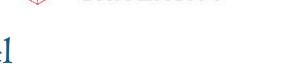
The G20 at the Leader's Level



WHAT DO WE WANT FROM ODA?

Different tools for different jobs: Disaster, Security, Development, Research, and ?

The Crowne Plaza Hotel, Petra, Jordan
November 10-11, 2005

Conference Background Materials

Centre for Global Studies, University of Victoria
www.L20.org

Conference Package

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Preliminary
PROGRAM
Petra, Jordan
November 10-11, 2005

Thursday, November 10, 2005

19:00 **Informal Dinner**
L20 Background, Context and Introduction
– Gordon Smith & Ramesh Thakur

Friday, November 11, 2005

9:00-10:15 **Problematique and Diagnosis:**
Background- *Francisco Sagasti, John Sewell*
Security dimension of development assistance – *Roland Paris*

10:15-11:30 **Elements of the Solution*** *– Margaret Catley-Carlson, Catherine Day, Mukesh Kapila, Stanlake J.T.M. Samkange*

Coffee break

11:45-13:00 **Different Prisms** *– Tony Killick, Marcel Massé, Ian Smillie, Umayya Toukan, Geoff Oldham, Adil Najam*

13:00-14:00 **Lunch**

14:00-16:00 **Synthesis** *Ramesh Thakur*

16:00-17:00 **Mapping the Way Forward** *– Andres Rozental, Stephen Wallace, Maureen O'Neil*

18:30 **Reception** – Ambassador *John Holmes*, Canada

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* While unable to attend, James Dobbins has written a custom tailored paper for this session.

OFFICIAL DEVELOPMENT ASSISTANCE:
Background, context, issues and prospects

Francisco Sagasti

1. Introduction

This background paper will briefly examine the background for the emergence of ODA as a key feature of the international development landscape during the last half century, place ODA flows and practices in the context of other development cooperation instruments, and explore some of the issues associated with ODA at the beginning of the 21st century, before venturing some ideas on the prospects for ODA in the medium term and offering a few concluding remarks.[i]

1.1. Origins of Official Development Assistance (ODA)[ii]

Development cooperation as we know it emerged over five decades ago against the backdrop of the Marshall Plan's success in re-building post-war Europe.[iii] The prevailing view at the time was simple and optimistic: development would come quickly to the poorer areas of the world through the provision by a few countries of capital, supplemented by the judicious provision of technical know-how. The reality proved far more complex and intractable. Fifty years ago, a small handful of institutions comprised the organizational arrangements of the international development finance system. At present, it is composed of the IMF, the World Bank, more than 20 regional and sub-regional development banks, over 40 bilateral development agencies, the UN family of organizations and thousands of large and small NGOs, and private foundations.

Yet, the most important drivers of development are internal to individual countries. The external factors that matter are less related to ODA and more to access to markets, capital, and technology, and to supportive international security, economic, socio-political and environmental conditions. The role that ODA plays at present has to be seen in the light of these other factors, and of the complex institutional and financial arrangements for development cooperation that have evolved over time.

1.2. Ideas in development and their influence on ODA

Ideas about how to bring about development and how to organize development cooperation, and particularly ODA, have continuously changed and evolved. At different times starting in the late 1940s, development thinking and practice were based on concepts such as the need for a 'big push' of investment to initiate self-sustaining economic growth, the priority of investments in human capital, the importance of fostering import-substitution industrialization and exploiting backward and forward linkages, and on the imperative of advancing through a well-established sequence of stages that would lead to a take-off into self-sustained growth.[iv] Later on, notions such as 'unlimited supply of labor', 'deterioration of the terms of trade', 'poles of development', 'development planning', 'circular cumulative causation', 'unbalanced growth, 'dependency theory', 'structural underdevelopment', 'unequal exchange', 'redistribution

with growth', 'basic needs', 'export-oriented industrialization', 'small is beautiful', 'ecodevelopment', among many others, were used to interpret the reality of developing countries and to offer policy recommendations.

With the end of the post World War II period of global economic expansion in the mid-1970s, many economic, social, political and technological tensions surfaced (oil shocks, debt crises, financial and trade imbalances, increasing inequalities, demographic transitions, geopolitical shifts, new technologies). These tensions characterized the 'lost decade' of the 1980s and presaged the turbulent post-Cold War decade of the 1990s. Against the backdrop of a relentless process of economic globalization, a new orthodoxy —firmly skewed towards economic liberalization, deregulation, privatization and the free play of market forces (and against state interventions)— emerged in the mid-1980s as the dominant mode of development thinking and practice. This new orthodoxy became known as the 'Washington Consensus' on economic development policies. Yet, this decade was also a period of intellectual ferment during which past experience was evaluated, basic assumptions questioned, complexity acknowledged and new approaches to development thinking and practice explored. The current formulation that has supplanted the Washington Consensus as the over-arching framework for development thinking and practices are the 'Millennium Development Goals' (MDGs). These combine with notions of nationally owned poverty reduction strategies, sensible macroeconomic policies, effective public expenditure management, and new forms of conditionality related to notions of good governance. The MDGs stipulate seven categories of outcomes and indicators that developing countries must meet by 2015, and an eighth category of objectives (but not indicators) to be met by donor countries.

ODA practices have been heavily influenced by the development ideas prevailing at a particular time. At present, the MDGs appear to provide the main organizing principle for ODA, even though international security considerations mostly linked to the 'war against terrorism', have intruded and are affecting ODA thinking and practice.

1.3. Motivations for ODA

Motivations for providing ODA have changed over time in line with the evolution of development ideas and the prevailing international concerns. *Development assistance, particularly when channeled through bilateral agencies, is an instrument of foreign policy for donor countries and is usually aligned with their strategic objectives and interests*. The mix of aid motivations varies from one donor country to another and also over time. At the beginning of the 21st century there appear to be three main sets of rationales for development assistance: international solidarity, narrow and enlightened self-interest, and the provision of international public goods (Table 1).

TABLE 1 **Motivations for development assistance**

International solidarity and religious motivations

Altruism, ethical and humanitarian concerns, which highlight the moral obligation of donor countries to assist the poor in developing countries:

- Alleviate human suffering and express solidarity with fellow human beings
- Help to cope with natural and man-made disasters through humanitarian and emergency relief.
- Build local capacities to undertake initiatives for improving living standards.

Narrow and enlightened self interest

Strategic and security interests, which respond to geopolitical and security considerations of donor countries:

- At the national level, which justify aid to developing countries of specific geopolitical importance to the donor country, particularly as part of the 'war on terrorism' and the 'war on drugs'
- At regional level, which considers the interests of regional alliances or treaties.

Political interests, which focus on obtaining political support for foreign and domestic policies:

- With foreign constituencies (through support to former colonial territories and other areas with special historic and cultural ties to the donor country, aid to obtain international political recognition and support)
- Centered on domestic constituencies (obtaining the support of immigrants and ethnic groups of foreign origin in the donor country).

Economic and commercial interests, which emphasize direct commercial and financial benefits to the donor country:

- Benefits may include export expansion, employment generation, support of domestic producers (e.g. food aid); greater security for investments in developing countries, securing access to resources (oil, strategic minerals); obtaining access to a pool of highly qualified potential migrants (e.g. graduate fellowships), and creating demand for exports (e.g. export credit, technology transfers).

Provision of international public goods

Emergence of regional and global problems, which concern both donor and recipient nations and require the provision of public goods:

- Confronting global and regional environmental threats (global warming, destruction of the ozone layer, loss of biodiversity, tropical deforestation) which affect developed countries directly
- Addressing global population growth and imbalances and health threats (AIDS, epidemics), that create negative spillovers across borders
- Supporting international cooperation initiatives to avoid regional and global 'public bads' (e.g. crime, drug traffic, money laundering, terrorism)

Maintaining stability of the international system, which aims at providing assistance to specific countries and regions to secure a stable world order and to foster the long-term interests of donor countries:

- Maintaining political stability by preventing and containing domestic conflicts (e.g. peace-making and peace-keeping initiatives), and by promoting the spread of democracy (monitoring and supervising elections, strengthening democratic practices and institutions)
- Ensuring world economic stability through policy reforms and through measures to avoid major disruptions of international finance and trade (e.g. provide funds to defuse debt crisis and sudden reversals of financial flows, funds to stabilize commodity prices)
- Maintaining social stability to prevent international migrations (programs to reduce population growth, combat poverty, promote human rights, improve the situation of women)
- Helping developing countries to improve their participation in the world economy (e.g. capacity building in knowledge, innovation and production), and in international agreements to make them more equitable, stable and effective (technical assistance, training negotiators).

As resources for ODA come from public budgets, donor countries have to balance their development assistance efforts with other national objectives, particularly when facing fiscal constraints. The current imbalances in the world economy and the uncertain prospects of resolution over the next few years, added to demographic shifts, suggest that fiscal constraints will remain tight in most donor countries. Reasons for providing ODA will have to be clear and compelling to compensate the weight of other public spending priorities.

1.4. The impact of ODA

There has been considerable debate regarding the impact of ODA on growth and, in general on improvements in the quality of life of people in developing countries.[v] Critics have charged that aid only discourages developing country initiatives, supports bloated bureaucracies, keeps in power corrupt and authoritarian regimes, enriches those in power, and also that it is ineffective, wasteful, distorts relative prices and should be thoroughly reformed or eliminated. Supporters argue that, while there have been aid failures and ODA need reforming, it has helped to lift millions of people out of poverty and to improve health and education, enhance economic performance in many countries (Korea, Botswana), and succeeded in tackling many challenges (green revolution, oral rehydration therapy).

Throughout these debates, it has become clear that *the impact of ODA varies according to the type of assistance provided, to the capacities of the countries that receive it, and to the policies of donor countries and international institutions*. It has been shown that aid for humanitarian and relief efforts, which take place during emergencies, does not correlate with growth (disasters reduce growth and increase aid); that aid to improve institutional and policy performance (public sector reform, education, health, environmental conservation) has an impact on growth only over the long term; and that aid for infrastructure, production and, in some cases, budget support, can have an early impact on growth.[vi] Recipient country policies and capabilities also matter, as ODA has greater impact on those countries that have the capacity and will to use it well (even though the concept of 'good policies' may change over time). In addition, donor policies and practices are important, for tied technical assistance has less of an impact than untied technical assistance and other forms of aid, and different forms of conditionality influence country ownership and development outcomes.

A general conclusion may be that ODA can have and has had a positive impact under the appropriate circumstances. While this begs the question of what are those circumstances, empirical evidence is building to help in sorting the various factors that influence the impact of aid.[vii]

2. ODA flows in context

The relative importance of ODA flows has changed in a major way during the last five decades. From being the main source of external financing in terms of net flows for developing countries, it now plays a relatively minor role in relation to other sources.

Moreover, ODA net flows have shown a downward trend since the early 1990s, at a time when demand for development assistance has been growing because of new concerns to be addressed (environment, conflict prevention, humanitarian assistance, security concerns, health threats).

2.1. Changes in development financing and the role of ODA

Since the 1950s, external capital flows to developing countries have undergone a succession of modifications in size, composition and distribution. These can be divided into four distinct periods: (i) 1950 to 1972 —a pre-eminence of ODA with a stable pattern of foreign direct investment (around 20 and 30 percent of external financing) and some modest expansion in export credits; (ii) 1973 to 1981 —a rapid expansion of private financing to almost two thirds of total external inflows, mainly in the form of loans from international private banks recycling the surpluses of major oil exporting nations; (iii) 1982 to 1991—a major and sudden contraction in private inflows brought on by deflationary macroeconomic policies in developed countries which triggered a global recession and debt crisis for much of the developing world; and (iv) 1992 to present —an unprecedented expansion in private capital inflows to between 80-90 percent of total inflows.

Two main features emerge from the data on net flows since 1970 (Table 2):

- *Shift of financing sources. In the aggregate, the balance between public and private net capital inflows to developing countries has undergone a profound shift towards reliance on private capital inflows*. Net official capital flows increased from an annual average of US$8 billion in the early 1970s to US$51 billion in the early 1990s, but decreased to about US$35 billion in the early 2000s. Over the same periods net private capital flows increased from an average of US$12 billion to US$125 billion, and to US$208 billion, respectively. Although the financial crises of the late 1990s reversed the growing trend of portfolio inflows, the resilience of foreign direct investment ensured the continuing dominance of private capital inflows that are the largest source of financial flows to developing countries (although these flows are heavily concentrated in a few emerging economies). Remittances of emigrant workers increased explosively from US$0.8 billion in the early 1970s, to US$40 billion in the early 1990s and to US$100 billion in the early 2000s, and now are the second largest source of external financing for developing countries.

- *Downward trend and higher volatility in net official flows*. Official net flows grew steadily from the early 1970s through the late 1980s, but declined through the 1990s and early 2000s. From an annual average of US$52 billion in 1990-1994 net official flows came down to US $36 billion in 2000-2004, with major shifts taking place in some specific years. For example, net official flows increased from US$32 billion in 1996 to US$62 billion in 1998, went down to US$23 billion in 2004 and rebounded to US$ 30 billion in 2004. This variability is the result of financial rescue packages (e.g. for the 1997-1998 Asian crisis), of changing ODA allocations in key donor countries, and also of accelerated repayments of official loans (several developing countries

TABLE 2. **Net capital flows to developing countries 1971-2004** (annual average US$ billion)

		1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2004
1.	**Net private flows [a]**	**11.98**	**44.97**	**54.02**	**38.97**	**124.81**	**239.78**	**208.26**
2.	**Net official flows [b]**	**7.67**	**17.72**	**31.59**	**33.60**	**51.67**	**49.47**	**35.83**
3.	**Net equity flows**	**2.87**	**6.69**	**10.86**	**15.38**	**71.16**	**169.94**	**177.61**
3.1.	Foreign direct investment [c]	2.87	6.69	10.84	14.47	51.08	151.54	162.45
3.2.	Portfolio equity flows	0.00	0.00	0.02	0.91	20.08	18.40	15.16
4.	**Net flows on debt**	**13.57**	**48.57**	**63.27**	**40.60**	**75.09**	**91.55**	**30.56**
4.1.	Official creditors (a+b)	4.46	10.30	20.11	17.01	21.44	21.71	-0.09
a.	*Multilateral creditors*	*1.10*	*3.05*	*6.59*	*7.90*	*11.83*	*24.05*	*10.74*
	-World Bank	1.10	3.05	6.59	7.90	7.00	8.06	2.53
	IBRD	0.63	1.88	4.43	4.57	2.35	3.00	-2.40
	IDA	0.47	1.16	2.17	3.32	4.65	5.06	4.93
	-IMF	n.d.	n.d.	n.d.	n.d.	1.36	7.42	6.31
	Non-concessional	n.d.	n.d.	n.d.	n.d.	0.74	6.87	5.89
	Concessional	n.d.	n.d.	n.d.	n.d.	0.62	0.55	0.42
	-Major RDBs	n.d.	n.d.	n.d.	n.d.	5.12	6.73	3.15
	non-concessional	n.d.	n.d.	n.d.	n.d.	3.47	5.00	1.77
	Concessional	n.d.	n.d.	n.d.	n.d.	1.65	1.73	1.39
	-Others [d]	n.d.	n.d.	n.d.	n.d.	1.56	1.85	0.81
b.	*Bilateral creditors*	*3.36*	*7.25*	*13.52*	*9.11*	*9.62*	*-2.34*	*-10.83*
	Non-concessional	0.45	2.18	4.86	0.56	1.90	-5.48	-9.45
	Concessional	2.91	5.07	8.66	8.55	7.71	3.13	-1.38
4.2.	Private creditors (a+b)	9.11	38.28	43.16	23.59	53.65	69.84	30.65
a.	*Net short-term debt flows*	*1.72*	*11.32*	*6.43*	*8.33*	*22.66*	*4.30*	*14.71*
b.	*Net L-M term debt flows*	*7.38*	*26.96*	*36.73*	*15.26*	*31.00*	*65.53*	*15.93*
	-Bonds	0.11	1.68	1.54	2.10	15.91	36.13	25.84
	-Banks	5.99	20.50	26.73	6.49	6.49	29.31	-4.05
	-Others [e]	1.28	4.78	8.45	6.67	8.60	0.09	-5.86
	Memo							
5.	Changes in reserves							
6.	Grants [f]		**32.97**	**-6.28**	**4.81**	**48.28**	**55.86**	**183.74**
7.	Worker's remittances	**3.21**	**7.42**	**11.47**	**16.59**	**30.23**	**27.76**	**35.91**

Source: Global Development Finance 2005. [a] Private debt plus equity; [b] Bilateral aid grants plus debt; [c] Net inflows; [d] Other multilateral sources (e.g. export credit); [e] Other private credits from manufacturers, exporters, and other suppliers of goods, and bank credits covered by a guarantee of an export credit agency; [f] Excluding technical cooperation grants.

took advantage of favorable international capital market conditions to issue bonds and used the proceeds to prepay their Paris Club loans). In addition, not all of the resources counted as ODA translate into actual transfers. For example, according to the UNDP, the three categories of assistance that accounted for more than 90 percent of the US$11.3 billion increase in bilateral aid between 200 and 2004 did not generate a transfer of new resources.[viii] One consequence is that official bilateral flows have been negative since the mid-1990s and increased from an annual average of US$-2.3 billion in 1995-1999 to an annual average of US$-10.8 billion in 200-2004.

2.2. Bilateral and multilateral ODA: balance, effectiveness, grants and debt reduction

The *balance between bilateral and multilateral channels for aid* has changed over time. In the early 1960s multilateral institutions accounted for less than 10 percent of total ODA, but their share grew rapidly and by the mid-1970s it was around 25 percent.[ix] The share of multilateral channels in total development assistance has been about 30 percent since the late 1970s.[x] However, there has been trend towards the 'bilateralization` of multilateral aid, as donor countries began to use multilateral institutions in the mid-1980s to manage their own bilateral aid programs, primarily by establishing trust funds and co-financing projects.[xi] This has reduced the amounts of 'core' resources available to multilateral institutions, increased the proportion of 'non-core' resources provided by donor countries for specific purposes, and led to hidden subsidies as donors rarely pay the full administrative costs associated with the use of non-core resources.

The recently announced increases in ODA will bring to the fore the question of the *relative effectiveness of bilateral and multilateral channels*, donor preferences for one or another, and will require a rethinking of their advantages and disadvantages. In particular, it is likely that regional and sub-regional institutions will acquire greater importance, and that it will be necessary to address the question of division of labor between bilateral, regional and global development assistance institutions.

There has been a heated debate regarding the *relative merits of grants versus soft loans in ODA for the poorest countries*, particularly for multilateral institutions. Grants do not generate long-term debt obligations, can be more readily and easily provided, do not necessarily require recipient country government commitments and can be channeled to non-governmental organizations, all of which may be more appropriate for very poor countries. Against these arguments, it is pointed out that soft loans contain a high 'grant element' and are provided in very easy terms, require commitments and discipline from borrowing country governments and public agencies, allow repayments to be used in other poor countries and are better ways of discharging the fiduciary responsibility of donors to their taxpayers. This debate has affected the replenishment processes in several multilateral institutions, and particularly at the World Bank's concessional lending arm IDA where —at the insistence of the United States government— up to 30 percent of flows to developing countries are now provided on a grant rather than a soft-loan basis. This is eroding the financial integrity of IDA and reducing its capacity to provide soft loans in the medium and long term.

Moreover, *the recent agreement to cancel multilateral loans to the 38 Highly Indebted Poor Country (HIPC) countries* (mostly in Africa) will eliminate up to US$42.5 billion in debts to IDA and US$10 billion to the African Development Fund. This could result in the cancellation of nearly US$ 51 billion in IDA loans outstanding as of June 2005, which would wipe out about 40 percent of total IDA's assets. However, these 'assets' are of dubious quality at best and would be non-performing without HIPC countries continuing to receive further loans to service their IDA debts.[xii] However, unless donor countries fully cover the cost of these debt write-offs (as they have offered to do at the 2005 Fall Annual Meetings of the World Bank and the IMF), IDA and the soft loan window of the African Development Bank would be severely crippled. In addition, some donor countries, for example the United Kingdom and Canada, have written off their outstanding soft loans to HIPC countries, and there is pressure for other donors to do so. However, it is not clear that many of these countries will be able to both cancel their bilateral debt and cover their share of the cost of multilateral debt reduction in the coming years.

3. Emerging issues for ODA at the beginning of the 21st century: an L-20 perspective

The changed international context for development finance requires a careful scrutiny of the mix of enduring and changing motivations for ODA, which need to be examined in relation to the *changing landscape of donors and recipients*, to the *leverage and catalytic role of ODA*, to *security and other emerging concerns*, and to preoccupations with the *effectiveness of aid*.

3.1. *Changing landscape*

The number, structure, size, priorities and orientations of donor countries and organizations engaged in ODA activities have changed over time. The weight and influence of specific donor countries has shifted, new actors have emerged and others faded, and there have also been significant changes in aid delivery instruments. At present, European countries provide the largest share of ODA, both through the EU and their own bilateral agencies; Japan, the star performer of the late 1980s and early 1990s, has significantly cut its participation in development assistance; the United States experienced a decline in its aid budgets, but has recently increased development assistance (although a large proportion of this increase is targeted according to geopolitical interests); and several transition economies of Eastern Europe are in the process of becoming donors after joining the European Union. Russia is back on the donor scene, primarily through debt relief operations, but is also creating a new development assistance agency, and the surge in oil prices could revitalize the OPEC Fund established by the oil rich countries in the 1970s.[xiii]

The rise of several emerging economies as regional powers is also prompting a rethinking of the aid landscape. Some of the possible L-20 countries —for example, Brazil, China, India, Korea, Mexico, Saudi Arabia and South Africa— have made

statements regarding their intentions to provide technical and financial assistance to other developing countries. These initiatives have an antecedent in the 1978 United Nations 'Buenos Aires Plan of Action' on technical cooperation among developing countries (TCDC), which the UN General Assembly has agreed to review and update. Among other issues, this review will examine the potential role of 'triangular cooperation', in which donor countries finance the provision of technical assistance from relatively more advanced to less advanced developing countries.[xiv]

The diversification of donor countries, together with the emergence of large private foundations (most notably, the Gates Foundation) and non-governmental organization (mainly in the environmental field) as key donors, has been matched by an even greater differentiation of developing countries. Traditional schemes to categorize developing countries, based primarily on income per capita, do not adequately reflect the diversity of situations, needs and possibilities of these countries with regards to external and domestic finance, which suggests the need for alternative classification schemes more closely aligned with their resource mobilization capabilities. This would allow a better match between sources of external finance, financial instruments and recipient countries, and also to define a more appropriate and effective role for ODA.[xv]

The changed landscape for international development finance suggests there may be a role for the L-20 in renewing ODA. Other gatherings, including the G7/8, the Development Committee of the World Bank and the IMF, the United Nations, the European Union, the G77, do not have the breadth, depth and legitimacy required to explore and put in practice new schemes for international development cooperation and finance.

3.2. *Volume and potential leverage*

Efforts to pressure donor countries to raise the volume of aid have centered on the achievement of the 0.7 percent of national income target, which only a handful of developed (mostly Nordic) countries have managed to consistently surpass. Development activists and some political leaders have argued, and succeeded to a certain extent, for ODA increases on the basis of this target.[xvi] Yet, however laudable the intentions, it is difficult to justify the use of such targets on theoretical and practical grounds, and it would be better (but admittedly, perhaps less flashy) to use arguments based on need, performance and effectiveness of ODA in specific circumstances. There is also a downside to the use of targets and indicators: when they are not achieved after considerable pressure and effort, they tend to generate frustration, apathy and even cynicism.[xvii]

Notwithstanding recent increases, the *prospects for ODA do not look bright over the medium term*. The share of ODA in total net flows to developing countries is likely to stabilize or decline, and also to focus on fewer and poorer countries. For ODA to maintain its relevance and effectiveness in a broader range of developing countries, it would be necessary to link it to other sources of finance, including direct foreign investment (to spread it more evenly between different types of developing countries),

capital markets (to reduce risk and induce investments in developing country financial assets), philanthropic grants (to complement and relate them to development needs), remittances (to encourage the provision of local public goods), and market creation (to promote development–oriented private and public market transactions).[xviii]

While there are many financial instruments that can leverage ODA, further ingenuity and experimentation are required. In particular, *new forms of private-public-private partnerships for special purposes, which could bring together bilateral ODA, capital markets, private foundations and multilateral institutions, need to be carefully examined*. A recent example is the launching of the International Financial Facility for Immunization (IFFIm) a scaled-down version of the International Financing Facility proposed by the United Kingdom.[xix] However, the proliferation of such special purpose funds should be balanced with the need to achieve economies of scale and reduce administrative and transaction costs in delivering aid. Other innovative possibilities include the levying of international taxes for development purposes,[xx] the establishment of development-oriented lotteries, and the creation of mechanisms for financing international public goods. This later option has been suggested as a way of complementing traditional ODA, primarily by inducing sector ministries in donor countries to finance developing country activities related to the provision of global and regional public goods under their purview (health has been the most widely mentioned example).[xxi]

The L-20 could provide a forum to promote debate, encourage experimentation and assess the relative merits of alternative ways of mobilizing external financing for development and, in particular, for leveraging ODA resources.

3.3. *Security and other emerging concerns*

After the end of the Cold War ODA began to decline but at the same time was asked to respond to a more diverse and growing set of demands. These were related to environmental sustainability, disease prevention and control, post-war reconstruction, the needs of transition economies, humanitarian assistance and debt relief, among others — all of which went beyond the traditional remit of ODA in the social sectors, poverty reduction, infrastructure, rural development, agriculture and other production activities.[xxii] During the 1990s *increased demands and reduced resources created an 'ODA squeeze' that strained bilateral aid agencies, multilateral institutions and international organizations* and made them scramble to cope with this situation by creating new programs and funds, dividing diminishing resources among a larger number of initiatives, and making (mostly futile until recently) appeals for ODA increases. As a reaction, long-standing calls for greater 'focus', 'concentration' and 'rationalization' of aid intensified and led to major program restructuring in several bilateral aid agencies.

The overwhelming concerns that have recently influenced the volume and structure of ODA for some key donors are global security and the war against terrorism.[xxiii] While domestic security in developing countries is a pre-requisite for development efforts, the current emphasis on global security could highjack aid as the

Cold War did for decades. The pursuit of narrow geopolitical and security interests distorts aid allocation patterns, reduces resources available for human development, and reinforces pernicious practices such as the provision of tied aid. The United States, Japan and European countries have all increased their volumes of aid since 2001, but a significant proportion of additional allocations have been motivated by security considerations that privilege a few countries of geopolitical significance and is directed to projects of dubious development impact. [xxiv]

The international security concerns of donors and the needs and priorities of developing countries do not usually coincide, even though they could conceivable be more aligned. Prospects for ODA will depend on the way in which motivations linked to global security and the war on terrorism interact with those related to human development objectives. It may be possible for security concerns to fuel large increases in aid which could be channeled to developing countries in a more coherent manner to improve standards of living. It may be equally possible (and perhaps more likely) that these concerns will displace human development considerations in ODA.

The 'ODA squeeze' of the 1990s has not been overcome by the aid increases of the early 2000s. Security concerns have, once again, intruded and run the risk of further accentuating the mismatch between growing demands for human development aid and ODA resources. Periodic gatherings of the L20 to address ODA issues could help to broaden donor perspectives on global security, particularly by including regional security considerations, and to address security and human development concerns in a more balanced and constructive manner.[xxv]

3.4. *ODA effectiveness*

The recurrent concern with the impact and effectiveness of ODA intensified in the 1990s, prompting a call for reforms in the international development financing architecture. These led to some significant improvements in several bilateral agencies (most notably in the UK), in achieving coherence between aid and other dimensions of international economic policy in some countries (most notably Sweden), and in several UN agencies and international financial institutions.[xxvi] Yet, efforts to improve ODA effectiveness have not radically changed an international development finance 'system' that has grown by accretion and appears inadequate to cope with the complex development realities of global interdependence.

The quest for greater aid effectiveness reached a high point with the adoption in March 2005 of the *Paris Declaration on Aid Effectiveness: Ownership, Harmonization, Alignment, Results and Mutual Accountability* at the High Level Forum on Aid Effectiveness, that gathered representatives of donor and recipient countries, of international institutions and of civil society organizations. This declaration underscores the importance of scaling up arrangements for more effective aid, taking into account and adapting to differing country situations, and of specifying indicators, timetables and targets to monitor and evaluate the implementation of aid reforms. Yet, it is difficult to anticipate rapid progress towards the Paris Declaration objectives —especially in the new

international security context— when lack of coordination, overlap, duplication, competition and attempts to 'raise the flag' are still pervasive in the aid community; when traditional technical assistance and tied aid account for a sizable portion of bilateral ODA; when some key donors continue on 'bilateralize' multilateral ODA; and when aid policies are at odds with trade, finance and other donor country policies.[xxvii] Moreover, some of the proposals for improving effectiveness, such as the repeated calls to 'focus' and 'concentrate' aid, appear to have been made without substantive empirical evidence to support them.[xxviii]

Recipient country ownership of aid programs and projects, transparency and accountability, and the insertion of aid programs within a coherent development strategy have also been linked to greater aid effectiveness. Countries with a large number of poor and with 'good policies' are supposed to be the most effective users of aid, even though beyond a few basic principles such policies depend on country circumstances and change over time. These arguments have fueled a debate between 'performance' and 'need' as main criteria for allocating ODA, and also underscored that countries most needing help may not be those that can use it best. All development assistance agencies face this dilemma and the way they resolve it depends largely on their mix of motivations for providing aid. Closely related to this dilemma are the choices related to aid for 'problem solving' or for 'capacity building', and to the idea that poverty reduction —the main organizing principle for ODA in the early 2000s— may not be a direct objective for aid, but a consequence of achieving other intermediate objectives such as growth, equity, sustainability and participation.[xxix]

While many of the issues involved in assessing development effectiveness are of a technical nature and require rigorous evidence, decisions on how to improve ODA effectiveness are highly political. The High Level Forum on Development Effectiveness has pointed the direction towards a more streamlined, coherent and effective international development financing architecture. Yet, there is ample room for the political support and guidance at the highest levels that a body like the L-20 could provide for reforming ODA.

4. Concluding remarks

The relative weight of ODA in development financing has declined over time and at present it plays a less important in role in aggregate financial terms, although for many of the poorest countries aid continues to be an important source of external finance (and even a major component of national budgets). In the coming decades ODA should be viewed as a complement and catalyst for other external flows and for domestic resource mobilization.

The way in which current world economic imbalances (fiscal and trade deficits, high savings and rising reserves, asset bubbles, high oil prices, among others) are resolved will have a major impact on development finance. A 'hard landing' will negatively affect investor confidence and curtail private flows, hurt the large emerging economies that are most vulnerable to large-scale sudden withdrawals of private financing, and thwart middle-income countries attempts to gain and consolidate access to

international capital markets. In addition, the fiscal retrenchment that would follow an abrupt correction would have serious consequences for poor countries that depend on official flows.

Assessments of the prospects for ODA in the medium and long term should keep in mind that ODA is an instrument of foreign policy for donor countries. In an ideal world, poor countries should evolve from being recipients of and dependent on aid to having full access to capital markets and other sources of private funds, and to being a source of capital for other developing countries.[xxx] With this in mind, what role can be anticipated for ODA in the coming years? Will it fade into the sunset as some observers anticipate, or will it renew itself and play an important role in development finance?[xxxi]

At worst, ODA will center around a 'grants ghetto' of poor countries dependent on the good will and largesse of donors, largely cut from other sources of finance; a 'security gang' dependent on large flows from security-minded donors that have a highly questionable development impact; and a 'tragedies fund' to provide humanitarian assistance in cases of natural or human made disasters. The rest of developing countries would be left to fend for themselves by attracting direct foreign investment in any way they can and by scrambling to access capital markets, with modest help from the international financial institutions.

At best, the donor community would make judicious use of limited ODA resources in a pluralistic setting and differentiated manner, seeking to catalyze other public and private flows, drastically reducing tied aid and restructuring technical assistance operations. A full spectrum of official, private and public-private partnership flows will be available to all types of developing countries and 'gradation' —not 'graduation'— will rule the transition from using one set of financial instruments to another. ODA would have become a smaller but strategic player in a highly diversified development finance field.

The issues involved in renewing ODA in this new setting exceed the reach, grasp and legitimacy of the G-7/8, the G-20 at finance minister level and of the OECD Development Assistance Committee. Neither are the World Bank/IMF Development Committee or ECOSOC at the UN the appropriate venues for dealing with them in the coming decades. The L-20, with its developed and developing country membership, with its high share of most indicators that reflect world economic activity, and with regional economic powers that could muster support from all parts of the world, could be an appropriate forum to explore how to revitalize ODA, for improving aid governance and for balancing excessive unilateralism and hegemonic tendencies of some key donors.

Notes

[i] This paper has been prepared for the meeting on "What do we want from ODA?" that will take in Petra, Jordan to explore the question as to whether a meeting of Leaders at 20 (of the countries say, in the G20 Finance Ministers group, as opposed to the G8 Summit) could produce some value added actions in the

area of Official Development Assistance. It is partly based on F. Sagasti and G. Alcalde, *Development Cooperation in a Fractured Global Order: An Arduous Transition*, Ottawa, IDRC, 1999; F. Sagasti, K. Bezanson and F. Prada, *The Future of Development Financing: Challenges and Strategic Choices*, New York, Palgrave-Macmillan, 2005; and K. Bezanson and F. Sagasti, "Prospects for Development Thinking and Practice", report for The Rockefeller Foundation, August 2005.

[ii] The Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) defines official development assistance (ODA) as the grants and loans to developing countries, together with technical assistance and the administrative costs of providing this assistance. The grants and loans should be provided by public institutions in developed countries, have economic and social development as their primary objective and to have soft or concessional nature (meaning they have at least 25 percent of "grant element", which in practice means loans with low interest rates of about 1 percent, repayment periods of 30-40 years, and 10-15 years before the first repayment is made).

[iii] See: "Main developments in the history of foreign aid from 1940-2005, background paper for Petra Conference on "What do we want from ODA", November 11, 2005.

[iv] Development ideas have an uncanny way of reappearing after several decades. Current proposals by Jeffrey Sachs (in his *The End of Poverty*, Penguin, New York, 2005), the United Nations Millennium Project report issued in January 2005, and by Gordon Brown, the United Kingdom Chancellor of the Exchequer (centered around the International Finance Facility), all argue for large up-front investments to reduce, poverty, particularly in Africa. See William Easterly, "Reliving the '50s: the Big Push, Poverty Traps and Takeoffs in Economic Development", Washington DC, Center for Global Development, August 2005.

[v] For a recent review and summary of these debates and additional evidence on the impact of aid on growth, see: Steven Radelet, Michael Clemens and Rikhil Bhavnani, 'Aid and growth', *Finance and Development*, September 2005, volume 41, number 3. For a more detailed assessment of earlier debates see F. Sagasti and G. Alcalde, *Development Cooperation in a Fractured Global Order: An Arduous Transition*, Ottawa, IDRC, 1999

[vi] Radelet *et al*, *op.cit*.

[vii] See, for example, 'Aid for the 21st century', chapter 3 of the 2005 *Human Development Report*, New York, United Nations Development Programme, 2005..

[viii] These three categories were: debt relief (US$3.7 billion); technical cooperation, which is mostly tied aid (US$5.2 billion) and emergency assistance (US$1.7 billion).

[ix] The 1969 Pearson Report argued that it was necessary to strengthen multilateral channels, which at the time were perceived to be more efficient and less politicized. See: *Partners in Development: Report of the Commission of International Development* (chaired by Lester Pearson), Praeger, New York, 1969. Multilateral assistance expanded in the late 1960s primarily for three reasons. First, the United States became more interested in multilateral initiatives and between the mid-1960s and the mid-1970s the share of United States share in multilateral aid more than doubled to 30 percent. Second, the Nordic countries (Sweden, Norway, Denmark and Finland), Canada and the Netherlands expanded their assistance and gave high priority to multilateral channels. Third, multilateral development cooperation institutions, most notably the World Bank and UNDP, improved significantly their administrative and technical capacities, and were thus able to attract strong support from bilateral donors.

[x] In the second half of the 1980s the United States share of total ODA declined to 18 percent. This coincided with a shift towards greater emphasis on bilateral security and political interests in the provision of aid, away from the priority awarded to multilateral initiatives a decade earlier. For example, the security-oriented Economic Support Fund, which provides bilateral assistance to countries of strategic interest to the United States, grew faster than other types of development assistance and accounted for about 50 percent of total United States bilateral aid in the late 1980s, with 90 percent of its funds earmarked for five countries (Israel, Egypt, Pakistan, El Salvador and the Philippines).

[xi] The increasingly important role of Japan in the world economy during the 1980s and the weakness of its development assistance organizations led to a growing reliance on multilateral institutions to channel Japanese aid. This was done through larger contributions to multilateral concessional assistance funds (e.g IDA, Asian Development Fund), and through co-financing arrangements and the establishment of trust funds. This allowed Japan to exert greater influence in the policies and practices of multilateral institutions while pursuing a policy of 'bilateralism' in multilateral assistance (trust funds and co-financing maintain a

separate identity and 'raise the flag' of the donor country). European donors also expanded their participation in multilateral channels during the 1980s, particularly through the European Community.

[xii] Geoffrey Lamb and Danny Leipziger, "The G8 Debt Relief Proposal: Preliminary Costs and Issues", World Bank, July 27, 2005, p. 3. Also, notice that OECD reporting arrangements on development assistance allow governments to report the entire stock of debt reduction as aid given in the year it is written off, which may lead to large increases in the volume of aid in a given year. According to the UNDP's 2005 *Human Development Report*, this inflates the actual value of debt relief since the real financial savings to the recipient country come in the form of reduced debt servicing' (p. 90).

[xiii] Ibid. note 7.

[xiv] The High-level Committee on South-South Cooperation of the UN General Assembly requested that these matters be discussed during the 2005 General Assembly meeting. The Buenos Aires Plan of Action was approved in September 1978 and endorsed by the UN General Assembly the same year.

[xv] On this matter see Sagasti, Bezanson and Prada, *op cit*, section 3.4 and appendix B.

[xvi] For a scathing criticism of the use of the 0.7 percent target see Michael Clemens and Todd Moss, 'Ghost of 0.7 %: origins and relevance of the international aid target", Washington DC, Center for Global Development, September 2005.

[xvii] Performance indicators have been used to determine the eligibility of developing countries for aid. For example, the Millennium Challenge Account (MCA) established by the United States uses 16 indicators, mostly related to good governance, economic performance and social conditions, to identify countries that should have access to MCA grants. Several of these are highly debatable and appear excessive.

[xviii] For example, the mismatch between investment requirements in infrastructure and basic services and resource availability in developing countries requires a careful aligning of risk/return considerations for private investors, social/economic return considerations for public sector institutions, and political economy considerations for users and governments. The problems experienced by foreign and domestic private investment ventures in the provision of transport infrastructure, water supply and sanitation, and health services in many developing countries indicates the need for continuing work in the design of incentive schemes and institutional frameworks to approach such an alignment.

[xix] IFFIm was launched in September 2005 by the governments of the United Kingdom, France, Spain, Italy and Swede, as well as the Global Alliance for Vaccines and Immunization (GAVI). It aims to provide an additional US$4 billion over the next ten years to support the work of the Vaccine Fund (largely supported by the Gates Foundation) and of GAVI to improve access to underused vaccines and speed the development and introduction of new vaccines in developing countries. It will issue bonds in international capital markets that will be repaid from bilateral ODA allocations of the participating countries. The resources obtained from bond issues will allow front-loading the expenditures associated with the vaccine programs. See: www.vaccinealliance.org and www.iffim.com.

[xx] France has recently proposed an air travel tax for development purposes, but this has encountered opposition in other EU countries. Other options are the Tobin tax on international currency transactions, the bit tax on information flows, and the carbon tax on the use of hydrocarbons. Of these, the latter would seem to make most sense, both on environmental and development grounds, particularly if the price of oil eases during the coming months and years.

[xxi] On this matter see the introduction and conclusions of the volume edited by Inge Kaul, Pedro Concieciao and Katell le Goulven, *Providing Global Public Goods and Managing Globalization*, Oxford, Oxford University Press, 2003.

[xxii] For example, see 'Ecology is key to effective aid, UN told', *Nature*, Vo. 437, 8 September 2005.

[xxiii] To a much lesser extent, the war on drugs has also emerged as a security-related concern of donors in some developing regions such as the Andean countries and particularly Colombia.

[xxiv] Ngaire Woods in 'The Shifting Politics of Foreign Aid', Global Governance Program, University College, Oxford University, 25 February 2005, points out that 'Most of the increase in US aid has been destined for projects designed to serve the security imperatives prevailing in the wake of September11. Hence, almost all of the $2 billion supplemental in 2002, the $4 billion supplemental in 2003 and the $20.1 billion supplemental in 2004, plus roughly $2 billion annually in 'budgeted' funds —a total of approximately $32 billion over the past three years— went to help countries on the front lines of Afghanistan, to build support for the war on Iraq or to fund the reconstruction of Iraq and Afghanistan' (p. 5). She also points out that: 'Even as Japan's ODA budget allocations have continued to decline (they fell again in 2004 by almost 5 percent), the country has made extensive commitments to help with postwar

reconstruction in Afghanistan and in Iraq' (p. 9); and that: 'British aid and the government's focus on poverty reduction, including in middle income countries, is undoubtedly being diverted by the new security imperatives. However, this effect is being mitigated by a rising overall aid budget and by multilateral lending to middle-income countries. Conversely, the high share of UK channeled through the EU is increasingly being used to meet new security imperatives'. Finally, Woods points out that 'The new [EU security] framework declares security as a 'first condition for development'. … It emphasizes the need to create synergy between security and development goals through a more coherent and comprehensive approach. … The new EU strategy fits with a broader shift among donors towards the use of aid for security purposes', (p, 13).

[xxv] On development and security linkages see Francisco Sagasti, Ursula Casabonne and Catherine Bellamy, 'Development and conflict prevention: beyond greed, grievance and alienation", Working Paper, San José, Costa Rica, University for Peace, August 2004; and Necla Tschirgi, "Security and development policies: untangling the relationship`, New York, International Peace Academy, 2005.

[xxvi] On the UK experience with reforming aid see: Owen Barder, 'Reforming Development Assistance: Lessons from the UK experience', Washington DC, Center for Global Development, October 2005; on Sweden's drive to achieve coherence see: *Shared Responsibility: Sweden's Policy for Global Development*, bill approved by Parliament in 2003; and for other attempts to improve the workings of the international development system see chapter 2 of Sagasti, Bezanson and Prada, *op cit*, 'Attempted Change: Recent Attempts to Transform the International Development Architecture'.

[xxvii] For an attempt to rank donor countries according to the soundness and consistency of their aid policies see the annual reports on donor performance by the Center for Global Development at www.cgdev.org.

[xxviii] On this matter see: Lauchlan Munro, 'Focus-Pocus? Thinking Critically about Whether Aid Organizations Should Do Fewer Thins in Fewer Countries", *Development and Change* Vol. 36 (2005), No.3, pp. 425-447. After a careful examination of arguments for and of the various dimensions of focus, Munro concludes that 'increased 'focus' is not an unalloyed good … and many of the arguments put forward in favor of increased focus in aid organizations are either invalid or need to be better thought and more carefully nuanced.' (p. 443).

[xxix] On the tradeoffs and complementarities between capacity building and problem solving in a specific field see: Francisco Sagasti, *Knowledge and Innovation for Development: The Sisyphus Challenge of the 21st Century*, Cheltenham, UK, 2004, Box 5.2.

[xxx] In such an ideal situation, perverse international finance flows moving from poor to rich countries through excessive debt repayments and capital flight would not obtain, and most countries would provide capital to each other through the workings of the international capital markets. For a scenario approaching this state see Michael Klein, 'One hundred years after Bretton Woods: a future history of the World Bank Group', *European Investment Bank Papers*. Vol. 3 (1998), No. 2, pp. 31-58.

[xxxi] On this matter see: Tim Hartford, Michael Klein and Klaus Tilmes, 'The future of aid (parts 1 and 2)', Public Policy for Private Sector notes Nos. 284 and 285, World Bank Private Sector Development Vice Presidency, March 2005.