United Nations

CDP

Committee for Development Policy

The role of ODA in the new financing for development landscape*

The Committee noted the substantial gaps in the fulfilment of official development assistance (ODA) commitments to the least developed countries and in meeting the principles of the Paris Declaration on Aid Effectiveness. It recognized the central role that ODA played in the development of the least developed countries and therefore reiterated the importance of meeting ODA commitments, which should benefit those countries currently in the least developed category, as well as those which were in transition from the category. In allocating ODA to the least developed countries and countries that had graduated, donors should take into account the heterogeneity of needs within the group and the differences in the capacity of countries to access other sources of finance and mobilize domestic resources for development. The Committee further recommended that increased ODA flows should be accompanied by strengthened mechanisms of international tax cooperation to address the problem of illicit capital flows.

Climate financing should be separate from, and additional to, regular ODA. The least developed countries, countries graduating from that category and other developing countries suffered from severe vulnerabilities to climate change and other environmental shocks. The Committee recommended the use of the economic vulnerability index for the allocation of new climate finance, independently of whether countries met or did not meet the criteria for being classified in the least developed country category. That recommendation would also further promote the implementation of General Assembly resolution 67/221, in which donors were invited to consider the least developed country indicators as part of their criteria for allocating ODA.

1. Introduction

The international community is discussing the objectives of the post-2015 development agenda to be adopted in September 2015. The resulting "Sustainable Development Goals" (SDGs) are to replace the "Millennium Development Goals" (MDGs). While the final list of sustainable development goals still needs to be finalized, it is already clear that these objectives are vastly more ambitious than the MDGs and will have wide-ranging implications for the development cooperation system.

The objectives of the Istanbul Programme of Action (IPoA) are equally ambitious as it sets the target of enabling half the number of least developed countries (LDCs) to meet the criteria for graduation by 2020. Lately, the number of LDCs meeting graduation eligibility has increased. However, to achieve faster progress towards graduation, LDCs will need to have better access to Official Development Assistance (ODA) and alternative sources of financing. In this context, a renewed global partnership for development to mobilize unprecedented resources and political engagement is of critical importance. New and more effective financial (and non-financial) resources oriented towards LDCs will be needed for making the IPoA a reality.

2. The changing financing for development landscape

The landscape of financing for development has changed significantly over the last two decades. New sources of financing and modalities of support (official and private, national and international, financial and non-financial) have emerged. All of these can be useful for supporting the post-2015 agenda and the IPoA. Each type of financial support has its own characteristics, which make them particularly suitable for some actions but less so or unsuitable for others. Given its unique characteristics, ODA (and other ODA-like flows), even with lower relative weight than before, is an important component of international financing for development, particularly for the poorest countries. ODA remains of critical importance for reaching the IPOA objectives.

Along with an expanding list of globally agreed objectives, the post-2015 era will play host to an expanding and changing group of actors and modalities of development support. While MDG Goal 8 could be characterized, broadly speaking, as actions which developed countries needed to take to support developing countries, such clear-cut definitions are no longer a reflection of the reality. Many countries are already both contributing and re-

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ceiving development cooperation, which is now a more complex web of interaction and mutual solidarity and interest than the traditional donor/recipient relationship.

Moreover, new actors from the private sector, directly or through foundations, are increasingly supporting international aid programs besides promoting other activities such as philanthropy or social impact investments that have positive developmental effects without necessarily being ODA. With these new actors, the development cooperation system has also increased the range of its available instruments.

Traditional donors are reviewing new concepts and methods of measuring these different types of support. In doing so, the central objective should be that the new concepts are coherent with the very nature of development cooperation policy. This implies that those international interventions and activities (public and private) should: i) specifically intend to support development; ii) operate through actions that would not be promoted (or at least not in the same way) by the market alone; iii) give preferential treatment in favour of developing countries, and particularly the LDCs, in order to widen their opportunities of progress; and iv) be based on cooperative relationships that enhance developing country ownership.

3. The need for increased development cooperation: improving aid allocation

Due to their low levels of per capita income LDCs suffer particular constraints that affect their capacity for significantly improving domestic resources mobilization (trough national savings or tax collection) in favour of developmental purposes. Moreover, international private flows - such as FDI, portfolio investment or loans - are only marginally oriented towards LDCs. These flows are also selective in their destination and sometimes highly instable. Given the central role that ODA plays in the financing for development in LDCs (over 70 per cent of total external finance), international official flows (particularly, ODA and other ODA-like resources) remain of critical importance to LDCs as funding sources for poverty alleviation and sustainable development. Therefore, donors should confirm their commitment of allocating 0.15 to 0.20 of their GNI to LDCs through effective development programmes adapted to countries´ priorities. Donors that have not fulfilled that commitment yet, should define credible paths for reaching the internationally agreed ODA targets for LDCs. During this transitional process, these countries should also define public commitments around a minimum floor of their ODA budgets dedicated to LDCs (e.g. 50 percent of their ODA allocated to LDCs). Other development partners should give increased weight to LDCs in their cooperation activities, in accordance with their respective conditions.

Empirical studies confirm that donors do not consistently allocate aid in accordance with recipient countries´ needs and capacities. The presence of other factors in this decision (such as donors´ political or economic interests) divert resources from where they are most needed, hindering the effectiveness of aid. Therefore, in their efforts for supporting the IPOA, it is important that development partners define and adopt sounder criteria in the process of aid allocation, based on recipient countries´ structural impediments and capacities for mobilizing alternative (domestic or international) financial flows.

There are three considerations that can support this process:

- Donors should consistently apply the LDC criteria (particularly HAI and EVI) in their process of aid allocation. This is in line with General Assembly resolution 67/221 and would make the allocation of ODA more stable, predictable and less pro-cyclical.
- In their patterns of aid allocation, donors should take into account countries´ constraints s for mobilizing domestic resources (trough national savings or tax collection) in favour of developmental purposes.
- Finally, in the ODA allocation process, donor should consider countries' ability to access a range of other sources of financing.

Funding to address climate change should not either be part of ODA, substitute or divert funding from development objectives. LDCs, countries graduating from the LDC category as well as other developing countries may suffer from severe vulnerabilities to climate change and other environmental shocks. The Economic Vulnerability Index (EVI) should play a major role in the allocation of new climate finance to those countries.

4. Improving the transformative capacity of aid: Matching needs with cooperation modalities and supporting strategic international public goods

In order to improve aid effectiveness, development cooperation modalities should also be tailored in accordance with the existing heterogeneity within the LDC group and country specific conditions. Even if general preferential treatment and means of support are common for the whole category, donors should assess how to organize LDCs into more homogeneous groups of countries to provide them with better targeted development cooperation responses. In this regard, clusters of countries affected by the same structural deficiencies and needs could be identified. In doing so, there is a need to identify key areas related to structural impediments that deserve international support, select the countries mostly affected by these impediments and identify those development cooperation modalities most suitable for tackling the issues identified.

Improvements in agricultural productivity are important not just for raising overall economic growth, but also for reducing poverty and improving the livelihoods of rural populations. In this regard, agricultural research and development (R&D), in particular on tropical agriculture, is among the international public goods with a potential positive impact on the development progress of most LDCs. Development partners should therefore dedicate a higher percentage of ODA towards expenditure on agricultural R&D and extension services to LDCs. Public sector agricultural research, globally and nationally, should be strengthened through traditional and other sources of funding and partnerships, including through South-South cooperation, support for research institutions in LDCs and active participation of agricultural producers in research activities. Moreover, development partners should increase their support to CGIAR, alongside with searching for new partnerships with an emphasis on funding for improving agricultural productivity.

5. Addressing aid coordination and dependency

LDCs are among the developing countries that have low levels of institutional capacity for implementing projects and coordinating international providers of support. These countries also suffer from a proliferation of donors and aid fragmentation. In order to overcome these problems, donors should be encouraged to improve the level of compliance to the principles agreed in the Paris Declaration on Aid Effectiveness. Particularly, there is a need for strengthening ownership by recipient countries of donor supported activities and aligning donors' activities with local priorities and procedures. In addition, donor coordination in recipient countries should be strengthened.

LDCs are among developing countries with high levels of aid as a percentage of GDP. Studies have shown the negative effects of high levels of aid dependency, in terms of harming aid quality, damaging institutions and governance, and reducing international competitiveness in the recipient country. However, the reduction of ODA flows is neither an efficient nor a fair response to this problem. For some LDCs, ODA (and other ODA-like) flows is a source for financing much needed social services, which is currently difficult to replace, and of critical importance for reaching the IPOA objectives.

The process of reducing aid dependency requires attention at various levels: i) be cautious about plans to increase aid without considering its potential effects on the country; ii) establish plans to gradually downsize aid where feasible while seeking and backing alternative sources for financing a country´s development; iii) pay greater attention to existing options for mobilizing domestic resources and improving public administration, which involves not only domestic reforms (e.g. strengthening tax systems), but also improved international cooperation to strengthen surveillance and enforcement mechanisms related to tackling tax evasion, improper transfer pricing, capital flight and illicit capital flows; and iv) dedicate more resources towards the provision of crucial international public goods with a developmental effect on LDCs.