

The Future of ODA: A Role for an L20?

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November 1, 2005

This paper starts from the proposition that the world has changed dramatically since the “aid business” began sixty years ago, and that it needs to be redesigned.

If an L20 is to consider taking on the future of ODA, it probably is useful to think about what kind of aid would be needed to meet current circumstances and challenges. In other words, what might leaders do if they were creating an ODA system from scratch in 2006? Is there still a role for ODA? If so, for what countries and purposes?

What follows is a series of assertions and propositions that deal with issues of considerable complexity. They are set forth with the intention of promoting discussion of what a meeting of heads of government might do to make ODA relevant for the decades ahead.

The World has Changed

The world for which ODA was designed has changed considerably, due both to development successes, technological change, and the impact of globalization:

- Trade and private financial transactions have exploded, and now dwarf any official flows, whether concessional or not. The outcome of the Doha round will have greater impact on development than any increase in ODA;
- Many countries are quite capable of running their own affairs. As a result, the role of ODA providers has changed.
- New economic and political powers have emerged that will have to be much more fully integrated into international decision-making. The need is particularly obvious in the Doha negotiations, and in the debates over the governance of the Bretton Woods institutions.
- Development progress has been historically unprecedented, whether measured in terms of economic growth or in human well-being. A growing number of countries, particularly in Asia, are now facing problems of “success” – growing obesity in children, and the needs of an aging population.
- Poverty persists at an unacceptable level, despite overall development progress. While the **percentage** of people living in absolute poverty has diminished considerably, the **number** of people living in poverty remains the same (due to population growth).
- We live in a global culture and marketplace. Communications have expanded rapidly and their cost has plummeted. The world is “wired” in ways that open new opportunities

(particularly the expansion of global civil society) and pose new threats (epidemics and terrorism and crime).

- As a result we run the risk of creating a new two-tier world; not the old “North-South” dichotomy, but between countries and groups that are doing well and many countries and human beings who are not.

The Development Agenda has Broadened

The development agenda now includes:

- preventing violent conflicts, both those that have longstanding historical roots and those that will inevitably arise in the process of creating market economies and open political systems (thereby lessening the opportunities for terrorists and criminals and preventing conflict from spilling over to other countries);
- promoting open societies and broad political participation both for their own sakes and because open, participatory societies make better political and economic choices over the long run, and give people the sense that they can affect choices that will shape their own future;
- expanding global trade so that it benefits not only industrial and developing countries but also poor people to ensure that the resulting growth does not further damage the environment;
- restructuring the international financial system both to dampen the costly instabilities that are inherent in a globalized financial system with no effective international regulation, and to lessen the ability of terrorists and criminals to transfer funds;
- addressing critical global problems most notably climate change and other environmental stress and health threats at both the global and local levels;
- eliminating absolute poverty (defined by the World Bank as those people living with an income of less than \$1 per day), not only because it is the preeminent ethical issue of our time, but also to ensure that people have the minimum capacities to utilize available opportunities and gain control over their own life. The MDGs are the critical first step.

Taken together, these issues form a coherent whole, linked to but separate analytically and programmatically from the security agenda. ODA has an important role in addressing all the issues on this agenda.

What Has Been Learned?

Much has been learned from the six decade long experience with promoting development. As a result, there is a much broader agreement on strategies for development that promotes growth and reduce poverty.¹ Both policy makers and specialists agree that:

- liberalized trade and economic openness have a beneficial impact on growth;
- growth is important, for its own sake and for reducing poverty. It is not sufficient, however, to eliminate poverty. Furthermore, both economic growth and affluence, and persistent poverty are pushing against the earth's limited carrying capacity;
- measures to directly address poverty also are important for their own sake, and if done right they enhance economic growth. In addition, participation by people in the development decisions that affect their lives is critical to the success of programs;
- similarly, good governance and democracy are important for growth, and also important goals in their own right;
- conflict, while not caused by poverty and lack of development, not only exerts a high human costs but also makes the solution to other problems much more difficult; and
- investment in poor people, and particularly poor women, by providing them increased access to education and health, as well as by redistribution of productive assets (credit and land), and by measures to support small-scale rural and urban enterprises, is critical.

These lessons are relevant for the period ahead and they need to be applied, particularly to ODA policy.

Many More Actors are in the Aid Game

Five decades ago, ODA volume and policy was dominated by the United States. The World Bank still was a bank, and the IMF was focused on the balance of payments problems of the OECD countries.

Now, the Bretton Woods institutions are the preeminent development agencies. Yet they provide only a small percentage of overall ODA. They set the intellectual debates on development choices and are the largest purveyors of research on development and global issues. There is no intellectual counterpart of similar weight in other parts of the UN, in the academy, or in NGOs. Furthermore, developing countries are their only clients (no industrial country has borrowed from the IMF since the mid-1970s) rather co-owners of the institutions.

The situation is further complicated because there are many more bilateral providers, and other multilateral programs have proliferated. Each has their own history and constituencies, as well as

a variety of country and regional interests. Furthermore, international NGOs are important players in development both as providers of assistance and active lobbyists on the global level.

The power imbalance between providers and users (or partners, to use the current jargon) of ODA remain great, and users remain in a weak bargaining position over conditions and uses. Furthermore, the burden for weak governments of managing multiple donors remains high. (I understand that the Tanzanian government has declared a donor ‘holiday’ – a three months period when they will accept no donor missions!).

Too much ODA still is being provided to middle and upper income developing countries, and is being used to support political or commercial interests. These interests may well be legitimate but they not the same as promoting development.

Finally, the multiplicity of donors means there is no way to determine when a country is getting too little ODA, and when it is getting too much. When is a reforming country committed to ending poverty getting too little aid to support reforms? And when is too much ODA diluting incentives to reform? Furthermore, a number of studies of aid and growth show that there can be diminishing returns from increased aid. ²

What’s Wrong With the Aid Business?

The current reality is that there are too many ODA providers trying to do too many things, in too many countries.

In a recent paper, Nancy Birdsall nicely summarizes the “seven deadly sins of aid donors”³

- *Impatience* – with institution building
- *Pride* – unwillingness to exit
- *Ignorance* – failure to evaluate
- *Sloth* – pretending participation is sufficient for ownership
- *Envy* – collusion and the failure to coordinate
- *Greed* – stingy and unreliable transfers
- *Foolishness* – under funding of regional public goods. (A recent glaring example is the under funding for programs to deal with easily treatable diseases, particularly in Africa).⁴

Many people involved in development share this critique, underscoring the need to seriously rethink the ways and instruments through which ODA is provided. In other words, some form of “donor structural adjustment” is needed.⁵

There is, however, uncertainty as to whether or not there is a consensus, either on what makes “good” aid programs or good provider policies.

What Could an L20 Do?

The reform of ODA may not be a good candidate for an L20 discussion. It may not be a topic that heads of government really want to spend time on. If so, that is a fatal flaw. Furthermore, not all providers will be at the meeting and will not feel committed. (This was nearly the case in the latest G-7 debt relief deal). Finally, an L20 may be more appropriate for dealing with multilateral agreements, than with the details of aid policy.

On the other hand, there is a considerable opportunity. There is now broad international agreement on the links between security and development, reflected in the reports and recent declaration of the United Nations. But the ODA “system” does not reflect that agreement in any strategic or operational way.

At the same time, ODA is increasing, and is projected to increase in a substantial way at least until 2010. But it remains a scarce resource when measured against the need and should be used much more effectively than now is the case.

Therefore it may well be time to think anew, a task that can best be ratified by a leaders “summit”.

If an L20 were to agree on an ODA system relevant for this century, what would what it look like?

It would:

- marry two components, both of which are essential: a) give responsibility for formulating and implementing development strategies to the user country, thereby giving ownership and increasing effectiveness, and b) enable providers to judge recipients development strategies according to their own criteria and make country choices accordingly;
- agree on a more rigorous, transparent performance-based approach to allocating ODA;
- give equal priority to dealing with global problems, regional needs, and country priorities.

Let me suggest a few elements of such a system. Others at the meeting undoubtedly will have their own views:

It would be country-centered, with ownership transferred to user countries. This is the only way to deal with the proliferation of donors. The Poverty reduction Strategy Papers (PRSPs) could play a useful role in transferring ownership if they were truly developed in a participatory manner.

It would be multi-tiered, providing ODA in different ways to countries based on performance. Preference would be given to “good performers”. For these countries, new aid mechanisms should be developed. For instance, providers could put their support in a “common pool” to fund country policies. Alternatively, a lead provider to partner with the user country could be agreed upon.

The Low Income countries would be another priority because ODA is their major source of development funding. For these countries, increasing the quality of ODA is particularly important.

Weak and failed states are a separate category that calls for particular kinds of ODA.

It would give first priority to meeting the MDGs (even after 2015). ODA should be focused on countries where most of the world's poor men and women live. Thirty-one countries contain 90 percent of the world's people living on less than \$2 a day. These countries are an obvious target for poverty-focused ODA.⁶

It would be “pull” oriented, rather than “push” oriented. Aid programs in recent decades have focused on conditionality. In return for ODA, government would agree to taking on reforms or meeting certain conditions. But conditionality has been a failure because many governments do not fulfill the commitments they made and donors ignore their failures.⁷

This should be replaced with incentive measures for countries, with longer term multi year commitments of ODA to countries that meet an agreed-up set of criteria. (The US Millennium Challenge Account is designed on this basis.)

It would put particular emphasis on building institutions and human capacities in order to address poverty and to take advantage of the opportunities opened by globalization, including market openings and the physical capacities to trade (infrastructure, etc)

It would include a focus on Global Public Goods, perhaps through a series of dedicated funds each designed to meet specific needs, for example:

- Health, including the Global Fund and the Vaccine Initiative
- Trade Related Capacity Building
- Environment
- Infrastructure, such as the recent infrastructure fund suggested by the Commission for Africa
- Humanitarian emergencies

It would agree on a new formula for financial support. The venerable 0.7 target remains very important on a political level, particularly to support domestic support for increased ODA. However, on an analytical level, particularly as a measure of need, it is not very helpful. It also is very weak analytically.⁸ Moreover, it is highly unlikely that any US administration will ever endorse the target, or try to reach it.

ODA already is increasing. Recent DAC projections show that if donors keep all their recent pledges (which are quite ambitious) ODA will reach \$130 billion in 2010. A useful first step would be to agree to disagree on 0.7 %, and instead focus on a new formula for burden sharing, linked perhaps to shares related to shares of world production.⁹

It would explore new innovative ideas for international sources. Momentum for new approaches is building. The new International Finance Facility that would use government pledges of financing to raise private funds from capital markets already exists. French President Jacques Chirac has issued a report assessing the prospects for various forms of international revenue raising; he has also proposed taxation of international commerce to generate funding for poverty and hunger reduction as well as capacity building for health. Others have proposed using a new

issuance of the IMF's Special Drawing Rights, a type of international monetary reserve currency, to bankroll development programs.

It would reform the governance of the major development agencies, particularly the Bank and the Fund, both to reflect the realities of the world as it is today and to make the institutions more legitimate in the eyes of the current users.

It would lay out an "exit strategy". After all, aid has been provided for over six decades. Will it ever not be needed?

One thing is clear. The "ODA system" that now exists is far from optimal. It is in urgent need of reform. An L20 meeting to that end could well make a useful contribution.

This paper draws heavily from the work of my former colleagues at the Overseas Development Council, and from the publications of its successor, The Center for Global Development. The notes that follow are designed to give credit to others or to expand on some of the points in the paper.

1. There is, however, considerable disagreement on the **priorities** among these strategies, and particularly what economic and political strategies should be used to implement these lessons. Some economists, notably Dani Rodrik of Harvard University, argue that while economic liberalization can bring growth and efficiency it will not do so automatically. Rather it is a country's ability to maintain macroeconomic stability in the face of the turbulent external conditions brought about by globalization that determines a country's success or failure. But countries that lack mechanisms and institutions to facilitate the political bargains that are necessary to manage economic and political stability will not succeed in capturing the benefits of economic liberalization.

2. The September 2005 issue of *Finance & Development* contains a number of useful articles on aid policy.

3. Nancy Birdsall. *Seven Deadly Sins: Reflections on Donor Failings*. Working Paper Number 50. Center for Global Development. December 2004.

4. Daniel M. Molyneux, Peter J. Hotez, Alan Fenwick. "Rapid-Impact Interventions: How a Policy of Integrated Control for Africa's neglected Diseases Could benefit the Poor." *PloS Medicine*. November 2005. Vol. 2. Issue 11

5. The recent *Paris Declaration on Aid Effectiveness: Ownership, Alignment, Results and Mutual Accountability* (OECD, 2005) , endorsed by Ministers from Developed and Developing Countries is a useful statement of principles, but its impact will depend on how seriously governments take it.

6. Thirty-one countries contain 90 percent of the world's people living on less than \$2 a day. This group includes two very large countries (India and China) where poverty is being cut dramatically; four large countries (Indonesia, Pakistan, Nigeria, and Bangladesh) each with approximately 100 million living in poverty; and 25 other countries, each of which contain 10 million to 25 million poor people. This very useful "map" of poverty countries can be found in William Cline, *Trade Policy and Global Poverty*, Center for Global Development and Institute for International Economics, Washington, D.C.. 2002. 11.

7. Tony Killick deals with these issues in an excellent article, "Politics, Evidence and the New Aid Agenda," in *Development Policy Review*, 2004, 22(1). 5-29

8. This point is made in *Ghost of 0.7 %: Origins and Relevance of the International Aid Target*, an excellent paper by Michael A. Clemens and Todd J. Moss. Working Paper 68. Center for Global Development. September 2005.

9. For instance, in Monterrey in 2002, George Bush pledged to increase US aid by 50 percent by 2005. He has come close to meeting that goal. If US aid were to increase by 50 percent every five years to 2015, the funds available would total \$43 billion, close to its "fair share" (i.e. 25 percent of total ODA) of the funds needed to meet UN MDG projections.