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# Proposal for a New Journey

**By Serge Tomasi, Deputy Director, Development Co-operation Directorate**

*The ideas expressed in this paper are those of the author and do not necessarily represent views of the OECD, the OECD's Development Assistance Committee (DAC), or their member countries, or the endorsement of any approach described therein.*

Official Development Assistance (ODA) was defined by the Development Assistance Committee (DAC) in 1969, at the request of the United Nations which wanted to establish a quantitative funding target allocated by donors to finance developing countries relative to their GDP. The following year, the UN General Assembly set the emblematic target for developed countries to provide 0.7% of their Gross National Product as ODA. Since then, the definition has hardly changed, but was clarified and supplemented by other concepts such as Country Programmable Aid (CPA) or Other Official Flows (OOF).

However, the financing for development landscape has since changed radically. The number of developing countries meeting the eligibility criteria to receive ODA has fallen by 55 between 1969 and today. Some developing countries have emerged as new economic powers themselves providing increasing amounts of foreign aid. Equally, financial instruments for development finance have diversified. At the same time, globalization has encouraged growth of foreign private investment in developing countries, as well as a rise in concessional funding provided by NGOs, foundations, private companies or migrants.

Today, traditional ODA accounts for approximately 20% of net external flows of developing countries whereas it represented around 50% in the 1960s. Total ODA from DAC countries currently stands at about USD 130bn per year, far behind remittances, over USD 345bn, and foreign direct investment, around USD 414bn. However, ODA's relative share varies greatly depending on countries' level of development. For example, it remains the largest source of external financing for low income countries in Sub-Saharan Africa, 60% of external funding; a region where foreign private investment becomes the main share of net external flows only in its upper middle income countries.

This gap between rapid economic development and the relative stability of ODA's definition has led to growing criticism of the indicator:

- That it is a dated terminology (development assistance) historically referring to a geopolitical and paternalistic vision of a North-South division that no longer corresponds to today's reality;
- That the definition provides little room for market-based instruments, being very focused on the grant element with a recurrent dispute on how to measure concessionality of loans. Moreover, that the concept is based on net flows and disbursements and tends to give more credit to investments that fail;[1]

[1] Indeed, the capital of a concessional loan will not produce ODA over the long term because it will be paid back by the borrower, the amount of capital reimbursed each year reducing the net ODA of the donor. On the opposite, if the loan

- That it is a complex aggregate that mixes apples and pears, integrating resource flows to developing countries as well as expenses incurred in the donor country;

- That the statistical system supporting it is strained as it seeks to account for both the donor's perspective (to measure and compare concessional aid effort) and the recipient's one (initially motivated by access to more abundant and/or less costly resources); and,

- Finally, the current ODA definition causes very perverse effects by encouraging integration into ODA of a growing volume of loans with little or no subsidy and with a high leverage effect. With one Euro of subsidy, and even in some cases with no subsidy at all, the system allows for the characterisation as ODA of five or six Euros provided through financial markets; as opposed to grants whose leverage effect is equal to zero but, on a Euro for Euro measure of funds extended to the recipient, has a higher budgetary cost!

This last effect can be less than optimal when the structure of the indicator linked to the pressure of achieving the 0.7% target leads to a choice of financial instrument, not because of its relevance to the nature of the expenditure to be financed in the recipient country, but because of its impact on the evolution of the donor country's aggregate (the volume of donor's total amount of ODA). Finally, it will lead to a sub-optimal ODA allocation because a growing share of ODA (financed with a growing share of low concessional loans) will be allocated mainly to Upper Middle Income Countries which find it easier to attract concessional loans compared to Lower Income Countries and Least Developed Countries.

At the end of the day, the ODA definition is criticized both because it includes some expenditures that (for some actors) perhaps should not be included such as in-donors expenditures, donors' administrative costs, margins of the consultants financed by ODA and high level cost of international experts; and it excludes others such as guarantees with strong leverage capacities on private flows and tax exoneration for private foundations etc.

The last ministerial meeting of the DAC, held in London in December 2012, bravely decided to tackle the problem. The DAC was asked to reflect on a new approach to development financing, revising if necessary the ODA definition. It was about time!

This paper's author proposes a new system to monitor development finance based on three criteria:

1. To have a simple and clear mechanism, a break from the current concept that is only understood by experts. To be legitimate in citizens' eyes, a development cooperation policy (we should drop the word assistance as emerging donors do not identify with it) like any other public policy, must be understandable and rely on concepts and indicators easily grasped by all;

2. To have a mechanism that takes into account the diversity of development financing means, creating positive incentives for their development; and,

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is not reimbursed because it failed to produce income to the benefit of the borrower, it will generate ODA. In the same vein, guarantees are included in ODA only if the guarantee is called following the completion of the risk.

3. To have a mechanism that takes into account both the donor's (the well-known aid effort), and developed countries' perspectives (the volume and cost of the resources) using different sub-indicators.

**What do we want to measure?**

**1. The donor's effort towards financing development:** The measure should gauge the budget expenditure allocated to projects, programs or public policies in developing countries including grants, the grant element of loans and subsidies for the cost of technical assistance provided in the recipient country. Consequently, it should be about following the budgetary expenditure voted by donor countries' national parliaments. (We should decide to include or not at this stage the in-donor expenditures).

This indicator would allow the measuring of fiscal effort for development, and for the comparison of effort between donors[2]. This indicator should be the one used to monitor States' commitments in the G8, the G20 or in the UN, because only this indicator reflects Leaders' political will and commitment as opposed to the current ODA, which by incorporating elements such as debt cancellation or net lending volume, is highly dependent on factors exogenous to Leaders.

**2. Public effort for development (1 +2):** This more holistic indicator would endeavour to monitor all public development financing instruments used by countries, regardless of their concessionality degree, and the time and place they are provided. It would therefore also incorporate, besides the fiscal effort, the capital of loans, market mechanisms such as guarantees, private equity from development banks and debt cancellations. Donor countries' expenditures, such as expenses for refugees, students and administrative costs could be integrated into this second category if we don't want to include them in the first one. Tax concessions for private charitable donations, see also 3. below, could also be included.

The advantage for the recipient country would be to be able to have more comprehensive information about the total amount of financial resources and instruments allocated by its partner countries.

**3. National effort for development (2 +3)**: Tracking the State's or public authorities' efforts are not enough. An increasing share of development finance is based on private initiatives (large foundations, NGOs, etc.) that raise resources directly from citizens.

It is time to recognize this form of solidarity and give it its rightful place in nations' efforts. This indicator will thus add to the two previous ones resources for development provided directly by citizens that do not go through public budgets.

**4. Private financing of growth:** This fourth stage would measure the evolution of private foreign investment in developing countries. This is an important indicator because these funds play a fundamental and growing role in financing the balance of payments' current account and economic growth, hence employment, in developing countries.

[2] It is today not relevant to compare the donor efforts taking into account growing differences among donors: indeed, some donors use only grants, with 100 % of budgetary efforts while others are using largely low concessional loans with a low level of budgetary effort.

It is also a good indicator of results in as much as it is a measure of a country's attractiveness to investors and therefore its ability to create an enabling environment for economic growth. However, it should be subject to specific monitoring as the primary goal is not to contribute to the international solidarity effort, but rather is subject to a business logic which aims to increase the revenue and/or improve the profitability for a private firm.

However, from the point of view of the recipient country, this remains fundamental. It is also in this last category where migrant remittances could be integrated. Indeed, remittances may represent a significant amount of external funding for developing countries, up to 10% of GDP in countries like the Philippines. It is primarily a savings effort from the nationals of recipient countries living abroad, who generally participate in the financing of growth through real estate investment or by providing family support, rather than in a logic of international solidarity.

Thus, through these four levels of indicators, the international community, providers and recipients alike, would have a clear and transparent monitoring system for development finance and growth in developing countries, where each indicator would have its own logic:

1. The first indicator, **budgetary effort for development**, would be used for monitoring provider governments' efforts and verifying whether commitments are being fulfilled;

2. The second indicator, **public effort for development**, would have as a goal to provide information to citizens and governments on all mobilized public funds to finance the development of poor countries;

3. The third indicator, **national effort for development**, would aim to highlight donor countries' national efforts, including those of civil society; and,

4. The last indicator, **private investment in developing countries**, would measure private investment flows and national capacity to attract Foreign Direct Investment (FDI).

Only the first three indicators would be integrated in a measurement framework for development finance by the DAC. Other multilateral agencies, for instance the International Monetary Fund (IMF) or the United Nations Conference on Trade and Development (UNCTAD), are able to monitor private financing.

This effort to clarify and modernise the concept of external development finance is a first step. It does not spare us from an effort to reflect on an extensive revision of the list of ODA-eligible countries. The current list embraces developing countries with very heterogeneous economic situations.

It cannot spare us either from reflecting on the purpose and the role of development agencies, which are moving from the traditional role of financing development projects to a role of financial intermediation in order to promote a better allocation of global savings in favour of growth in developing countries. As pointed out by the UN report of the High Level Panel of Eminent Persons on post-2015 Development Goals, annual resources managed by institutional investors account for $70 trillion and sovereign wealth funds annually for over $5 trillion. These savings are available and, unlike in the past, can be invested everywhere. It is our responsibility to create the right incentives to direct them effectively in favour of the economic and social development of poor countries.