Development Co-operation Directorate (DCD-DAC)

DACnews February2014

FEBRUARY 2014

Discussing development finance

This issue of the DACnews focuses on recent discussions around the numerous existing and emerging forms of development finance. From discussions on climate finance at COP19, to domestic revenue mobilisation in fragile states, to the role of institutional investors in financing development. All these and many more resources must be co-ordinated and stepped up to meet the development challenges ahead.

DAC delivers key messages at COP19

DAC work on climate finance, climate change adaptation and green growth featured in two side events at the 19th UN Framework Convention on Climate Change (UNFCCC) Conference of Parties (COP19) in Warsaw, Poland in November 2013.

The OECD held a joint consultation **with the Climate Policy Initiative (CPI)** in the margins of COP19 to discuss two key policy issues: tracking international public climate finance and strengthening development co-operation for adaptation.

On international public climate finance, discussions revealed a broad consensus on the basic principles for improved tracking of climate-related aid, including: clear definitions and methodologies; transparency; and robust and integrated data management systems that work across multilateral and bilateral providers of development finance.

The meeting concluded that the OECD and CPI will work together with Multilateral Development Banks (MDBs) and other development finance institutions to advance an integrated system of tracking over time. The OECD reporting system (through the DAC statistical system and Rio markers), the Multilateral Development Bank reporting initiative and various surveys could be brought together in this effort.

Trends in climate-related aid

Two-year averages, 2006-11, bilateral commitments, USD billion, constant 2011 prices

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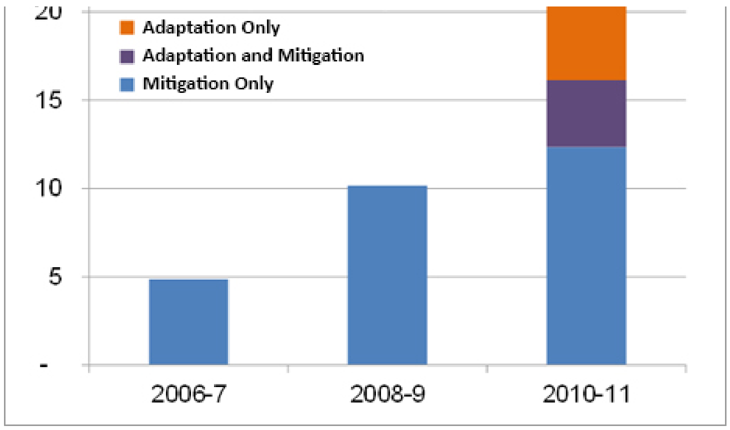


Source: OECD DAC CRS, [November 2013]

The DAC CRS [Rio Marker] methodology defines climate-related aid and currently provides comprehensive data on climate-related flows for bilateral official development assistance (ODA), partial data for multilateral ODA, and limited information for bilateral other official flows (OOF).

On strengthening development co-operation for adaptation, the OECD and CPI also agreed to work together with the UNFCCC, its Least Developed Countries Expert Group (LEG) and other key stakeholders to advance country-led policy and planning for adaptation together with good practice in development co-operation and finance for adaptation. OECD's Development Assistance Committee and its Environment Policy Committee have long-standing competence on adaptation and development co-operation; through their joint Task Team on Climate Change and Development Co-operation, they are well placed to support developing countries and promote good practice.

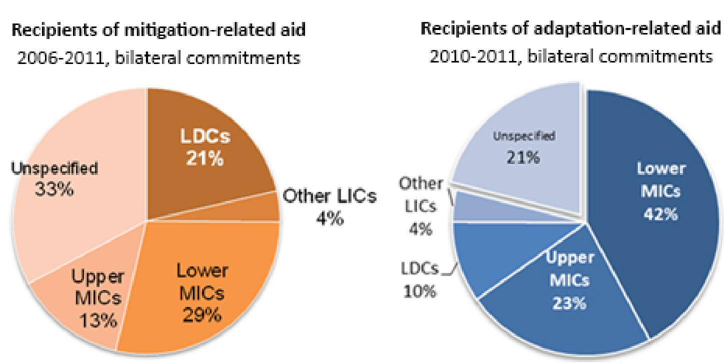
DAC findings also featured prominently in the official OECD side event **at COP19.**

Serge Tomasi, Deputy Director of the OECD Development Co-operation Directorate, joined Simon Upton, OECD Environment Director, to lead a panel discussion on efforts to improve the consistency and coherence of climate, energy and investment policies and the effectiveness of climate-related co-operation. The panel featured high-level government officials from Colombia, Costa Rica, Denmark, South Korea and the UK, and representatives from the Climate Markets and Investment Association.

Mr Tomasi presented the three pillars of international co-operation on green growth, drawn from the OECD publication Putting Green Growth at the Heart of Development:

- facilitate trade in green goods and services
- promote green technology and innovation through co-operation
- strengthen green finance and investment.

Statistics from the DAC Creditor Reporting System demonstrated that total bilateral climate-related aid commitments have been increasing at a steady pace.



Source: OECD DAC Creditor Reporting System, November 2013 Statistical Flyers

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PEER REVIEWS

Development Co-operation Peer Review: Norway 2013: Norway gave USD 4.8 billion in official development assistance (ODA) last year, or 0.93 percent of its gross national income (GNI), making it the third most-generous DAC member in terms of its ODA/GNI ratio. The DAC peer review of Norway praised the country's long and on-going commitment to high aid targets and noted that its steady economic growth should result in an increase in aid volumes in the future.

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PUBLICATIONS

OECD and Post-2015 Reflections: The two most recent papers in this series explore enabling investment in sustainable energy infrastructure and measuring and monitoring external development finance.

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2013 Partner Report on Support to Statistics provides a snapshot of ongoing support to statistical development across the globe and presents an overview of major trends.

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"Green Growth and Poverty Reduction: Policy Coherence for Pro-poor Growth" explores the policy coherence for development (PCD) dimensions of green growth strategies pursued by OECD member states.

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"Risk and Resilience: From Good Idea to Good Practice" outlines how resilience can be applied and how development

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Fragile States 2014: Domestic Revenue Mobilisation

The OECD report Fragile States 2014: Domestic Revenue Mobilisation is a reminder to the international community of the development challenges in fragile states. Here is a selection of key facts:

Aid to fragile states declining - new sources of financing needed

- By 2018, half of the world's poor (living on less than USD 1.25 a day) will be in fragile states.
- Progress on the Millennium Development Goals (MDG) has been much slower in fragile states than in other developing countries. Of the seven countries that are unlikely to meet a single MDG, six are fragile.
- Despite this, aid to fragile states is falling. It declined by 2.4% in just one year (2011) and is expected to shrink further, especially in least developed fragile states.
    - Remittances from migrants are the largest financial inflow in fragile states (56%), compared to aid (29%) and foreign direct investment (15%). The international community has yet to harness remittances as a development resource - for instance by facilitating their transfer, supporting their use to secure access to financial capital and matching them with aid where they are used to finance development.
    - In fragile least developed countries, aid remains the largest financial inflow (45%). Several depend heavily on aid and have few alternatives: in Tuvalu, the Solomon Islands, Afghanistan, Liberia, Sao Tome and Principe, Kiribati and Burundi, aid represents between 20% and 56% of GNI.
    - With aid on the decline, the volatility and difficult access to foreign direct investment, and the insufficient use of remittances as a development resource, securing other sources of financing is ever more important.

A wake-up call for domestic revenue mobilisation

- Domestic revenue is considered the most sustainable resource for development and a way out of aid dependency. Tax systems are also a crucial factor in building states. On average, developing countries raise 17% and OECD countries 34% of GDP in taxes. Fragile states, however, mobilise less than 14% of their GDP in taxes. Only Bosnia and Herzegovina and Kenya's rates meet the benchmark of 20% considered by the UN to be the minimum to achieve the MDGs. Afghanistan, Ethiopia, and Pakistan have rates below 10%.
- Providers of development assistance have recognised the importance of domestic revenue generation at Monterrey, Busan, the G8 and the G20. Investments in this sector can yield impressive returns: between ten- and twenty-fold. Yet development co-operation directs only a very small amount – 0.07% of all aid – towards building accountable tax systems.
- Using more aid to support fragile states in building accountable tax systems can strengthen statebuilding, enhance the credibility of governments and engage citizens.

A panel of experts will debate key issues from the report in an event at the OECD on 6 February in Paris. Find out more at: http://www.oecd.org/development/incaf/

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The DAC welcomes Slovenia as its 29th member

co-operation providers and key partners can incentivise integrating resilience into programming.

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"The Evolution of Official Development Assistance: Achievements, Criticisms and a Way Forward" documents the evolution of the ODA concept and proposes a possible new approach to measuring aid effort.

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"Evaluation Insights 8: Support to Civil Society" provides a summary of current trends in support to civil society, synthesises emerging lessons from recent research and evaluations on civil society support, and highlights some implications for policy makers and civil society partners.

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On 3 December 2013 Slovenia joined the DAC, becoming its 29th member. Slovenia is the fifth OECD country to accede to this forum in 2013, after the accessions of the Czech Republic, Iceland, Poland and the Slovak Republic earlier during the year.

The DAC welcomed the accession of Slovenia to the Committee. In the words of the DAC Chair Erik Solheim, "Slovenia's achievements in maintaining its development co-operation programme in difficult economic times is a testament to political leadership."

Slovenia has provided development co-operation since 2004. Over the past few years, and in particular since the Special Review conducted by the DAC in 2011, Slovenia has made considerable progress in building-up the foundations of its development co-operation. More specifically, it has established an institutional structure to manage its assistance with the Ministry of Foreign Affairs, the national co-ordinator for international development co-operation. In addition, Slovenia is progressively upgrading its performance monitoring and evaluation system.

Despite a strong economic downturn in recent years, Slovenia has managed to maintain its budget for official development assistance (ODA) at the level of 0.13% of its gross national income (GNI). In 2012, ODA stood at USD 58 million. Around two-thirds of Slovenia's ODA is given through multilateral assistance, mainly channelled through the European Union, and therefore indirectly reaches most ODA-eligible countries. Slovenia's bilateral ODA is concentrated in the Western Balkans (Albania, Bosnia and Herzegovina, Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia), as well as in Cape Verde and Moldova. The orientation towards the Western Balkans reflects their geographical proximity and common past, as well as the intensive degree of political and economic relations among countries in the region.

Slovenia's development projects emphasise good governance, environmental protection and the empowerment of women. Some of them also focus on enhancing human security, facilitating post-conflict rehabilitation, eliminating landmines and explosive remnants of war, and addressing the issue of illicit ownership and use of small arms and light weapons.

The State Secretary at the Ministry of Foreign Affairs of the Republic of Slovenia, Mr Bogdan Benko, declared that "Slovenia will contribute constructively within its capacities to the efforts of the international community to guarantee a better future for developing countries."

For more information, see the DAC Global Relations website:
http://www.oecd.org/dac/dac-global-relations/

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DAC Development Debates

International development at a crossroads

Bruce Jenks, (Professor, Columbia University; former Assistant Secretary-General, United Nations Development Programme [UNDP]), recently published the study United Nations Development at a Crossroads. There, together with his co-author Bruce Jones (Director and Senior Fellow, Center on International Cooperation, New York University; Senior Fellow and Director of the Managing Global Order Program, Brookings Institution), he analyses the challenges of international development co-operation at large, and of the UN in particular.

Bruce Jenks shared his thoughts during this DAC Development Debate, stating that development co-operation is not "fit for purpose" because it has failed to adapt to the changing development landscape. In particular, the system does not adequately account for the new role of the private sector as a financier and agent of development co-operation, the growth of the global economy and new financial flows, the rise of the BRICS, and the fact that the majority of poor people no longer live in poor countries (as also discussed in the Development Co-operation Report 2013: Ending Poverty). Furthermore, it has not overcome the simplistic North-South model. Against this background, Mr Jenks advocated for "deep reform" and "strategic repositioning" of the UN and other international organisations. This should include:

- moving from a Millennium Development Goals (MDG) world to a Global Public Goods world in which development issues increasingly involve collective responses

- redefining coherence as the alignment of all key players behind the provision of a specific Global Public Good
- aligning form, finance and governance to functions of the UN/international system, and imagining and implementing new forms of facilitating collective responses via new partnerships and systems of (hybrid) governance
- reforming ODA to overcome wrong incentives and to better leverage other resources
- continuing to move development co-operation from project implementation to standard and norm setting
- engaging in knowledge sharing among all countries (especially South-South co-operation).

Adam Rogers (Senior Advisor on Strategic Communication, UNDP) represented the UN in the debate and recommended the incorporation of all relevant development co-operation partners. From his point of view, greater emphasis needs to be placed at the global level, but at the same time, local ownership of reforms is necessary to develop sustainable solutions.

Participants discussed the role of the OECD DAC in this context, agreeing that OECD and UN member states need to be the proactive drivers of the required changes.

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FEATURE ARTICLE: Two birds with one stone: OECD's role in promoting long-term investment in developing countries

by Sony Kapoor, Managing Director, Re-Define; Senior Visiting Fellow, London School of Economics

A prominent expert on international finance and development, Sony Kapoor has worked in a policy advisory and strategy consulting capacity for international organisations such as the World Bank and the UN, international NGOs such as Oxfam and Christian Aid, financial institutions such as the Industrial Credit and Investment Corporation of India and Lehman Brothers, and governments including that of Norway. He is currently a member of the OECD-DAC Expert Reference Group on External Financing for Development*. This group advises the DAC and its Secretariat on work to modernise the way the DAC monitors and measures development finance flows.*

The world faces two major problems for which, luckily, there is an attractive common solution.

Problem one is the scarcity of capital in general, and of money for infrastructure investments in particular, in large swathes of the developing world. It is widely recognised that poor infrastructure holds back development, reduces growth potential and imposes additional costs, in particular on the poor who often do not have access to energy, water, sanitation and transport.

Problem two is the current sclerotic, even negative rate of return on listed bonds and equities in many OECD economies. The concentration of the portfolios of many long-term investors in such listed securities also exposes them to high levels of systemic - often hidden - risk. Most developed economies have considerable financial and economic inter-linkages and are exposed to common risk factors, such as demographic decline and elevated public and private debt. This leaves investors such as the Norwegian Sovereign Wealth Fund – which invests more than 90% of its portfolio in listed OECD securities – in highly vulnerable positions. They have locked-in, low returns for what is an inordinately high level of risk.

How are these problems connected?

Most long-term investors, including pension funds, insurance firms and sovereign wealth funds, would greedily buy up chunks of portfolios (well-diversified across countries and assets) of infrastructure assets in non-OECD countries. Not only would this offer a significantly higher rate of return for the long term; it would also diversify investors away from some of the excessive exposure in structurally similar OECD economies. The long-term nature of the investment would also match the long-term liability structures of investors such as pension funds.

At the same time, developing economies such as India are desperately short of the kind of long-term finance that is necessary to fund infrastructure; they are, thus, hungry for such investments. Long-term capital is in particularly short supply in developing countries, where neither governments nor private domestic markets have the capacity and depth to fill this funding gap.

But what about risk?

It is true that developing countries pose, on average, a higher degree of policy uncertainty and political risk than developed ones. It is also true that investing in infrastructure means that investors will find it hard to pull their money out on short notice, and therefore, such investments pose liquidity risk. However, three significant caveats are important here.

First, the events of the past few years have demonstrated that on average, political risk and policy uncertainty in developing countries have both fallen, even as they have risen in OECD economies. About a third of my friends who worked on political risk analysis in emerging and frontier economies have been hired away to work on OECD-country political risk. It is fair to say that the gap in political/policy risk between developing and OECD economies is diminishing.

Second, financial risks in developing countries are well known and often assumed to be much higher than in OECD economies; the truth is, however, more complicated. OECD economies are exposed to serious risk factors such as high levels of indebtedness and demographic decline. Moreover, as the financial crisis demonstrated, they are also likely to face other "hidden" systemic risks not captured by commonly used risk models and measures. Hence, the differential between the financial riskiness of developing economies and OECD countries may be less than commonly assumed.

Third, the kind of risks that dominate in developing countries, such as liquidity risks, may not be real risks for long-term investors, such as insurers or sovereign wealth funds. Given that the present portfolios of these investors are dominated by OECD-country investments, any new investments in the developing world may look more attractive and may actually offer a reduction of risk at the portfolio level.

What are the next steps?

Given the arguments provided above, why is it that long-term investors are not investing in developing country infrastructure in a big way?

The biggest constraint is the absence of well-diversified portfolios of infrastructure projects and the fact that no single investor has the financial or operational capacity to develop these. Direct infrastructure investment, particularly in developing countries, is a resource-intensive process. Also, because exposure to large fractions of a few infrastructure projects is risky, with the exception of a few very large investors, most do not have the capacity to actively cultivate such projects.

That is why the G-20, together with the OECD and other multilateral institutions such as the World Bank, must urgently address this collective action problem by facilitating the development of a diversified project pipeline on the one hand, together with mechanisms to ease the participation of long-term investors on the other. This work involves challenges of co-ordination, more than commitments of scarce public funds. The OECD, which uniquely houses financial, development, infrastructure and environmental expertise under one roof, must take charge. When the rare opportunity to kill two birds with one stone arises, it should not be squandered.

For more information, listen to the recording below, where Sony Kapoor highlights his three main points from a DAC Development Debate on "Is profitability compatible with development?: Institutional investors and their potential as a source of development finance".

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NEWS IN BRIEF

CALL FOR FOCUS SESSIONS: First Global Partnership High-level Meeting

The first High-Level Meeting of the Global Partnership for Effective Development Co-operation, which will be held in

Mexico City from 15-16 April 2014, will feature a limited number of focus sessions alongside the main plenary sessions. Focus sessions are meant to deepen the discussion, share successes or tackle common challenges in improving the way development co-operation is delivered.

If you would like to submit a focus session proposal, please refer to the guidelines and application form on the Global Partnership website for further information. Completed application forms should be sent to **HLMFocusSessions@effectivecooperation.org** no later than Friday, 21 February 2014.

To find out more about the Global Partnership and preparations for the First High-Level Meeting please refer to the documentation prepared for the upcoming Global Partnership Steering Committee meeting in Abuja, Nigeria on 13-14 February 2014.

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SAVE THE DATE: Expert Workshop on Green Growth, Development Planning and Policy

The DAC Network on Environment and Development Co-operation will hold an Expert Workshop on Green Growth, Development Planning and Policy on 20 February at the OECD Conference Centre. The Workshop will focus on in-country green growth initiatives and on how development partners are organising themselves to support these. It will build on the recent OECD report, *Putting Green Growth in the Heart of Development*, and on the International Institute for Environment and Development's publication on national green economy dialogues and diagnostics, *Scoping a Green Economy*. The Workshop's aim is to share experiences, identify lessons and promote good practice amongst development partners so as to advance inclusive green-growth initiatives. The Workshop will explore a number of specific themes such as integrating natural resource management, climate risk and adaptation objectives into development policies. For further information, contact Jan Corfee-Morlot (jan.corfee-morlot@oecd.org) and Juan Casado (juan.casadoasensio@oecd.org). For additional insights on our green growth work, visit our Green Growth and Development website.

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DAC Prize 2014: Taking Development Innovation to Scale

The past decades have seen unprecedented development progress in all regions of the world, including the halving of extreme poverty.

Innovative solutions that can be taken to scale (beyond the pilot phase to a wider application) will provide a key contribution to ending extreme poverty and closing the remaining development gaps. Many development partners have increased their focus on and support for innovation to offer solutions for development challenges, and a wealth of innovative ideas have been conceived, developed and tested over the past years.

The new DAC Prize for Taking Development Innovation to Scale recognises and promotes the scaling-up of innovations that address important development gaps, celebrating achievements in the belief that success is contagious.

Read more at http://www.oecd.org/dac/dacprize2014.htm.

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INCAF discusses Fragile States Report and post-2015 framework

The DAC International Network on Conflict and Fragility (INCAF) held its Sixth Director-Level Meeting from 16-17 January 2014 in New York, preceded by a side event on 15 January on engaging the private sector to help create jobs in fragile and conflict-affected states. Discussion focused on *Fragile States Report 2014: Domestic Revenue Mobilisation in Fragile States* as well as the planned Fragile States Report 2015, which will make the case for including conflict and fragility issues in the post-2015 development framework. The meeting also discussed the challenges and progress towards implementation of the New Deal at the country level, with an in-depth focus on the lessons learned from developing the New Deal compacts in Somalia and South Sudan, and a frank discussion on the ongoing crisis in South Sudan. Finally, members expressed their interest in engaging with the Global Partnership in the lead-up to their First High-level Meeting in Mexico and called for fragile states to figure prominently in the agenda.

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OECD DAC releases detailed final 2012 aid figures and new visualisation tool

The detailed final aid figures for 2012, which are now available on the OECD Aid Statistics web site, show that in 2012 net ODA was USD 127 billion, representing 0.29% of DAC donors' combined gross national income. The new data add significant detail to preliminary Official Development Assistance (ODA) statistics that were released in April 2013, including on: aid (ODA) and other resource flows (other official and private flows) by

donor and recipient countries; aid (ODA) by region and sector (such as education and health); information at a project level; and additional information such as policy markers, interest rates and tying status. These data are available in a number of formats, including through a new data visualisation tool that allows users to explore information down to the project level on how much aid has been provided or received and in which sectors.

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OECD DAC COUNTRIES' NET ODA IN 2012:

USD 126.9 billion, down by -3.6% in real terms and representing 0.29% of DAC members' combined GNI. For more information, see: http://oecd.org/dac/stats/idsonline.htm

Also Available

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