did not follow "Washington Consensus" (ie.Korea, Singapore, Malaysia, periphery Europe)

Developing Countries at the Beginning 21st Century

Transition Economies:

- Transition has not resulted in broad-based growth ("jobless growth")
- Poverty and inequality increasing, social indicators worsening
- Transition to democracy but civil unrest growing

East Asia:

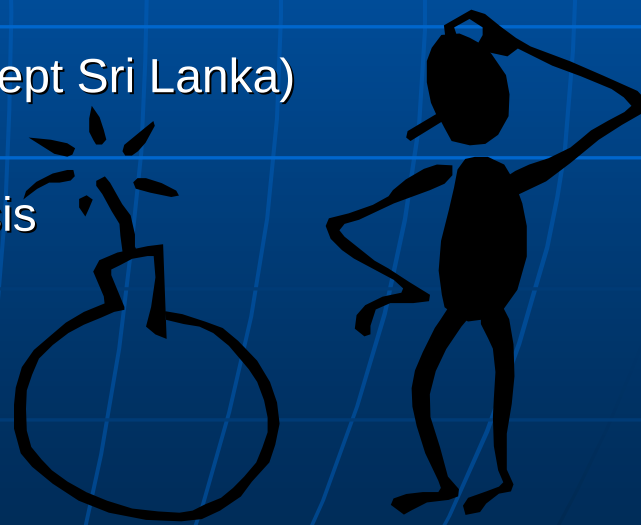
- Social and Economic Impacts of Asian crisis 1997-98
- Recovery but growth volatile
- China rising – Developing world unable to compete – ILO "The race to the bottom"

South Asia:

- Positive growth but highly unequal societies (except Sri Lanka)

Latin America:

- Higher growth but volatile, recurrent financial crisis
- Worsened social indicators



Africa:

- Limited growth, social indicators worsening

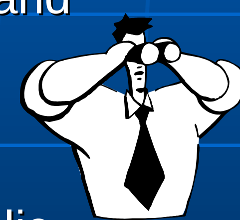
Middle East ...

=>STILL ½ OF THE WORLD POPULATION LIVES BELOW $2 POVERTY LINE

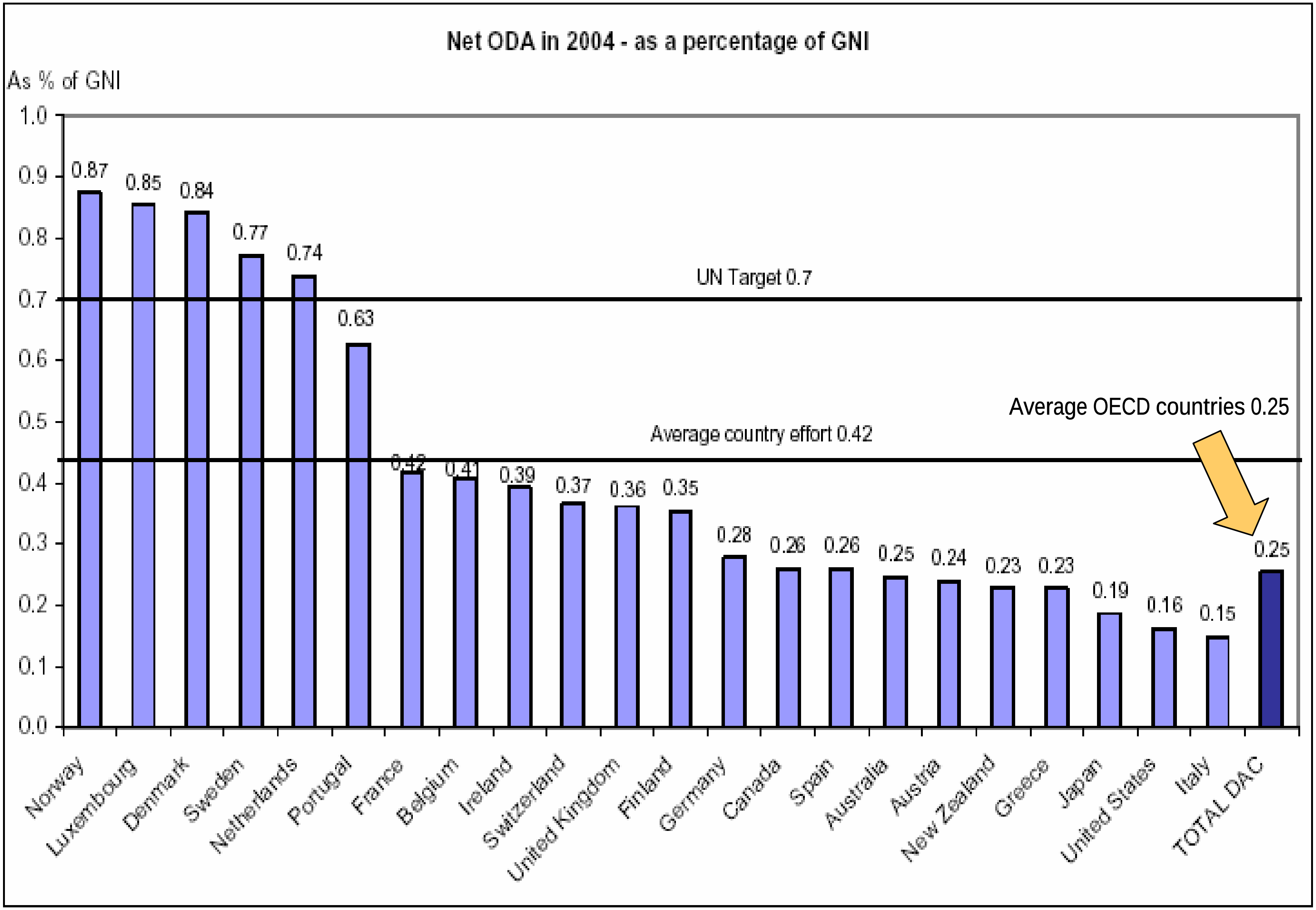
Development Aid in the 21st Century

A. Limited development resources:

- **Transfers from OECD to developing countries:**
  - **0.25% of GNI (not even half of committed 0.7%)**
  - Early 1990s contributions were 0.32% of OECD's GDP as an average
  - Reduction in ODA seems to come from a fatigue of the limited effectiveness of development aid = did not contribute sufficiently to reduce poverty or to create sustainable conditions for economic development
  - Donors also fatigued of corrupt governments -- Good governance and egalitarian policies a precondition of aid



- **Lack of adequate domestic taxation policies:**
  - Debate: why should middle classes in OECD countries pay for public expenditures in developing countries, when the rich local elites (and corrupt, some argue) are not properly taxed?
  - Neoliberal underpinnings of the 1980s-90s (and of current conservative governments) disliked issues such as taxing the wealthy
  - Topics like redistribution, fighting corruption, tax evasion and tax heavens have only emerged recently in multilateral organizations



Source: OECD 2005

A. Limited development resources (continued)

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Private sector: Some argue that private sector will take over development aid – But no evidence:

- **80% of FDI flows go to only 13 "developing" countries:**
  - **Argentina**
  - **Brazil**
  - **China**
  - ***Hong Kong (developing?),***
  - **India**
  - **Indonesia**
  - ***Korea (?)***
  - **Malaysia**
  - **Mexico**
  - **Philippines**
  - ***Singapore (?)***
  - ***Taipei (?)***
  - **Thailand**

- Private flows are insignificant in the least developed countries of Africa and elsewhere.
- Private flows to developing countries have decreased since Sept. 11 and Afghanistan War.
- Private sector flows are not a replacement of development aid – but a complement

Total Net Flows from OECD Countries by Type of Flow

USD million

	1987-1988	1992-1993	1999	2000	2001	2002	2003
I. Official Development Assistance	43 834	58 318	53 233	53 749	52 435	58 292	69 029
1. Bilateral grants and grant-like flows	23 479	34 133	33 931	33 040	33 522	39 813	50 965
of which: Technical co-operation	9 043	13 279	13 036	12 767	13 602	15 452	18 366
2. Bilateral loans	6 956	6 756	3 912	3 024	1 602	939	-1 153
3. Contributions to multilateral institutions	13 399	18 364	15 390	17 685	17 311	17 540	19 217
of which: UN	3 251	4 425	3 654	5 185	5 233	4 634	4 705
EC	2 275	4 207	5 017	4 950	4 946	5 695	6 834
IDA World Bank	4 762	5 636	2 834	3 672	3 599	3 279	3 120
Regional development banks	1 897	2 450	1 860	2 187	1 491	1 813	1 734
II. Other Official Flows	3 022	8 567	15 589	-4 326	-1 589	- 45	-1 127
III. Private Flows at market terms	21 491	49 803	115 999	78 128	49 745	6 252	30 481
1. Direct investment	21 202	33 309	94 314	71 729	66 041	36 286	36 660
2. Bilateral portfolio investment	319	18 396	25 575	2 416	-14 946	-26 902	-6 611
3. Multilateral portfolio investment	2 033	-2 297	-5 786	-3 369	-4 086	-3 146	635
4. Export credits	-2 064	396	1 896	7 352	2 736	14	- 203
IV. Net grants by NGOs	4 123	5 848	6 715	6 934	7 289	8 765	10 162
TOTAL NET FLOWS	72 470	122 539	191 536	134 485	107 881	73 263	108 545
Total net flows at 2002 prices	87 226	119 083	182 612	134 043	112 019	73 263	95 956

Source: OECD, 2005

A. Limited development resources (continued)

Monterrey development conference (2002)

- Donors reconfirmed their commitment to contribute 0.7% of GDP
- Developing countries agree to mobilize domestic resources

In view of the lack of results, at the initiative of President Lula from Brazil, a 2004 meeting of world leaders (not US, not Japan) pronounced the Action Against Hunger and Poverty Declaration to identify new sources of development finance.

1. A tax on global negative externalities, such as arms sales, pollution, and destabilizing cross border speculative financial flows (the so-called TobinTax)
2. The creation of an International Financial Facility
3. The issuing of new Special Drawing Rights (SDRs)
4. Concerted international action to fight tax evasion and tax heavens
5. Increase voluntary donations using new methods (percentage of credit card sales, lotteries, etc)
6. Improvements in the portfolio of ethical social equity funds
7. Increased remittances from overseas workers, in order to complement limited development resources

B. Increased bilateralism and the lack of a common global agenda

ODA 2000-2003:

- 64% is bilateral (with an upward trend)
- Only 36% given to multilateral institutions like the UN agencies and the development banks (and the trend is to remain cutting contributions to them)

Powerful countries don't agree on a common agenda => worrisome!

- Global problems like the environment or fighting tax evasion, require global solutions
- Moving towards smaller bilateral deals may benefit donor countries (in terms of political or economic influence), but -- benefits developing countries? Critics argue 21st century starts with a return to neo-colonialism
- Multilateralism better from point of view of transparency and defense of public interests in world's policy-making
- Urgent need of better global governance

B. Increased bilateralism and the lack of a common global agenda (continued)

Additionally, multiplicity of donors creates problems for governments in developing countries

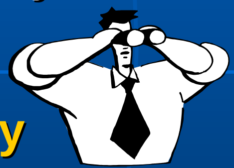
- High transaction costs: different procedures and mechanisms to identify, plan, implement, monitor and evaluate its activities, and different reporting requirements => lot of time and paperwork for government officials!!
- Each donor has its own policy priorities, often contradictory to other donors = inconsistent policy reforms
- Frequently, donors use a joint-piecemeal approach, splitting areas of intervention among them, leaving governments with unbalanced support in the different areas
- Donor agencies have their own disbursement processes; sometimes their funds are unreliable, disbursements are delayed and programs discontinued

⇒ **Aid Harmonization and Alignment Initiative (DAC, 2003) to improve situation**

- **New aid instruments are being created to pull funds together under the same roof: Sector Wide Approaches, Direct Budgetary Support etc following common strategy outlined under PRSPs**
- **This is a positive attempt to patch-up the problem of increased bilateral aid**
- **Global vision still missing**

C. Who benefits? Tied Aid

- **Tied aid means that development funds are given with the condition that all goods and services have to be procured exclusively from the donor country, no matter the price**
  - Colonial powers used to do this with their colonies
  - Marshall Plan to post 2WW Europe was tied aid.
- **World Bank calculates that tied aid causes the loss about 25% of aid, given that cheaper and better quality goods and services could likely be bought in the international market**
- **=> Tied aid is a de-facto subsidy to companies in the donor country**



- **Unacceptable in the case of loans which the poor country must repay - taxpayers in poor countries should not be supporting companies from rich developed countries!**
- In 2005, only few countries have fully untied their aid contributions - Finland, France, Germany, Ireland, Japan, the Netherlands, Norway, Portugal, Sweden, Switzerland and the UK.

D. Investment priorities: The development agenda

- Main aid recipient countries (2000-03) are D.R. Congo, Indonesia, Viet Nam, China, Pakistan, India and Serbia-Montenegro. 2004 – Irak
- Recipient countries tightly Linked to economic and political interests of the world's main powers
- OECD/DAC statistics: Main recipient sectors (2000-03) are:

  - Social investments such as education, health, social protection or wate 32% of the total investments, with an upward trend;
  - Economic sectors like transport and energy, 10%, decreasing trend;
  - Post- conflict and emergency assistance, 8%, upward trend
  - Agriculture, 4% downward trend
  - Others 56% (Finance?) [-- *Problem of different national classification systems, difficult to aggregate data!]*
- This shows a difference from the 1980-90s when structural adjustments priority => Because of Millennium Development Goals (MDGs) and Poverty Reduction Strategy Papers (PRSPs)

D. Investment priorities: The development agenda

RECAP: Priorities of development aid have changed over time

- 1950s – infrastructure
- 1960s - civil works remained top together with agriculture, the "green revolution"
- 1970s - social development topics introduced
- 1980s-90s - structural adjustments after the debt crisis - the "Washington Consensus"
- Late 1990s
  - poverty reduction (PRSPs)
  - debt relief (HICP)
  - governance (good public management)
  - the environment (sustainable development)
- Changes due to Wolfowitz presidency at the World Bank?

Millennium Development Goals/Targets

1995 World Social Summit, adopted by UN General Assembly in 2000

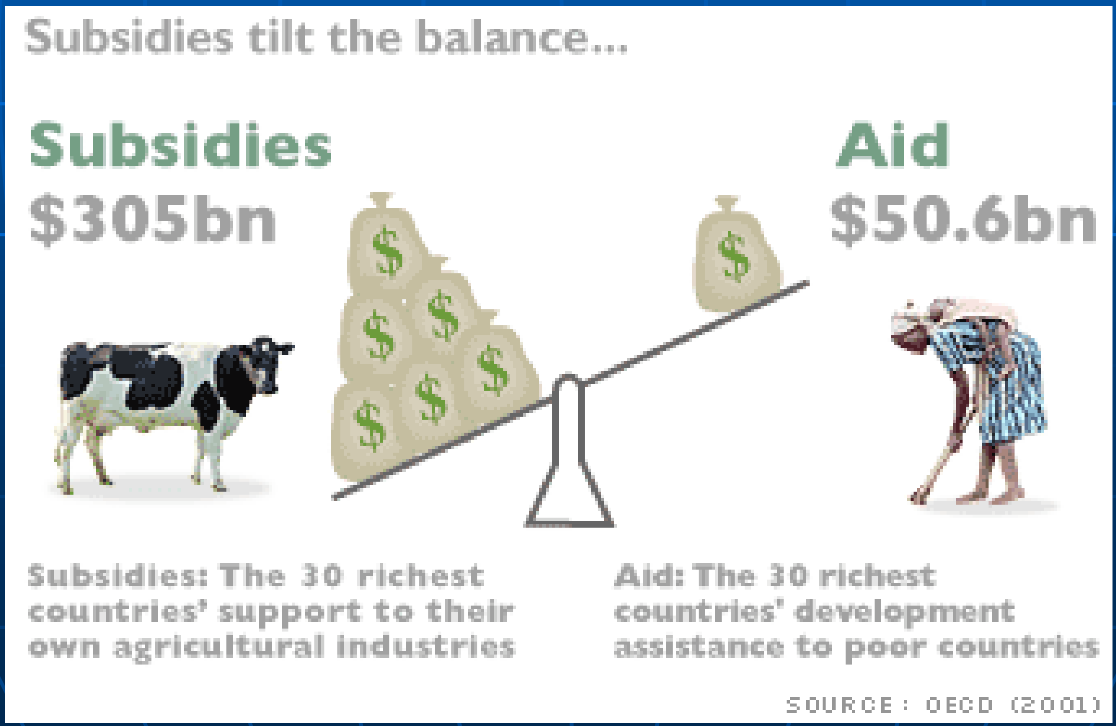
GOALS	TARGETS by 2015
1. Eradicate extreme poverty and hunger	Reduce by half the proportion of people living on less than a dollar a day Reduce by half the proportion of people who suffer from hunger
2. Achieve universal primary education	Ensure that all boys and girls complete a full course of primary schooling
3. Promote gender equality and empower women	Eliminate gender disparity in primary and secondary education preferably by 2005, and at all levels by 2015
4. Reduce child mortality	Reduce by two thirds the mortality rate among children under five
5. Improve maternal health	Reduce by three quarters the maternal mortality ratio
6. Combat HIV/AIDS, malaria and other diseases	Halt and begin to reverse the spread of HIV/AIDS Halt and begin to reverse the incidence of malaria and other major diseases
7. Ensure environmental sustainability	Integrate the principles of sustainable development into country policies and programes; reverse loss of environmental resources Reduce by half the proportion of people without sustainable access to safe drinking water Achieve significant improvement in lives of at least 100 million slum dwellers, by 2020
8. Develop a global partnership for development	Develop further an open trading and financial system that is rule-based, predictable and non-discriminatory. Includes a commitment to good governance, development and poverty reduction—nationally and internationally ▪Address the least developed countries' special needs. This includes tariff- and quota-free access for their exports; enhanced debt relief for heavily indebted poor countries; cancellation of official bilateral debt; and more generous official development assistance for countries committed to poverty reduction ▪Address the special needs of landlocked and small island developing States ▪Deal comprehensively with developing countries' debt problems through national and international measures to make debt sustainable in the long term ▪In cooperation with the developing countries, develop decent and productive work for youth ▪In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries ▪In cooperation with the private sector, make available the benefits of new technologies—especially information and communications technologies

Poverty Reduction Strategy Papers (PRSPs)

- PRSPs are planning documents that focus policy-making on poverty issues.
  - The PRSPs analyze the causes of poverty in a country
  - Identify the country-specific development priorities to reduce poverty
  - Participatory process with input from government, civil society organizations and development partners
- From a poverty reduction point of view, 1st wave of PRSP very positive – but can and should be improved.
- Second wave of PRSPs needs to better incorporate:
  - Participation processes: PRSPs designed to bypass non-participatory policy-making. The problem of "policy without politics".
  - Trade missing or very weak analytical section ("Washington consensus" orientation = free trade). Only 4 world PRSPs "deviant" from neoliberal free trade approach:
    - **Ethiopia - The Agricultural Development Led Industrialisation (ADLI) programme advocates the use of protection with offsetting policies for exporters.**
    - **Rwanda - Subsidies for coffee production.**
    - **Vietnam - Anti-dumping tariffs as a means to counter 'unfair competition'**
    - **Zambia - Emphasis on Export Promotion Zones (EPZs) (WB considers them failure in Africa)**

The hypocrisy of the absence of trade in aid

- Institutional Problem: Trade not in development aid/PRSPs because not traditional territory of development banks + bilaterals. Bretton Woods => GATT and later WTO. But WTO no concern (or very limited) on poverty reduction.
- Main issues: Subsidies and protection in OECD countries, dumping, market access, falling prices of commodities vs. manufactures, absence of labor and environmental standards, free trade and competition China.
- Not *free* trade but *fair* trade, a system that discriminates in favor of developing countries, ensuring that all countries have a role in the world economy.



E. Instruments of development assistance: grants vs. loans, projects vs. budget support

Aid can be provided as:

- **Grant -** Preferable for a country as it does not generate debt
- **Loans –**either commercial or concessional interest rates (preferred for a country)
  - As a reminder, most Third World debt was not to multilaterals, but to private banks [irresponsible borrowing and also lending] – but debt transferred to IMF/WB in countries under HIPC initiative for debt relief.

Aid can be provided as PROJECT or DIRECT BUDGETARY SUPPORT (DBS)

- **Projects (ie. constructing a hospital or road) decreasing trend**
- **Harmonization initiatives => trend towards increasing DBS**

Aid instruments: Types and characteristics

MORE TRUST GOV'T

INSTRUMENT	TYPE	CONDICIONALITY	RESTRICTED FUNDS?	ACCOUNTABILITY Y AUDITING
BALANCE OF PAYMENTS SUPPORT		MACRO	NO	NO
GENERAL BUDGET SUPPORT Ex: PRGF Ex: DEBT RELIEF (HIPC)		MACRO, PRSP & BUDGET (MTEF)	NO	GOVERNMENT but DONORS CLOSELY MONITOR MTEF + BUDGET EXECUTION
SECTORAL BUDGET SUPPORT		PRSP & BUDGET (MTEF) & SECTORAL STRATEGY	SECTOR	GOVERNMENT but DONORS CLOSELY MONITOR MTEF + BUDGET EXECUTION
SECTOR WIDE APPROACH (SWAP)		PRSP & SECTORAL [MTEF PREFERRED]	SECTOR	GOVERNMENT but DONORS CLOSELY MONITOR MTEF + BUDGET EXECUTION
PROJECTS USING PUBLIC SYSTEMS		SOMETIMES POLICY CONDITIONALIT'S	PROJECT	GOVERNMENT
PROJECTS USING PARALLEL SYSTEMS (NON-GOVERNMENT)		NO	TOTAL	DONOR
TECHNICAL ASSISTANCE		NO	TOTAL	DONOR

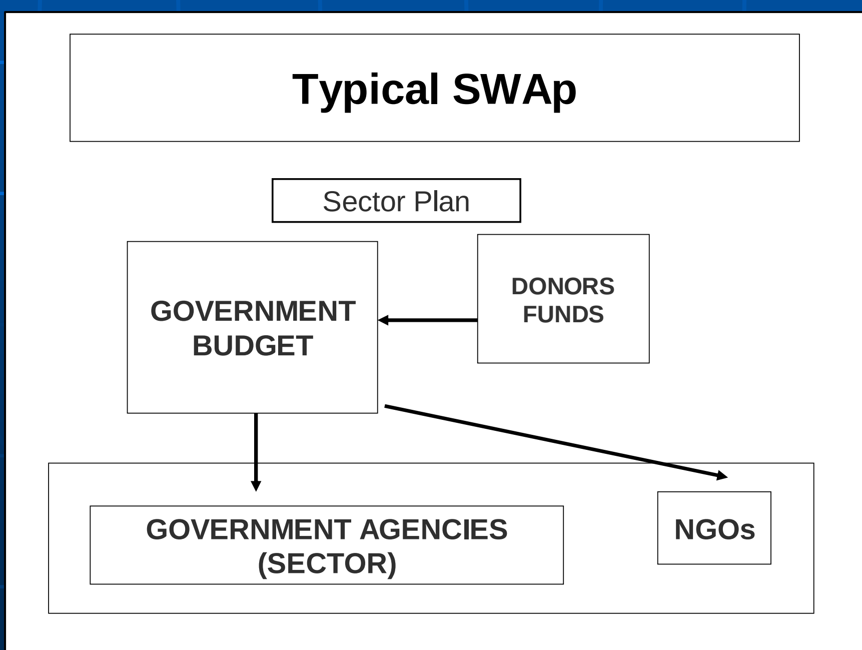
LESS TRUST GOV'T

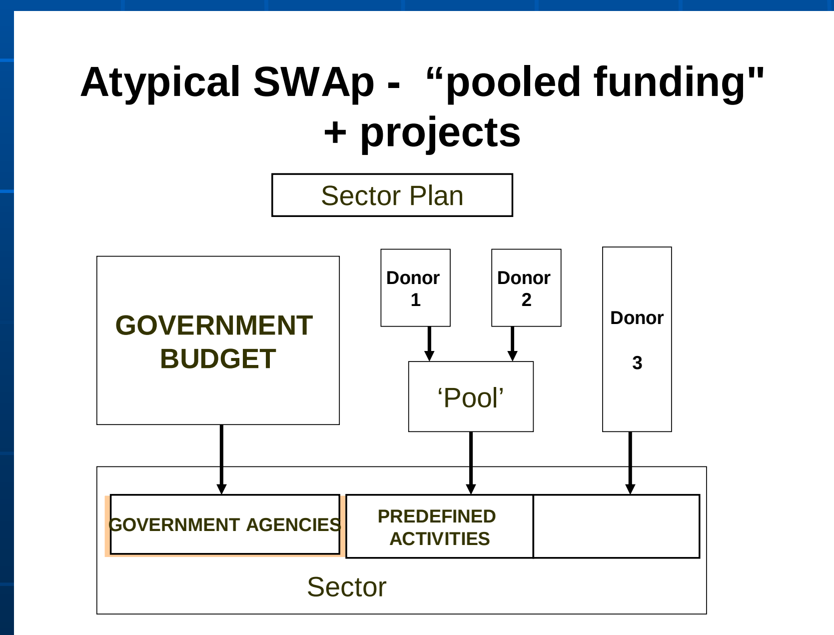
New Instruments: Direct Budget Support (DBS)

- **Once government and donors agree on policies ("conditionality") funds are transferred.** These tend to be:
  - PRSPs - Strategic planning tool for policy priorities
  - Medium Term Expenditure Frameworks (MTEFs) – to ensure that funds spent according to priorities
- Often require a degree of technical assistance for implementation
- It implies more delegation and trust on the Government than traditional projects – but it also requires more government transparency and good governance to ensure funds not wasted
  - The Poverty Reduction Growth Facility (PRGF) - an IMF program for the poorest countries, replacing ESAF (structural adjustment facility), must be based on a country's PRSP.
  - Poverty Reduction Support Credits (PRSC) provided by the World Bank to support implementation of a PRSP in a country
  - Multi-donor DBS provided donors agree with the quality of a country's PRSP and MTEF.

New Instruments: Sector Wide Approaches (SWAps)

- Multi-donor support to a government sector strategy and budget;
- Once there is an agreement/partnership between government and major donors/institutions, donors release funds to the government's budget, relying on government procedures to disburse and account for all funds
- Solves/alleviates the problem of multiplicity of donors
- In early 2004 there are about 100 SWAps in the developing world, 85% of them in Africa, mostly on health and education but increasingly in areas such as agriculture, water supply, environment, energy and others.





Projects vs. New Instruments

PROJECTS	DBS/SWAps
Administred by Donor	By National Administration
Government must adapt to donor procedures	All donors adapt to gov't same system (more work for donors)
Very complex for government given many donors. Gov't spends a lot of time to satisfy donor procedures, distracts attention to run the country	• Less transaction costs for gov't • Harmonized support PRSP • Strengthens National Administration • BUT REQUIRES A TRANSPARENT GOV'T AND GOOD GOVERNANCE

SOMETHING TO AVOID IS DONORS PORING MONEY ON A CORRUPT GOVERNMENT!! IF A GOV'T NOT TRANSPARENT AND COMMITED TO REDUCE POVERTY, PROJECTS REMAIN A BETTER OPTION

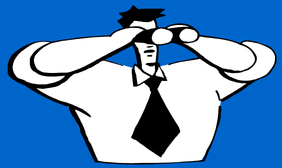
What Is Missing: The Vision of Global Development

Development aid as it is today is a necessary but not sufficient condition for development. Positive points:

- PRSPs are focusing policy making into reducing poverty
- Harmonization of donor initiatives, working together to strengthen public administrations, more trust in governments
- It forces both governments and donors to be more transparent and have better governance

However:

- Development resources remain very low – A 'Marshall Plan for the South'?
- Trade and finance inadequately included in development
- What is missing in development aid is a vision of global development, a plan for the development of the whole world
- Bilateralism will not deliver this; neither it will contribute significantly to global public goods like the environment, tax evasion
- Economic globalization, the closer integration of the countries of the world, has generated a greater need for collective action on global issues => for a political globalization – or better global governance.



Things to Watch Out

- Resources: How abundant and reliable are development resources? Have they increased or decreased? Are the different programs of all donors coherent and sufficient to develop the country? What is missing?
- Can resources be mobilized domestically? Is income inequality significant in the country? Is there a wealthy elite that can be adequately taxed to bring new resources for development? Is the government transparent and proactive reducing poverty, making policies that benefit the majority of citizens and not a privileged minority?
- Is a country's PRSP analyzing well the obstacles to development, and providing adequate solutions to overcome them? Are the priorities well determined? Is the PRSP comprehensive? Does the PRSP include a section on trade? How can the next PRSP be improved?
- What are donor priorities in terms of countries and sectors? Are they all harmonized under a country's publicly discussed PRSP and government policy, or is a donor running its own show? Is a donor willing to develop DBS/SWAps coordinated with the rest of donors and government? Is the government committed to poverty reduction, transparent and following good governance practices, or is serving other interests?
- Is a program untied or must it procure goods and services from the donor country?
- Is a program a grant or a loan?