Reengineering Development Finance in the 21st Century

> **'Official Development Assistance' (ODA) is dying…What we are witnessing is the dilution of an outdated concept – one based on long gone illusions about the unity, the clarity and the purity of the 'international community's' goals – into a new complex breed of public policies that attempt to confront the challenges of a globalized world. A triple revolution of objectives, players and instruments is reshuffling the cards, dynamiting old practices and habits. The bustling creativity of development finance is precipitating a change of era: a new phoenix is rising from the ashes of a half-century old policy.**
>
> **(Severino and Ray, 2009)**

A Changing Pattern of Flows

The mixture of development resources is in flux and the future of traditional aid is in turmoil. This is likely to have a profound effect on the planning of any post-2015 scenarios. Only a decade ago, development assistance was predominantly supplied by traditional OECD donors and conformed to an established set of norms. Developing countries now have access to an increasing variety of resources to finance their development. While Official Development Assistance (ODA) still plays a catalytic role in low-income and least developed countries, it is also increasingly challenged by alternative sources of finance such as Foreign Direct Investment (FDI), remittances and emerging new non-traditional forms of development finance. The latter fulfil similar purposes and include South-South Cooperation (SSC), climate finance, philanthropy and other forms of private development assistance. Both traditional and non-traditional flows have been growing in volume over the past decade – a trend likely to continue in the future. The development finance agenda is undergoing a rapid transformation, which is questioning the relevance of ODA and making it necessary for donors to rethink their strategies.

Greenhill et al (2013) estimate that total development assistance grew from $77.1 billion to $213.5 billion between 2000 and 2009. In 2000, the 'non-traditional' component of these flows was only $5.3 billion, or 8.1% of the total. By 2009, non-traditional flows had increased tenfold to $53.3 billion, making up 30.7% of total development assistance.

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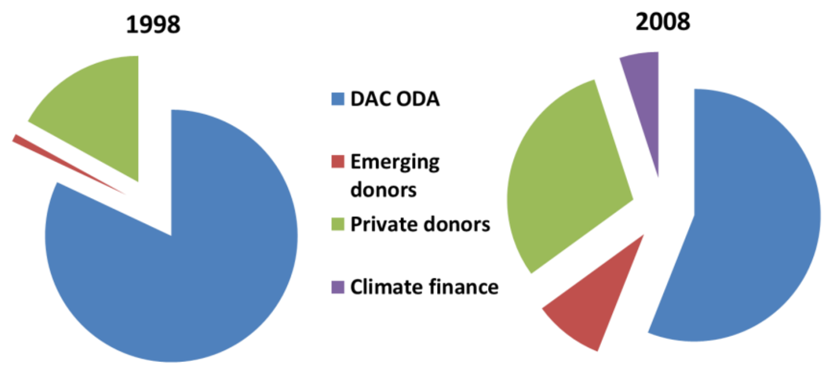
Figure 1: Changing pattern of aid flows



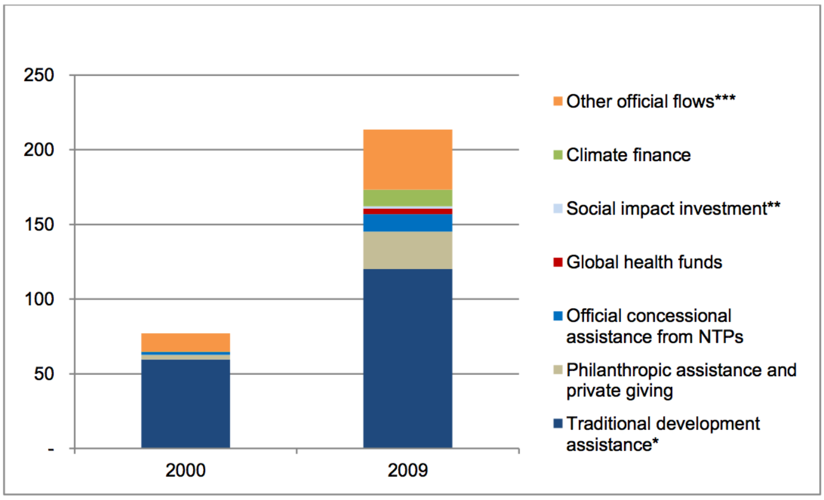
Source: Kharas (ed), 2011

Figure 2: Which financing resources matter? Changing nature of capital flows to sub-Saharan Africa (USD billion)

	2001	*2011*
Private capital flows		
FDI, net inflows	15	40.9
Bond flows	2	6
Net portfolio equity inflows	-0.9	8.3
Total above	**16.1**	**55.2**
Other financial flows		
Aid for Trade	2.5	9.2
All ODA aid	14	43
Remittances	4.8	31
IFC investments		2.2
IDA / IBRD credits		36.3

Source: Te Velde, 2013 (European Parliament Hearing presentation)

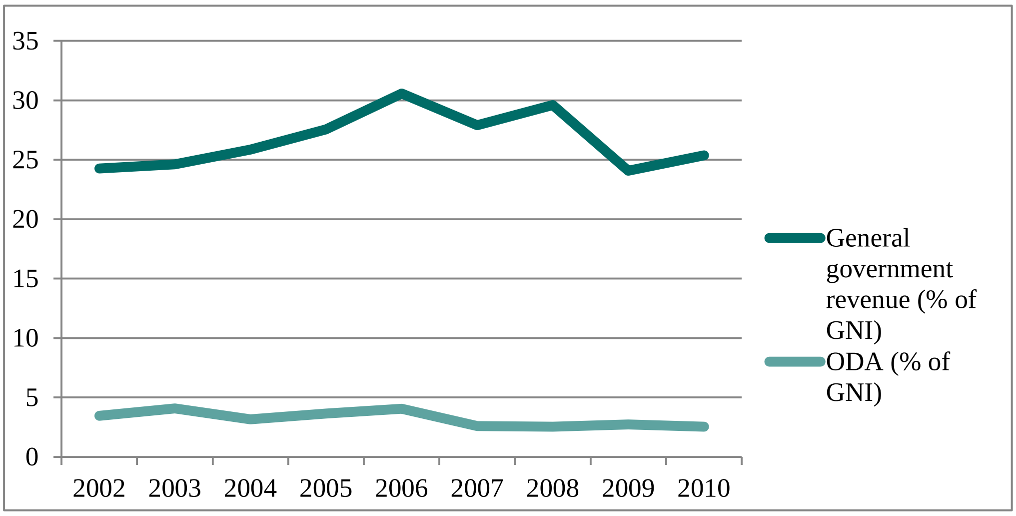
Figure 3: Trends in development assistance flows, for 2000 and 2009 (in billions)



Source: Greenhill et al. 2013

Domestic Resource Mobilisation

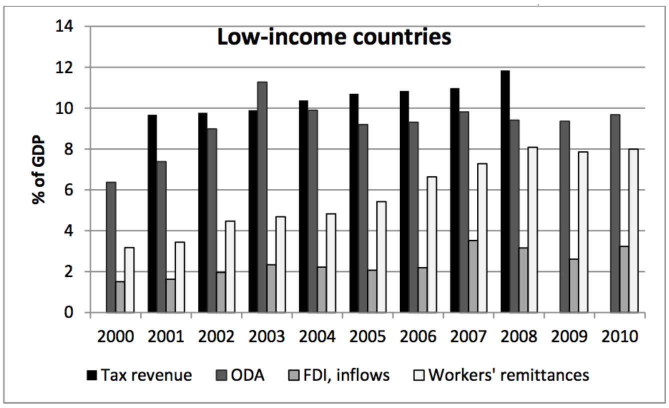
Figure 4: Trends in Government Revenue and ODA in Sub-Saharan Africa



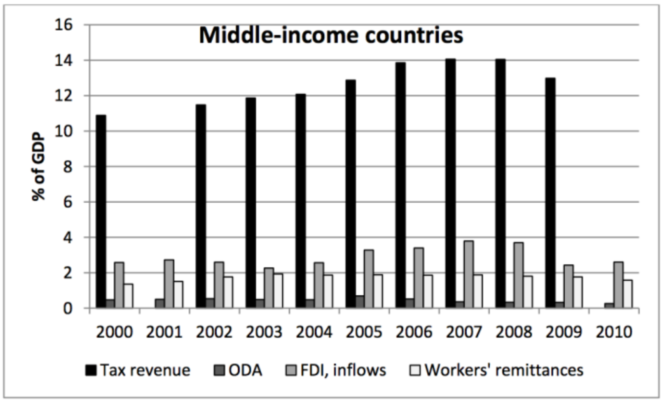
Source: Author's own construct using IMF and OECD-DAC database

A more prominent source for development resource mobilisation in the future could come from developing countries themselves. The high government revenue ratio (government revenue as a percentage of GNI) in countries in sub-Saharan Africa suggests that governments have considerable means to promote development. As the global financial crisis has affected ODA growth, the case for domestic resource mobilisation has become more prominent, although there is little clarity on how to channel and increase the contribution of such funds. A large body of empirical work suggests that developing countries can increase tax revenue to raise development finance, or at least increase the extent to which taxation is used to finance development.

The distribution and importance of the different development finance flows are highly uneven across income categories. For MICs tax revenue is significantly higher than ODA, FDI or remittances, whereas for LICs ODA is close to, or in some years even higher than, tax revenues. Other sources of development finance were and will continue to be concentrated in MICs: the level of FDI inflows and remittances to MICs in 2010 was considerably higher than to LICs and has been increasing at a higher rate (Greenhill and Prizzon, 2012).



Figures 5 and 6: Domestic and cross-border flows as a share of GDP: LICs vs. MICs

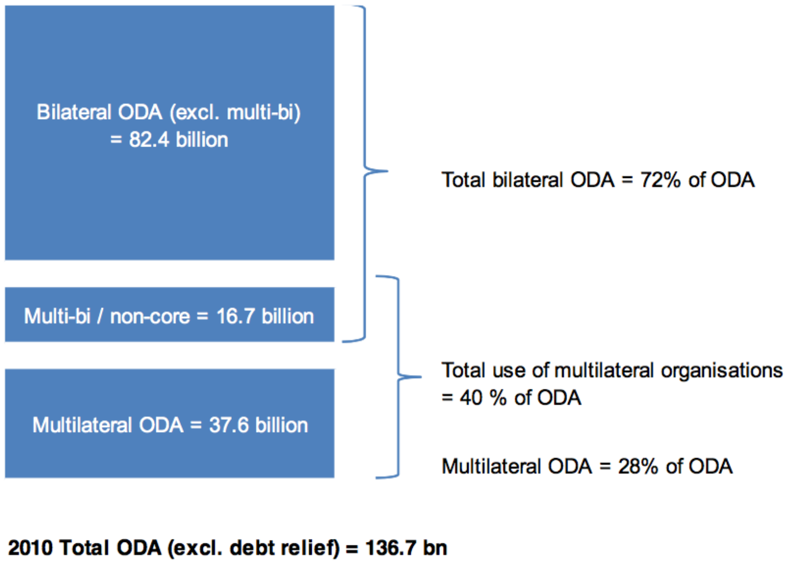


Source: Greenhill and Prizzon, 2012

Multilateralism vs. Bilateralism

Figure 7: Gross ODA disbursements (2010) (excluding debt relief and contributions from EU Institutions, in constant 2010 prices)

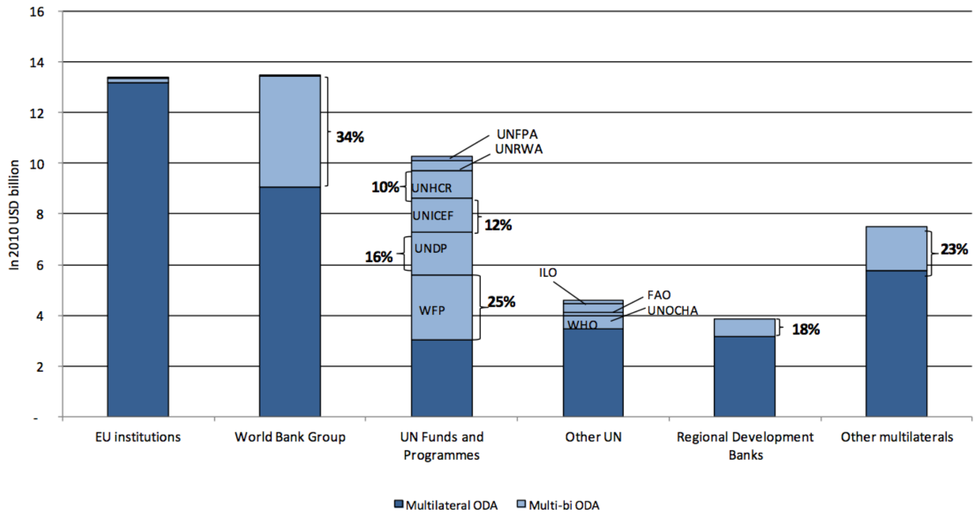
Source: OECD DAC 2012 Report on Multilateral Aid



In 2010, the multilateral system accounted for 40% of gross ODA (an 8% increase in real terms compared to 2009). Bilateral aid comprised 72% of all ODA: 12% of total ODA (USD 16.7 billion) was identified as bilateral but was in fact channelled through and implemented by multilateral agencies.

45% of multi-bi aid is not allocated by country, but is earmarked for a specific region, theme, and/or sector (e.g. Sub-Saharan Africa, food security, climate change, or education). Of the 55% that does go to particular countries, the bulk is disbursed to fragile and conflict-affected low-income countries, which means that the multi-bi aid serves as a channel for donors to reach the poorest and most fragile countries.

Figure 8: Total use of the multilateral system, gross ODA disbursements in 2010

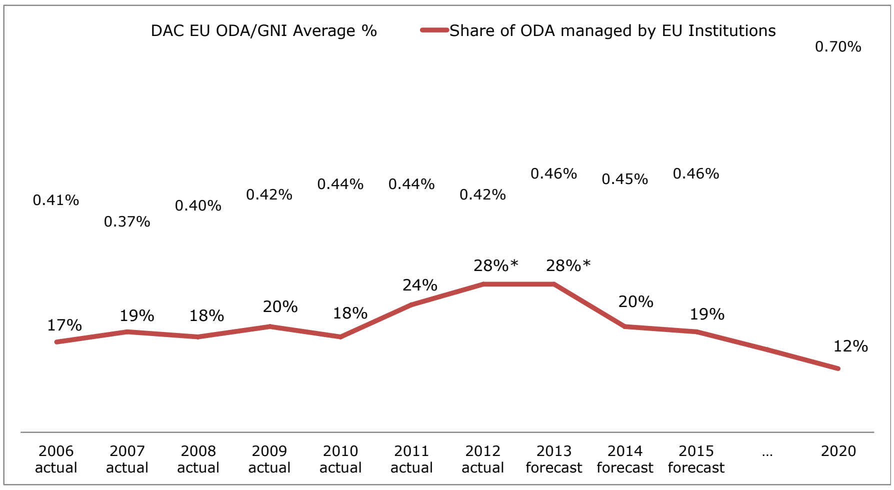


Source: OECD DAC 2012 Report on Multilateral Aid

The largest volume of multi-bi flows is channelled through UN Funds and Programmes and the World Bank Group. Since it only recently started to accept earmarked funds, the EU has a relatively small share of multi-bi flows but it channels the largest volume of multilateral development aid.

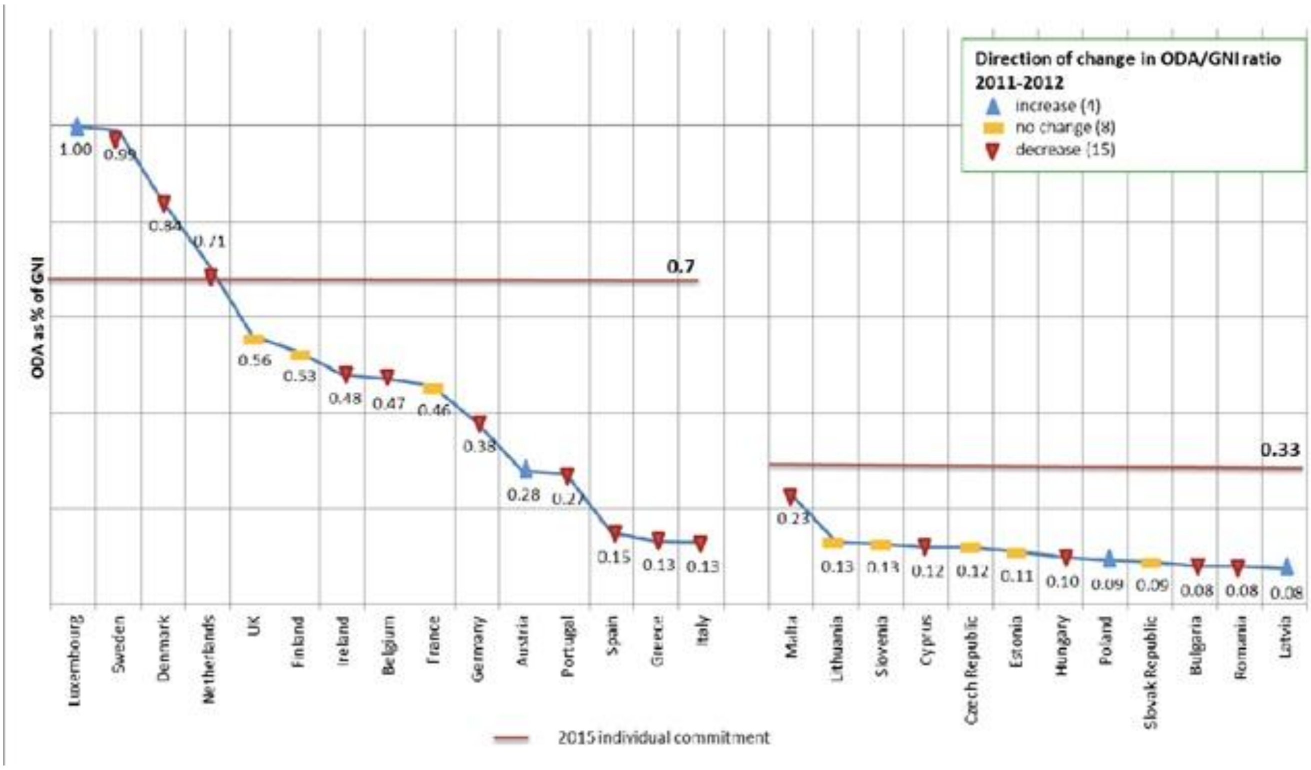
However, as the Member States' ODA levels grow in an attempt to reach the 0.7% target, the respective share channelled and managed through the EU will decline – this is because the individual contributions by Member States are fixed for the following seven-year term by the MFF and the EDF agreements.

Figure 9: A declining footprint of the European Union



**The increase in the share of ODA managed by the EU for 2012 and 2013 to 28% is due to an increase in loans.
Source: Gavas, 2013

Figure 10: Gap between 2012 ODA levels and 2015 agreed individual targets of the 27 EU Member States and direction of change from 2011 to 2012



Issues for discussion

- Is ODA still relevant?
- Does having more choice regarding sources of development finance put recipient countries in a stronger negotiating position?
- To what extent should donors support the diversification of sources of development financing?
- Should ODA become exclusively concentrated on countries which cannot access private development flows?
- How can donors use ODA to leverage other investment flows?
- Is it better to be a big multilateral donor or a small bilateral organisation?
- Is climate finance changing the entire framework of development finance?

Further Reading

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