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Initiative for Policy Dialogue

United Nations Department for Economic and Social Affairs

DEVELOPMENT AID IN THE 21st CENTURY

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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**
- **The need for better global governance**



Background: Interest groups in development



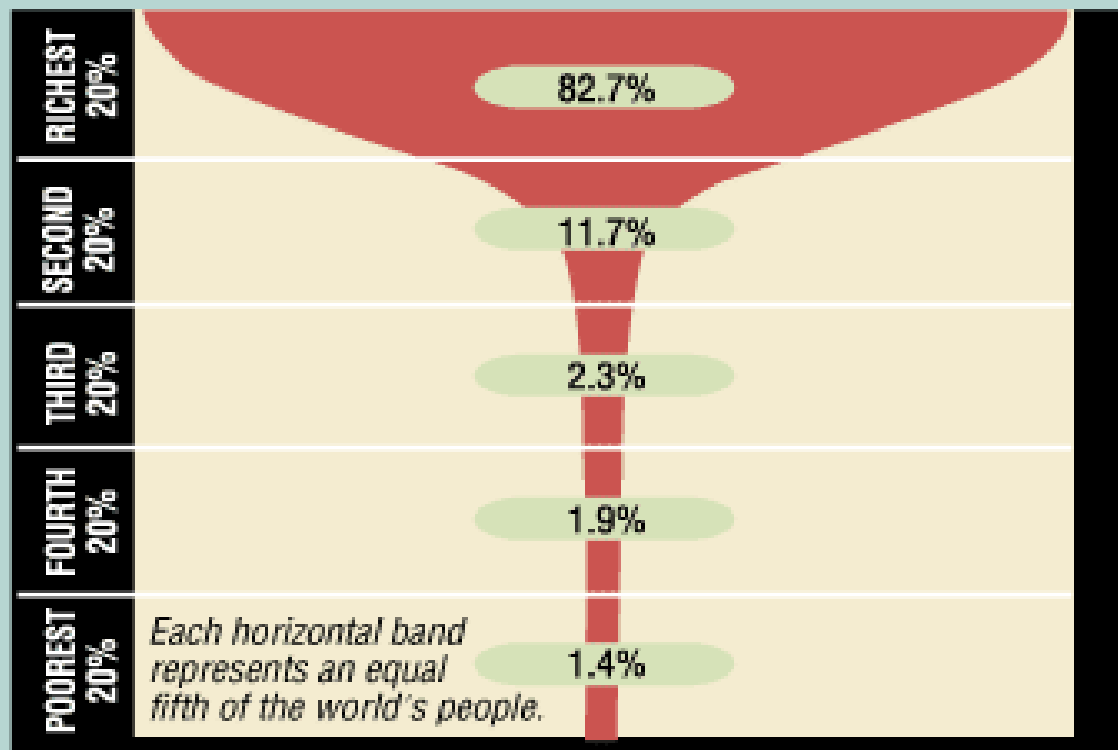
Different interest groups/actors may not share the same goals in development:

- **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**
- ⇒ Attention to rent-seeking behavior
- ⇒ 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 or vested interests (ie. influential groups/elites)

Justification of Development Aid

Distribution of world GDP, 1989

(percent of total, with quintiles of population ranked by income)



Source: United Nations Development Program, 1992, Human Development Report 1992 (New York: Oxford University Press for the United Nations Development Program).

The benefits of globalization, as it is managed (or mismanaged), go to a few companies and individuals, in a few countries.

The justification for international redistribution, in the form of more and better aid, cannot be stronger



Development Aid in Perspective

- At the beginning of the 20th century, development aid still linked to the colonial system
- 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" (see presentation on poverty reduction)



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

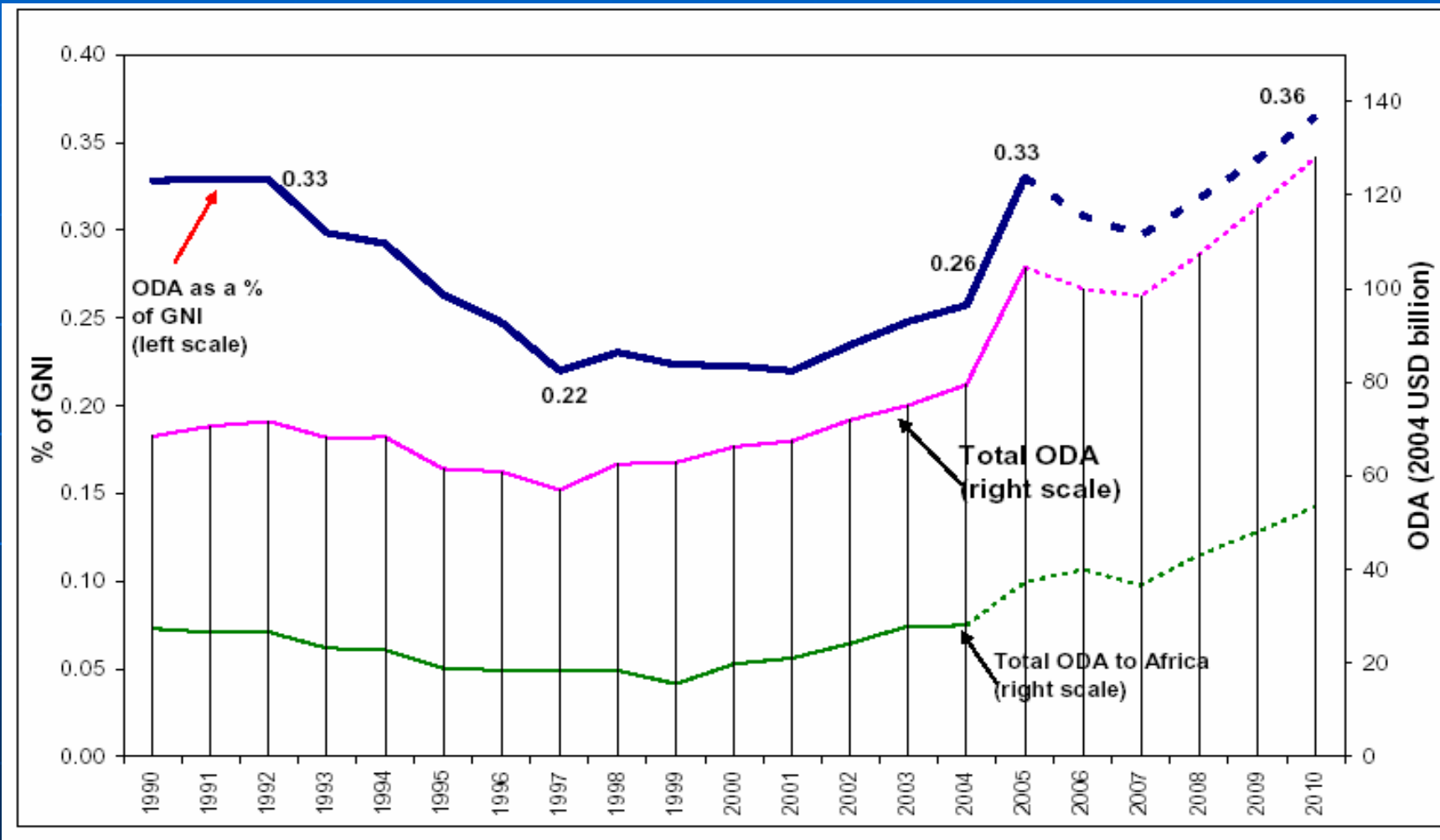
A. Limited development resources:



Transfers from OECD to developing countries:

- Exceptionally, ODA in 2005 was 0.33% of GDP of OECD countries (half of committed 0.7%!).
- In 2004, ODA was only 0.25%. ODA is expected to fall back in 2006-07.
 - Reasons for 2005 “increase” are
 - Debt relief for Iraq and Nigeria
 - Tsunami relief
- During the 1990s- early 2000s there was a significant reduction in ODA.
- Low 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 corruption and mismanagement, want to see taxpayers money falling in good hands -- Good governance and egalitarian policies as preconditions of aid.
- Vicious circle (*very limited aid => lack of funds for development => slow results*) that needs to be broken. Need of an international “social contract”.

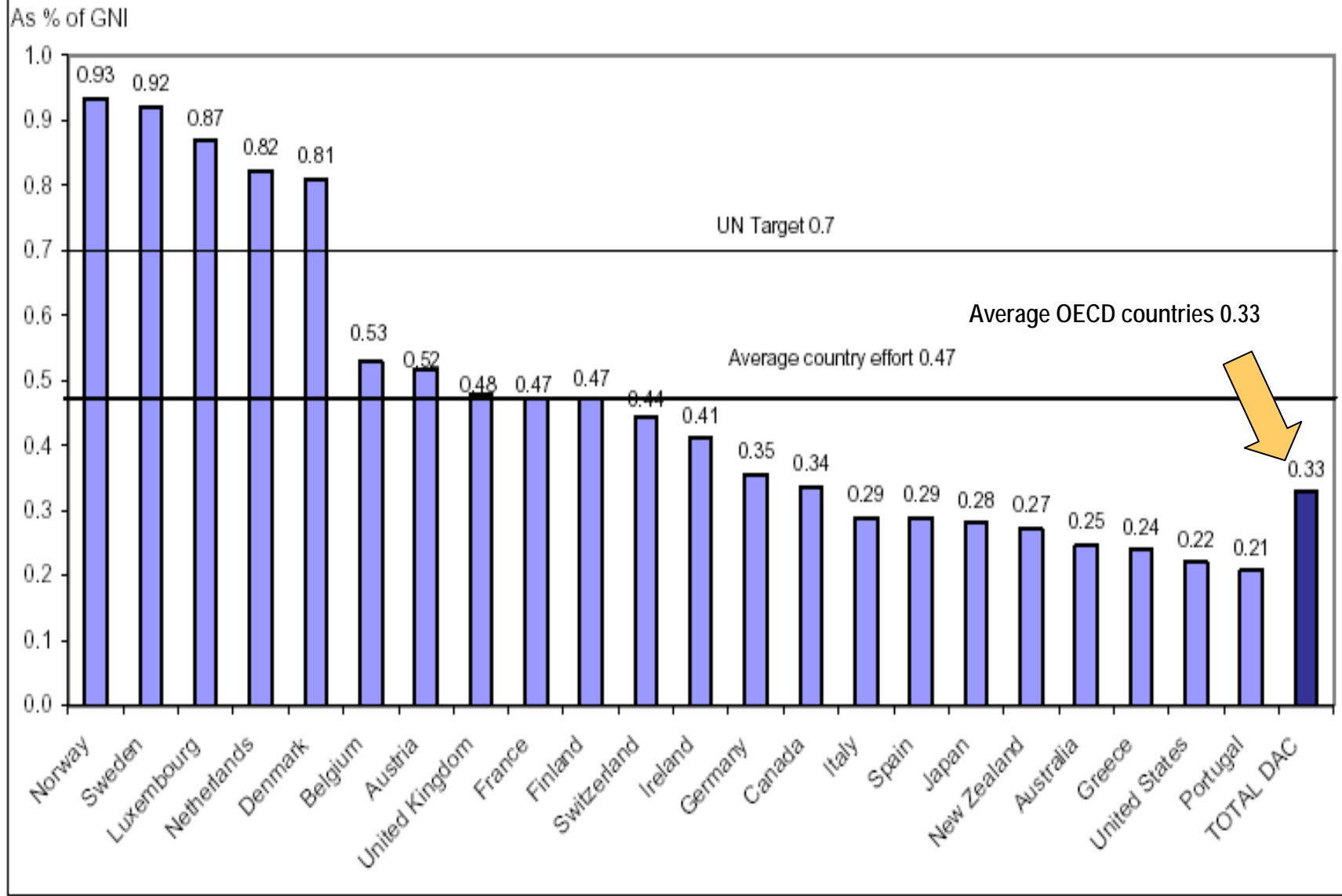
ODA 1990-2005, and Forecast 2006-2010



Source: OECD 2006



Net ODA in 2005 - as a percentage of GNI



Source: OECD 2006



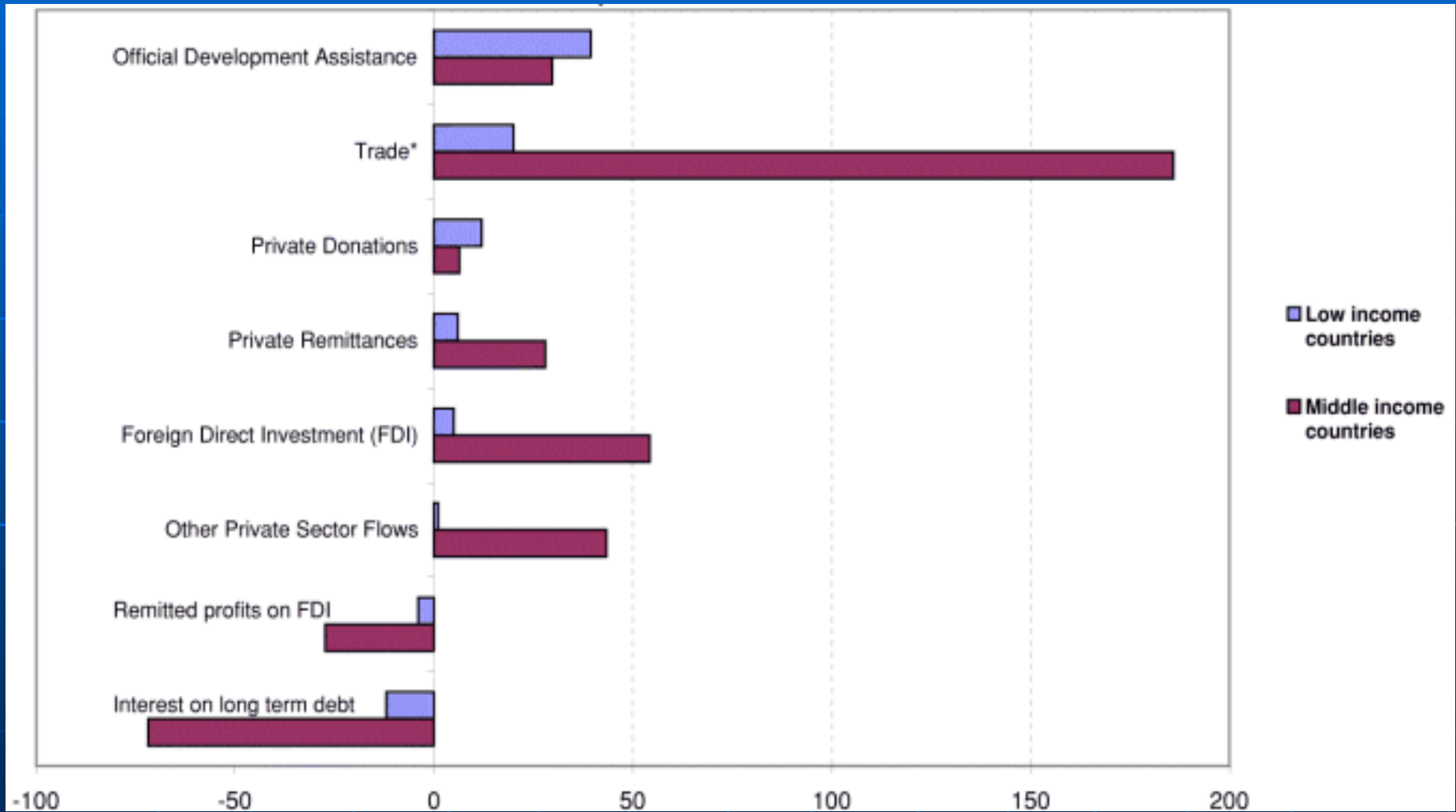
A. Limited development resources (continued)



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 (?)*
 - *Taiwan POC (?)*
 - Thailand
- Private flows are insignificant in the least developed countries of Africa and elsewhere.
- Private flows to developing countries have decreased since Sept. 11, Afghanistan and Iraq Wars.
- Private sector flows are not a replacement of development aid – but a complement

Aid is critical for the poorest countries, while middle-income countries benefit more from trade, 2004



- Exports less imports of goods and services excluding oil.
- Source: OECD DAC 2005



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 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 multilaterals	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 Dev 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



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

New ideas since: aviation taxes, being started



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 – does it benefit developing countries? Case of trade – World Bank, UN RWSS demonstrate bilateral trade agreements benefit the powerful partner
- 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, it does not allow them to work managing their countries.
- 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 (OECD 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.**
- This is a positive attempt to patch-up the problem of increased bilateral aid
- But global vision still missing



C. Who benefits? Tied Aid

Always question:
Who gets the
contracts???

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.
- Aid from most countries = contracts for their national companies or subsidies to their national NGOs.
- **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/NGOs 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** (2000-04) are:

- Iraq
- D.R. Congo
- China
- India
- Indonesia
- Afghanistan
- Egypt

- Recipient countries tightly linked to economic and political interests of the world's main powers
- Main **recipient sectors** (2000-03) - OECD/DAC statistics are best (and even so, present problems):
 - Main sector is "Others" 56% (Budget support? Finance? Multisector?) [*Problem of different national classification systems, difficult to aggregate data!*]
 - Of the defined sectors – Main recipients are education and health, debt relief, emergency and post-conflict reconstruction assistance.

Distribution of ODA, 2003 continent/per capita

Chart 1: 2003 Net aid per capita /
Aide nette 2003 par habitant

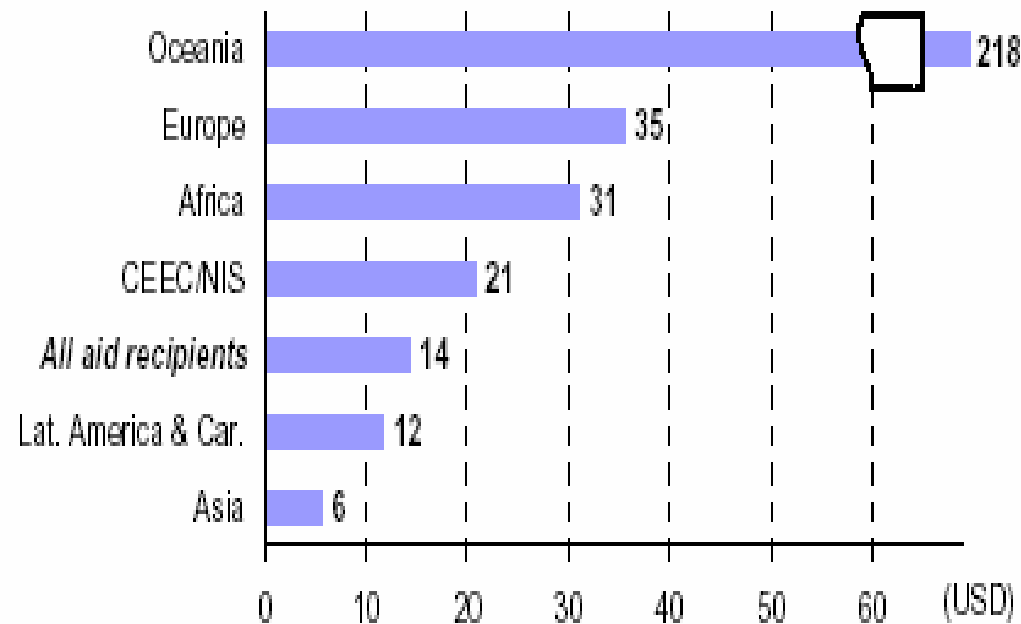


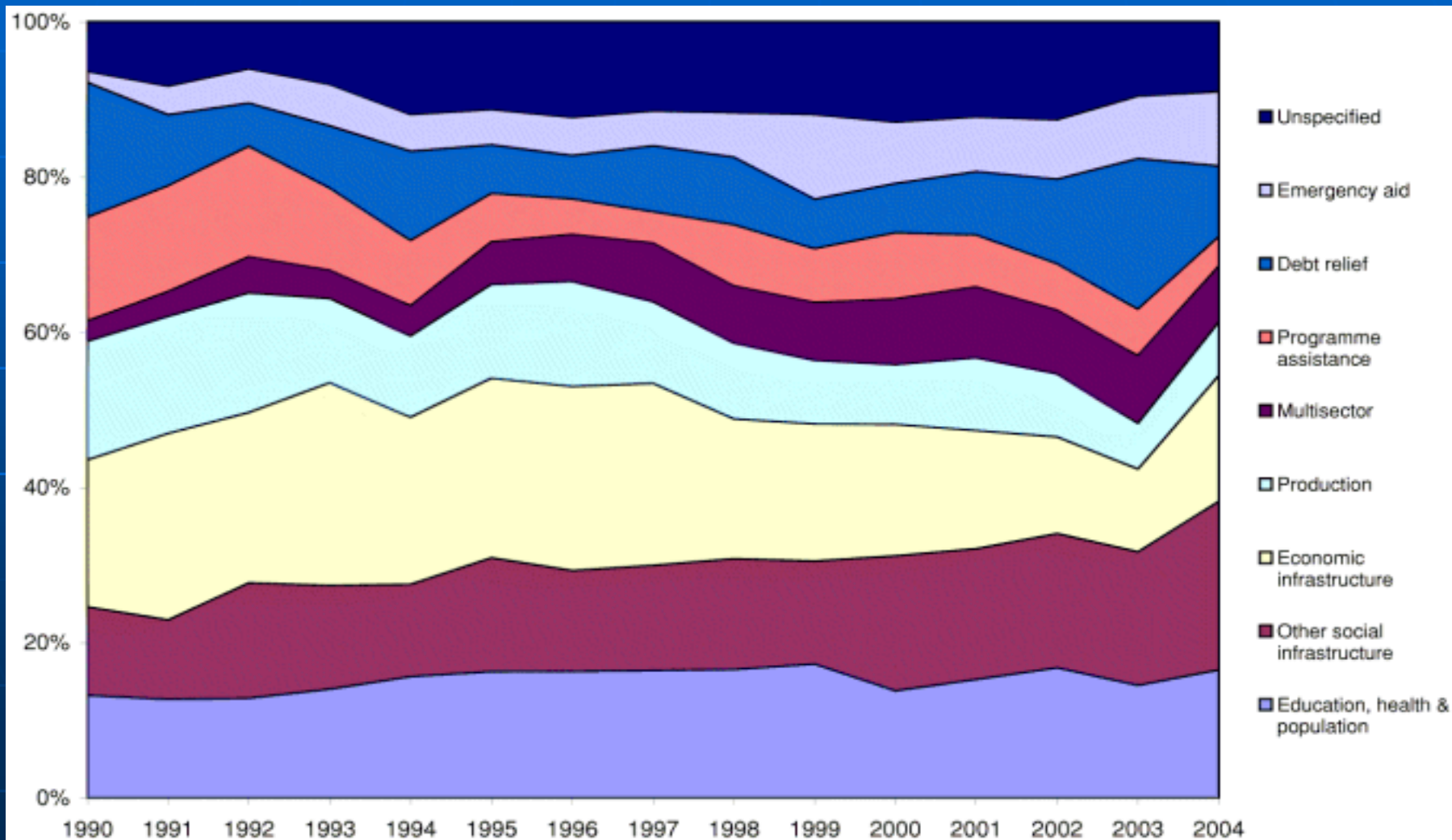
Table 1: Net aid and population by region, 2003 /
Aide nette et population par région, 2003

	Net aid USD million	Population thousands
Africa	26318	848
Asia	20230	3607
CEECs/NIS	7971	383
Europe	3551	100
Latin America and the Caribbean	6246	535
Oceania	1786	8
All aid recipients	77453	5402

Source: OECD 2005

ODA by sector, 1990-2004

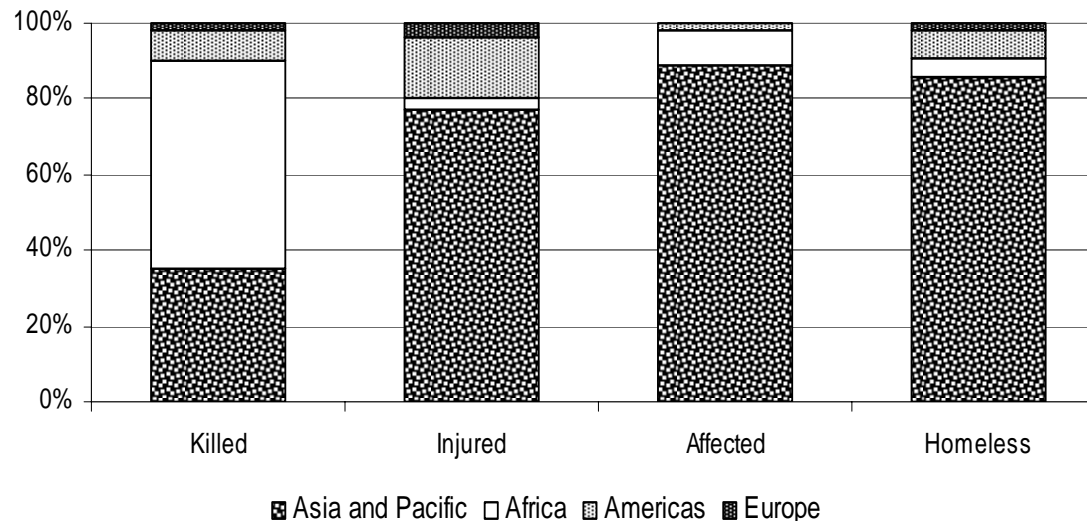
- Because the weight of Africa/MDGs - Education and health steady at 15%
- Rising trend for budget support (“unspecified”), debt relief and emergencies
- Downward trend for infrastructure and production



Source: OECD 2006

A Note on Disaster Relief

Impact of Disasters by Geographical Region 1972-96



Disasters affect people differently depending on their vulnerability => casualties in Asia, Africa.

- There has been a recent trend towards increased disaster relief aid programmes. Most of it is tied aid, benefiting donor countries.
- Relief efforts are notorious for their bad governance; the World Bank estimates that as much as 50 per cent of funds/goods have disappeared in corruption in some cases.
- Relief is necessary; however, the huge economic and human loss caused by disasters points the need to invest in disaster preparedness, to reduce people's vulnerability.

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
 - First attempt poverty reduction (PRSPs)
 - First attempt debt relief (HICP)
 - Governance (good public management)
 - First attempt environment (sustainable development)
- Changes due to Wolfowitz presidency at the World Bank?
- Changes at the UN?



D. Investment priorities: The development agenda (II)



The UN World Social Summit – Copenhagen 1995

- From social development point of view, great push forward
- World agrees on most comprehensive ever social agenda: people at the center of development, poverty reduction, full employment, inclusive/integrated societies, gender equity, education and health for all, integration of economic and social objectives in policy making (ie. no more 1980s-type structural adjustment), increased financing for development (and decreased military expenditures), debt relief.
- Main priorities operationalized in 2000: the Millennium Development Goals

The UN World Social Summit – New York September 2005

- Development – MDGs + employment through more equitable National Development Strategies, recommit to Monterrey Consensus (0.7% donors GDP ideal but no commitment, encourage private + domestic financing), free trade.
- Peace and collective security – A “Convention on Terrorism”, UN peacekeeping role
- Human rights and the rule of law – A Democracy Fund
- Strengthening of the United Nations

The World Bank and IMF Annual Meetings

- Investment priorities maintained (with new emphasis on infrastructure)
- Debt cancelled (but aid will be reduced proportionally!)

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 programmes; 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 <ul style="list-style-type: none"> ▪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 in theory 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 positive, much better than earlier Bank “Country Programming” experiences, is a first attempt by development banks to tackle poverty – but must be improved.
- If PRSPs are to continue, the next wave needs to avoid to be Bank-driven and better incorporate issues outside standard Washington prescriptions, such as (see presentation on Poverty):
 - Role of public sector in development
 - Economic policies geared towards national development (inclusive finance, technology etc see *presentation on Poverty Reduction*) as well as employment and decent work.
 - Universal social policies (=for all), as part of national development
 - The international aspects need to be better included– ie. Trade.



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, and the issue that free trade by itself will not help small farmers.
- **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, supported by programs to help small local producers (=employment generation) to export.
- **Commodity prices keep falling while manufacturing prices rising:** Developing countries need more than agriculture
- **“Aid for trade initiative” insufficient**

Subsidies tilt the balance...

Subsidies
\$305bn



Aid
\$50.6bn



Subsidies: The 30 richest countries' support to their own agricultural industries

Aid: The 30 richest countries' development assistance to poor countries



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**



Projects vs. New Instruments

PROJECTS

Administered by Donor

Government must adapt to donor procedures

Very complex for government given many donors. Gov't spends a lot of time to satisfy donor procedures, distracts attention to run the country

DBS/SWAPs

By National Administration

All donors adapt to gov't same system (more work for donors)

- Less transaction costs for gov't
- Harmonized support PRSP
- Strengthens National Administration
- BUT REQUIRES A TRANSPARENT GOV'T AND GOOD GOVERNANCE



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 funds are transferred. These tend to be:
 - **A National Development Strategy** (often a PRSP)
 - **Medium Term Expenditure Frameworks (MTEFs)** (see presentation poverty) to ensure that funds spent according to priorities
- Often require a degree of technical assistance for implementation
- DBS is a positive development, it implies more delegation and trust on the Government than traditional projects – Ultimately, GBS supports governments as the legitimate institutions with a social contract to supervise a country's economic and social development to benefit its citizens.
- FYI - Bank/Fund Instruments:
 - **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

Bank/Fund instruments not essential. **Multi-donor DBS** => provided donors agree with the quality of a country's National Development Strategy and MTEF



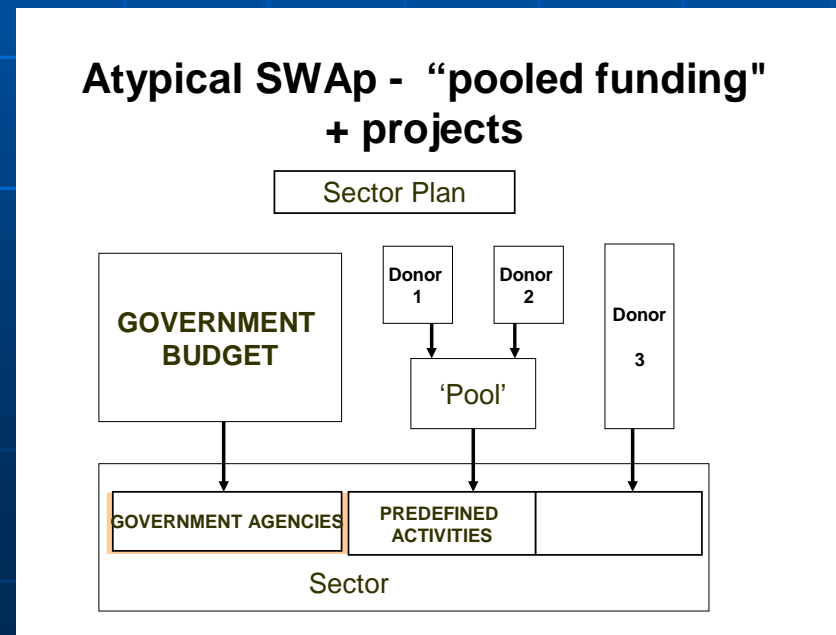
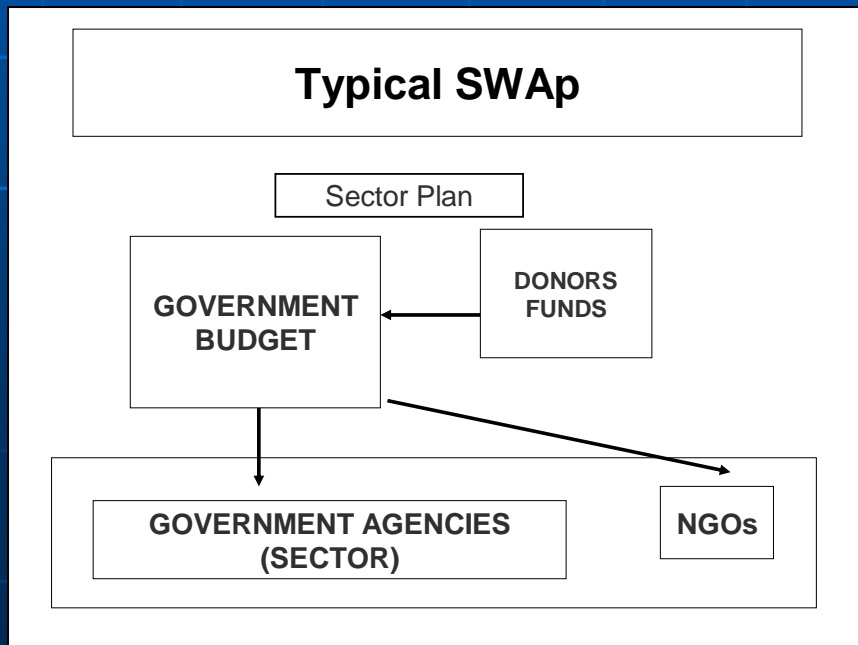
New Instruments: Sector Wide Approaches (SWAs)



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 SWAs 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.





Things to Watch Out



How abundant and reliable are development resources? Have they increased or decreased?

- What are donor priorities? Are they all harmonized under a country's equitable National Development Strategy, 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 an equitable National Development Strategy, transparent and following good governance practices, or is serving vested interests?
- Who gets the contracts in a development program? Is aid tied?
- Is a program a grant or a loan?
- How can DBS be best used to support development and, ultimately, people? It is essential that SWAPs and DBS be used as instruments of redistribution and social justice, this is, that they reach people, and
 - Not utilized to sustain institutions (e.g. a Ministry)
 - Not utilized to sustain processes (e.g. completion of an MTEF or PRSP)
 - Simply used as fast disbursing mechanisms of donors aid.

Some DBS donors like the EU want to link DBS to development outcomes



What Is Missing: The Vision of Global Development

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

- Resources remain very low – A 'Marshall Plan for the South'?
- Aid often does not support equitable National Development Strategies to promote sustainable economic and social development (but disaster relief etc)
- International trade and finance inadequately included in development
- What is missing in development aid is a vision of global development, a plan for the long term development of the whole world, managing it equitably and sustainably.
- Bilateralism will not deliver this; it will not contribute to global public goods like the environment, tax evasion, etc
- **What is needed is collective action on global issues => a political globalization, or better global governance, a global social contract to redress inequality across countries through aid, and new global rules and regulatory arrangements to provide for public goods, protect the environment and manage global financial risks, among others.**