Julca, Alex, Manuel F. Montes, and Rob Vos. "Towards a New Aid Architecture." *Retooling Global Development and Governance*. Ed. Rob Vos and Manuel F. Montes. London: Bloomsbury Academic, 2013. 49–72. The United Nations Series on Development. *Bloomsbury Collections*. Web. 26 Apr. 2023. <<http://dx.doi.org/10.5040/9781472544933.ch-003>>.

Downloaded from Bloomsbury Collections, www.bloomsburycollections.com, 26 April 2023, 01:16 UTC.

Copyright © United Nations 2013. You may share this work for non-commercial purposes only, provided you give attribution to the copyright holder and the publisher, and provide a link to the Creative Commons licence.

Chapter III

Towards a new aid architecture

ALEX JULCA, MANUEL F. MONTES AND ROB VOS

The past 60 years have seen substantial shifts in the system of official development assistance (ODA) as shifts in the dominant development ideas have changed and as the relative economic power among countries have changed the mechanisms and modalities of aid. The emergence of significant global economic players from the ranks of developing countries as well as the international philanthropy community has begun to initiate a new realignment of the international aid system. The increased participation of new players, the deep rethinking of decades-old beliefs regarding correct economic management, the challenges facing donors in raising the aid resources required, and emerging development challenges such as climate change present both dilemmas and opportunities to reshape the global aid system.

This chapter examines the strengths and weaknesses of the current international aid system. It assesses the effect that aid and its delivery mechanisms have had on the support for economic development and the building of partnerships for development cooperation. Over time, the aid “architecture” has become increasingly fragmented and its components increasingly dispersed. If aid is to become more effective and meet today’s challenges, the ways in which resources are mobilized and the modalities for providing assistance will need to be fundamentally reformed.

The motivations for development assistance may be divided into three categories: developmental, geopolitical and humanitarian, all of which overlap and are subject to changes over time. While it is difficult to make across-the-board generalizations about donors, one can argue that the approach to development aid has been strongly influenced by changing views regarding the development process itself. As discussed in chapters I and II, infrastructure investment and economic diversification were de-emphasized in the structural adjustment programmes that followed the

debt crisis in the 1980s. Then as the social costs of structural adjustment became clear, aid moved further away from supporting broader transformative development processes and became more narrowly focused on poverty and the social sectors.

This shift has been visible in the sectoral allocation of aid by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD).¹ As shown in table III.1, the share of ODA allocated to social infrastructure and services increased from an average of 21 per cent during 1970-1979 to 36 per cent in 2000-2010. The shares of debt relief and humanitarian aid also increased. This was at the cost of general programme support as well as support for economic infrastructure and production sector development (including support for agriculture). The combined share of these previously predominant destinations of aid resources fell from 50-60 per cent in the 1970s and the 1980s to about 30 per cent in the 2000s.

A COMPLEX AND FRAGMENTED AID ARCHITECTURE

Shifting aid objectives and mechanisms have created an increasingly fragmented and highly dispersed aid architecture, which, while it has been responsible for the clear and tangible benefits enjoyed by recipient countries in specific areas, does not appear to be supporting an effective system overall. Aid effectiveness has been found wanting on several counts. While abundant in some contexts, in others resource flows have fallen short

Table III.1:
Sectoral allocation of net disbursements of ODA^a

Percentage				
<i>Sectors</i>	<i>1970-1979</i>	<i>1980-1989</i>	<i>1990-1999</i>	<i>2000-2010</i>
Social infrastructure & services	21.27	25.22	26.98	35.60
Economic infrastructure & services	12.31	19.06	19.84	14.01
Production sectors	18.43	21.03	11.23	6.43
Multisector/cross-cutting	1.76	2.92	5.03	7.59
Commodity aid/general programme assistance	19.52	15.86	9.94	4.59
Action relating to debt	4.22	2.58	10.28	12.58
Humanitarian aid	1.03	1.72	4.71	6.96
Unallocated/unspecified	21.57	11.60	11.97	12.25

Source: OECD/DAC Database.

a Period averages.

of needs. Transaction costs have increased because aid delivery has become highly fragmented. For many recipient countries, resource flows tend to be volatile, thereby complicating budget processes and development project implementation. Finally, policy conditionality has undermined country ownership and effective use of resources.

Is aid sufficient?

A proliferation of donors does not necessarily mean more aid. The average size of aid programmes has become smaller. DAC donors, the major providers of ODA, have gradually increased disbursements in absolute terms over the past 50 years. There had been a drop during the 1990s after the fall of the Soviet Union, reflecting the significance of geopolitical influences on aid giving, and a revival during the 2000s. As a proportion of donors' gross national income (GNI), however, aid flows have been on a declining trend since the 1960s, falling from a high of 0.54 per cent in 1961 to a low of 0.22 per cent in the late 1990s (see figure III.1). Over the past

Figure III.1

Trends in ODA disbursements from OECD/DAC members, 1960-2010^a

Source: OECD/DAC Database.

^a Data for 2010 based on OECD/DAC projections.

10 years, ODA recovered as a share of donor country GNI, and that share is estimated at 0.31 per cent in 2011. However, the recovery in aid flows is, to a large extent, attributable to debt relief (Addison, Arndt and Tarp, 2010), reflecting a disregard for the principle agreed in the Monterrey Consensus of the International Conference on Financing for Development (United Nations, 2002) that debt relief should be additional to traditional aid. The recent increases in total aid flows from DAC members fall far short of the long-standing United Nations target of 0.7 per cent of GNI.

The delivery gap in fulfilling the commitments to support the development agenda centred around the Millennium Development Goals (MDGs) has been made all the more glaring by the poignant calls for additional assistance to the poorest countries to enable them to address food security problems and climate change. That delivery gaps are largest in aid commitments for Africa reflects the continued unevenness in the distribution of aid flows, which does not strongly favour populations in low-income countries. The 10 per cent of the developing world's population that lived in the poorest countries (excluding China and India) received 14 per cent of bilateral ODA in 2006-2007, slightly up from their share in 2000-2001 (figure III.2). Overall,

Figure III.2

**Distribution of DAC bilateral ODA by population decile for developing countries
a ranked by GDP per capita, 2000/01 and 2006/07 (percentage)**

Source: United Nations (2009c, p. 15).

bilateral aid from DAC countries is not strongly concentrated among the poorest countries. In contrast, multilateral aid, which accounts for about one fifth of ODA flows generated by DAC members, shows a stronger bias towards the poorest countries (United Nations, 2009c).

DAC members contribute about 90 per cent of the total volume of ODA flows. Recently, a number of non-DAC countries, including emerging developing countries like China, Brazil and India, have increased their role as donors. This is not a new phenomenon. Recently, China has expanded its foreign assistance to low-income countries, in particular to Africa, but previously—during the 1960s and 1970s at the height of the cold war—it also provided substantial foreign assistance, including for the financing of infrastructure projects in parts of Africa. Several oil-exporting countries have substantially increased their ODA over the past decade in the wake of higher world oil prices, as they did during the 1970s and 1980s. Figure III.3 shows the acceleration of non-DAC aid flows during the 2000s but it also shows that, in real terms, these flows have been well below the amounts of South-South development assistance provided during the 1970s.

China, India, Saudi Arabia and Venezuela (Bolivarian Republic of) are among the most active non-DAC donor countries, but the contributions

Figure III.3
ODA provided by non-DAC countries, 1970-2010

Source: OECD/DAC Database.

of Brazil, the Republic of Korea, Thailand and Turkey have also been on the rise. Countries in Asia and Africa are the main recipients of non-DAC South-South aid flows. Africa's share declined significantly, however, during the 2000s as compared with previous decades.

Private foundations and international non-governmental organizations have become quite prominent in the area of development assistance, particularly within specific fields such as health services. The 2009 Index of Global Philanthropy and Remittances (Hudson Institute, Center for Global Prosperity, 2009) estimates that foreign assistance to developing countries financed from private foundations, non-governmental programmes and individual donations in OECD countries amounted to \$49 billion in 2007.

Even after adding flows from DAC, non-DAC and private sources, total aid remains far from reaching the OECD target of 0.7 per cent of GNI. Hence, is the level of aid inadequate? When measured against the political commitment, clearly it is. The origins of this target date back to 1958 when the World Council of Churches argued that only with substantial aid from the advanced countries, could the poorer nations carry out their development plans and "avert the human disasters that follow from their failure".² The Council estimated that at least 1 per cent of the national income of the rich countries should be allocated for this purpose, but as it expected that 0.3 per cent of GNI could come from private sources, 0.7 per cent would need to be provided in the form of official grants and concessional loans.

The target was subsequently sanctioned by influential economists, including Paul Rosenstein-Rodan and Hollis Chenery, who independently estimated that the foreign exchange needed (calculated as the difference between capital requirements and domestic savings) to reach a target rate of growth of about 5 per cent per year in developing countries would be in the order of \$10 billion. This happened to have been equal to 1 per cent of the combined GNI of the advanced countries in 1961.³ Although the nature of global development challenges has changed radically, the target of 0.7 of donor GNI for aid is still accepted internationally, perhaps due to the fact that the target has never been met and the needs of the poorest countries remain so large.

However, there are several reasons to rethink the target. First, it does not appear to make much sense to calculate the financing requirements of one set of countries as a fixed share of a largely unrelated aggregate of a different set of countries. Second, the original estimate of the required level of ODA was based on the assumption that all of the aid would support investment and all of the investment would lead to commensurate increases in income

growth. The related evidence is not very strong. Moreover, the motivations behind disbursing aid have changed and the focus is far from exclusively on promoting economic growth. Third, it is likely that needs vary over time and will be context-specific. One attempt to estimate the aid flows required to meet the MDGs based on recipients' needs resulted in a figure of 0.54 per cent of rich-country GNI (United Nations Millennium Project, 2005). However, these estimates were based on a few country-level needs assessments and it is doubtful whether, given the diversity in contexts, total aid requirements can be derived by "scaling up" financing needs of a few individual countries. Further, we need to ask the question how to incorporate other recipient needs that may require additional support through ODA, such as those relating to food security, climate change and natural disaster relief.

Aid fragmentation

The trends in ODA flows just described have caused the aid architecture to become more fragmented, with a largely uncoordinated proliferation of destinations, donors and modalities. This has made the sufficiency of aid even more difficult to determine. The number of donors has risen exponentially while the average size of aid projects has declined considerably. The World Bank (2007) has estimated that, in 2006, donor support for development encompassed over 60,000 ongoing projects, with some partner countries engaging in over 1,000 donor-funded activities, hosting over 1,000 missions each year, and preparing as many as 2,400 progress reports annually. In low-income countries, as the number of projects has gone up, the average size of projects have gone down. The average number of official donors—bilateral and multilateral—per country has increased threefold since the 1960s; the number of countries with over 40 active bilateral and multilateral donors has ballooned from zero to over 30 since 1990 (*ibid.*).

Resurging Southern providers and non-governmental organizations and private foundations have added to this proliferation. Southern bilateral development assistance is virtually all in the form of project loans and grants, each with its own modalities and procedures. Through international philanthropy, historic contributions have been made to achieving malaria eradication and the goals of other global health programmes and in the area of the discovery and dissemination of high-yielding agricultural crops, among others. At the same time, non-governmental aid mechanisms have contributed to further aid fragmentation, as their operations and disbursements are more difficult to align with national priorities.

Aid fragmentation can be costly: donors undertake identification missions, negotiate the terms of projects to be funded, maintain their own accounting methods, tend to set their own conditions, and prefer to do their own monitoring and evaluation. A European Union (EU) report estimates the costs of delivering EU aid programmes at €2-3 billion; if all EU aid had been delivered in the form of budget support, transaction costs might have been less than €0.9 billion (European Commission, 2009). Indirect costs may be even much higher, thereby affecting the institutional capacity of developing countries and complicating the pursuit of coherent long-term development policies by governments, especially when they are highly dependent on aid and are dealing with multiple donors every day.

Earmarking of aid and proliferation of vertical funds

The last two decades have seen the proliferation of special-purpose funds for specific aid objectives. Among the major funding pools are the Global Environment Facility, which provides support for a set of multilateral environmental agreements, and the Global Fund to Fight AIDS, Tuberculosis and Malaria. Aid for Trade is a donor facility launched during the Doha Round of the World Trade Organization to help developing countries exploit the market access that they have obtained through trade negotiations.

While the establishment of special-purpose aid vehicles facilitates coherence in particular areas on the supply side of aid, it gives rise to many dilemmas on the demand side because of well-known inflexibilities of earmarked funding. For example, the delivery of health services in response to AIDS is often hampered by inadequate health systems. To achieve the goal of “fighting AIDS” it may be necessary to rebuild the whole health system, but special-purpose funds by their very nature cannot be re-channelled in this way. The administrative demands associated with accessing different special vehicles on the recipient side are high; and the costs of earmarking are just as relevant at the international as at the domestic level. Here lies one argument for providing assistance to countries through the overall budget channel and allowing recipients to use these resources according to their own priorities.

Aid effectiveness

Since the 1970s, aid effectiveness evaluations have generally been used to assess aid’s contribution to overall economic growth, even as its purposes and role in development have shifted. Addison, Arndt and Tarp (2010) and

de Haan (2009) argue that aid has a positive impact on economic growth, albeit with decreasing returns. In general, for each 10 per cent increase in the proportion of ODA to gross national income (GNI), the impact would be an increase of 1 per cent in economic growth (Tarp, 2010). Successful post-war European reconstruction through the Marshall Plan and other “economic miracles” in the second part of the twentieth century demonstrate that aid effectiveness can be achieved through carefully designed development objectives, appropriate institutional settings, and a stable flow of resources. Easterly (2006), in contrast, argues that while aid has been successful in a number of specific programme cases, failure has been the norm, owing mainly to both donor fragmentation and the diversion by recipients of fungible aid resources towards unproductive uses. Bhagwati (2010) also underlines absorptive capacity and fungibility problems as key factors undermining aid’s effectiveness. From different analytical perspectives, other studies have stressed the risks of becoming aid-dependent and experiencing few incentives for economic development (Reinert, 2005).

Donors have been trying to mend the situation. The 2005 Paris Declaration and the 2008 Accra Agenda for Action have called for greater coherence among aid objectives and for the acceleration of the implementation of the agreed principles therein. The Paris Declaration provides new codes of conduct for donors which aim to reduce fragmentation through target-setting for greater harmonization in the provision of aid, alignment behind recipient country development programmes, coordination of donor missions and diminishing the use of project implementation units. The quality of aid is to be enhanced by more predictable aid flows programmed at the country level. Strengthening mutual accountability of donors and recipients, an additional aim set out in the Paris Declaration, should help reduce transactions costs and strengthen state capacity.

Nonetheless, putting these principles into practice has not proved to be easy. Despite the targets agreed by the signatories of the Paris Declaration, “only 15 per cent of donor missions are undertaken jointly with other donors, well below the 40 per cent target set for this indicator, and only 9 per cent of partner countries undertake mutual assessments of progress in implementing agreed commitments and more broadly their development partnerships, against a target of 100” (World Bank, 2006b, p. 79). Reconciling national development priorities with the taxpayer-approved objectives of donor countries has been difficult. Less than a quarter of aid flows from DAC donors is provided in the form of budget support and in a few instances aid flows are part of multi-annual programmes. One of the

objectives of the Poverty Reduction Strategy Paper (PRSP) agenda was to give recipient countries more of an opportunity to occupy the driver's seat, aligning donors behind nationally defined development strategies. In practice, the PRSPs have not only been found to come with too many strings attached and to be excessively donor-driven (United Nations, 2009a) but have often proved ineffective in improving ownership and donor alignment (Wood and others, 2008).

With the rise in South-South cooperation, some DAC members have expressed concern that the aid provided by non-DAC donor countries (many of whom do not report their ODA figures and are not bound by the principles of the Paris Declaration and other aid conventions) may undermine progress to improve aid effectiveness. The presence of additional donor channels in an already crowded field increases the risk of duplication of activities and could lead to a setback for DAC donors who have the intention to reduce transaction costs for aid recipient countries by rationalizing reporting and accountability obligations. South-South cooperation partners have expressed their own concern that the “aid effectiveness” process is being driven too much by OECD, and that project aid—the preferred modality of South-South cooperation—could become a casualty of the preference for programme aid as governed by the principles set out in the Paris Declaration. There is still no international venue where these issues can be addressed, except possibly the United Nations Development Cooperation Forum held by the Economic and Social Council.

Aid volatility

In countries where aid flows are a large driver of their economy, aid volatility has compounded macroeconomic instability, affecting private and public investment spending and long-term growth. One study (Kharas, 2008) found that for the average recipient country, ODA flows are five times more volatile than gross domestic product (GDP) and three times more volatile than exports earnings.⁴ ODA thus could magnify real business cycles in recipient countries. Measured volatility cannot be associated with donor actions alone: using their own procedures, donors often have to respond—by halting aid disbursements, for example, if the prior year's resources were unutilized—to unexpected and unfortunate economic and political events beyond their control in recipient countries. Figure III.4 suggests that, for a sample of 65 recipient countries, higher levels of aid volatility was found to be associated with lower long-term rates of growth of GDP per capita. Least

Figure III.4

Aid volatility and economic growth in 65 recipient countries, 1970-2007

Source: UN/DESA, based on World Development Indicators Online.

developed countries and small island developing states are among the aid-dependent countries facing the highest levels of volatility in ODA inflows.

The deadweight losses associated with aid volatility can be as large as 15-20 per cent of the total value of aid, which, at the current aid levels, would amount to welfare losses of about \$16 billion (Kharas, 2008).⁵ To an average recipient, the deadweight loss of aid volatility is about 1.9 per cent of GDP. Per dollar of aid provided, the cost would lie between 7 and 28 cents, depending on the donor. In the same study, the degree of aid volatility varies across donors and losses due to aid volatility are largest in cases where the United States is the major donor, with losses from volatility for every dollar disbursed being more than double those associated with Japan, the next most “volatile” donor.

Conditionality and country ownership

Political considerations and concerns about accountability to taxpayers have led donors to attach conditions regarding how aid is to be spent. As indicated,

funds have often been rigidly earmarked for particular purposes. Determining the role and the mechanisms of conditionality in foreign assistance projects depends on a practical and effective characterization of “ownership”. In donor community attempts to explain shortfalls in country performance, for example, the recipient government’s insufficient ownership of what the donors regarded as a sovereign commitment, was deemed a key reason why they had not been met. Ownership therefore became a criterion for programme success.

By the late 1990s, donor governments and aid agencies had come to realize that their differing approaches and requirements were imposing high costs on developing countries and making aid less effective (Mkandawire, 2010). In an attempt to address the need to reduce the aid delivery costs, recipient countries sought access to funding “earmarked” for particular purposes. Through the PRSPs, the donor community shifted the focus of its aid more towards poverty reduction. As discussed in chapter II, the aim was to generate comprehensive long-term strategies for reducing poverty, while remaining sufficiently operational to guide aid efforts and to ensure that their focus was reflected in the allocations of annual government budgets. A study by Dijkstra (2010) concludes that, in practice, the PRSPs tended to be weakly linked to the actual processes of formulation and approval of government budgets. Part of the explanation is to be found in the perception that there was too strong a donor influence on the design of the poverty strategy, which eroded the sense of government ownership of both the strategy and the external funding mobilized in support of it.

True ownership would require that countries have control over their own policies, yet this often comes into conflict with the mechanism of donor conditionality (Dijkstra, 2010). The question then comes down to determining how to achieve country ownership in practice and reconcile this with the conditions that donors feel compelled to impose in order to justify the use of the money of their own taxpayers.

TOWARDS A NEEDS-ORIENTED INTERNATIONAL AID SYSTEM

Incoherence in the international aid system has been built up by a process of accretion of elements derived from various sources. The existing system is the product of changing fashions in concepts of development, the responses of donors to the challenge of redeploying their resources more effectively, and well-intentioned, and mostly unilateral, efforts to reform the system. The overarching principles of reform were identified in the Monterrey Consensus of the International Conference on Financing for Development (United Nations, 2002), which called for “[e]ffective partnerships among

donors and recipients ... based on the recognition of national leadership and ownership of development plans and, within that framework, sound policies and good governance at all levels” (para. 40). The process initiated by OECD under the rubric of aid effectiveness encompasses most of the details associated with successful pursuit of this goal. It is therefore agreed that this reform process must be completed and its promise fulfilled.

Addressing the system’s key weaknesses, as highlighted above—namely, fragmentation, instability and unpredictability of aid flows, lack of flexibility and alignment with recipients’ priorities, long-term dependence on external aid, and deficient partnership and country leadership/ownership, as well as recipient country problems of absorptive capacity and misuse of funds—will require even more good intentions and political will than has already been demonstrated.

Putting recipient countries in the driver’s seat

Overcoming the continued fragmentation and problems of country ownership that undermine aid effectiveness will require that the donor community renew its commitment to the principles of the Paris Declaration. Specifically, progress should be made regarding needs-based allocations and the alignment of aid flows behind national development strategies. Instead of the current programme of gradual improvements, what is needed is a decisive shift towards full adherence. Based on this approach:

- Sustainable development strategies would provide the framework for policy coherence at the national level and also articulate the nature of the financing gaps that aid flows can fill and the timing of those flows.
- Bilateral and multilateral as well as non-governmental donors would be aligned and asked to respond to needs through multi-year commitments.
- Alignment with other sources of development financing would be achieved as part of the same process (see below).
- Earmarking of aid funds by donors would become less relevant, although still possible if it served specific purposes (such as rallying private sector support through vertical global health funds), but always with the requirement of coherence with the priorities and financing needs of the development strategy.
- Monitoring, evaluation, accountability processes and the updating of funding requirements would be the responsibility of a joint standing committee of donors but one chaired by the recipient country.

- Donors will no longer impose *ex ante* policy conditionality for their support to recipient countries with defined national development strategies; instead, continued support would be decided upon based on monitored progress and outcomes of the implemented strategy.

Similar principles, in fact, were the basis for the successful Marshall Plan for post-war reconstruction and development in Western Europe (see box III.1; and United Nations, 2008, chap. IV). Even though the current environment for developing countries is quite different from that of post-war Europe, the Marshall Plan principles can help provide a coherent framework for coordinating national development strategies with international assistance. Adopting a central feature of the approach, for example, the international donor community could ensure the effectiveness of limited supplies of foreign assistance (both financial and technical) by requiring an articulated account of a government's macroeconomic objectives—and how the objectives relate to detailed programmes for infrastructure investment, the sustainable development of the agriculture, energy and industrial sectors, productive job creation, education, health and social protection.

Mkandawire (2010) suggests that the ideas that were embodied in the Marshall Plan also shaped the European Union's subsequent effective economic cooperation with Ireland, Portugal and Spain through needs-oriented assistance programmes. The Marshall Plan achieved a coherent framework for coordinating economic recovery and development plans. It relied on domestically generated planning and configured both its time frame and grant-to-loan proportion to meet the problem at hand. At the time, the Marshall Plan essentially intervened to ease shortages, bottlenecks and other constraints on growth and structural change.

The currently prevailing view is that programme failures are due to a weak commitment to reform (or a lack of ownership) and a slackening of discipline through postponement of necessary adjustment. In contrast, Marshall Plan resources were seen as investments in social cohesion and structural change and as providing governments with the breathing space required to make difficult policies succeed (United Nations, 2008). When such policies threatened to cause social upheaval on a scale that might upset the adjustment process, as was the case in post-war Italy at one point, Marshall Aid was available to cushion the social costs through support to the government budget.

European recipients of Marshall Plan resources had the advantage of dealing with only one donor (Mkandawire, 2010). With the multiplicity of donors in the currently fragmented aid system, there is a need to establish

Box III.1: Seven virtues of the Marshall Plan

The Marshall Plan was the assistance framework established by the United States of America for the economic recovery of Western European countries in the post-war period (1947-1951). The seven principles under which the Plan operated are summarized below.

1. Realistic time frame. The post-war adjustment applied a more realistic time frame than that normally envisaged by the United States Treasury or by an International Monetary Fund (IMF) programme. Instead of 18 months, the timescale was from 4-5 years.

2. Alignment with an overall economic programme. The architect of the plan, United States Secretary of State George Marshall, made it clear that there was to be an end to piecemeal assistance, which had suffered from a lack of coordination and had had less impact than expected in stimulating economic recovery. A key requirement, therefore, was that each State recipient of aid had to produce a four-year outline plan for recovery, setting out targets for the main economic variables and providing an account of how the Government intended to achieve its objectives.

3. Genuinely domestic programming. Marshall insisted that these plans, together with estimates of the need for assistance, had to be drawn up by the Western Europeans themselves: "It would be neither fitting nor efficacious for (the United States) to undertake to draw up unilaterally a program designed to place Europe on its feet economically. This is the business of Europeans ... The role of this country should consist of friendly aid in the drafting of a European program and of later support of such a program..." Marshall thus acknowledged the existence of national sensibilities, admitted that the recipient countries were better informed about the facts of their situation than outsiders, and generally showed a deference towards European traditions and preferences that has subsequently been conspicuously absent from the attitudes of the rich countries and international institutions towards the rest of the world.

4. Flexible intermediate targets. A fourth feature of the Marshall Plan was the release of aid in tranches that depended on the countries' intermediate targets' being met. Marshall Plan conditions were different from those established in recent practice and more flexible and were to be met over a longer period than that allowed by IMF rules, for example.

5. Gradual and asymmetric international integration. The Marshall Plan acknowledged that the damage to European productive capacities and the great disparity in economic strength between the United States and Europe meant that rapid liberalization of trade and payments would quickly lead to European payments-related crises. It was accepted that Europe would gradually dismantle a wide range of direct and indirect controls on its trade between 1950 and 1958 according to an agreed timetable within the framework of the European Payments Union. This gradual liberalization of trade provided European producers with protection against competition from

the United States and gave them time for, and encouragement in, the reconstruction of enterprises capable of producing competitive substitutes for dollar imports. At the same time, the United States agreed to a more rapid improvement in access to its own market for European exports, a policy of asymmetric liberalization which stands in marked contrast to the present approach of the European Union and the United States, which insists on a rapid opening of developing countries' markets and on restricting the range of policy options available for their development.

6. Significant grant component. Marshall Aid consisted largely of grants and the small proportion of loans had a large grant component: they were usually offered for 35 years at 2.5 per cent interest with repayments starting in 1953. It is worth emphasizing this structuring of financial help at a time when the terms "aid" and "assistance" are used loosely to cover everything from gifts to loans at market (or above-market) rates of interest. The wisdom of adding to the debts of already heavily indebted economies is highly questionable—all the more so when they are grappling with economic restructuring and institution-building, which is typically the case for countries trying to accelerate their development or to recover from the chaos that normally follows the end of violent conflict. A generous supply of grants, monitored within and conditional on a coherent economic programme along the lines of the Marshall Plan, can be more effective than loans in lifting countries out of a "stagnation trap" where heavy debt-servicing obligations hold back the domestic and foreign investment that could improve the longer-run performance of the economy, including its capacity to service debt. Another advantage of grants is that they are not usually subject to the long and complex negotiations, legal and financial, associated with the provision of loans. This is important inasmuch as one of the lessons of the Marshall Plan is that prompt assistance at the start of a promised programme can help to sustain positive expectations, which most likely will have been raised by politicians, and generate a momentum for change that will stand a chance of becoming self-reinforcing.

7. Coordination among recipients. Finally, yet another virtue of the Marshall Plan that is still relevant to attempts to tackle current problems is its insistence that there should be a degree of united and cooperative effort among the Europeans themselves, and that the plans of the 16 recipient countries and the allocation of aid should be coordinated within a regional body. This requirement partly reflected United States foreign-policy objectives with regard to a more integrated Europe, and also provided a structure for cooperation in areas where there are significant externalities, economies of scale and other transboundary issues. The peer review of national programmes provided national policymakers with a regional perspective on their own policies and encouraged a culture of regular contact and cooperation among national bureaucracies which is today taken for granted in Europe.

Source: Adapted from United Nations, 2008 (chap. IV, pp. 143-145).

mechanisms of coordination, a need that has also been recognized in the “aid effectiveness” process. The panel on donor coordination in the United Republic of Tanzania, operational since 1995, is one example of a country-led approach to improving coordination and making donors accountable for their activities (Helleiner, 2005). Formal public expenditure reviews and the application of the medium-term expenditure framework appear to have been effective in fostering wide participation of stakeholders in the budget process. Ngowi (2005) has indicated that these mechanisms have improved resource use by strengthening the links between sector policies and resource allocation and by providing valuable analyses and feedback on budget execution. He notes that although the impact on poverty reduction appears to be weak, efforts will perhaps bear fruit in the long term.

A key aspect of the donor relations experience of the United Republic of Tanzania has been the more central role played by the broader macroeconomic framework. To achieve such an arrangement was also the intention of the PRSP approach; this was stymied, however, by the fact that, in practice, the estimation for the maximum resource envelope was undertaken mainly by IMF. Ngowi (2005) reports that the United Republic of Tanzania Revenue Authority consistently met its revenue targets and collections reached an average of 12.5 per cent of GDP in the past 10 years compared with a figure of less than 8 per cent in the previous decade.

The aid effectiveness principle of country ownership/leadership itself suggests that, in a situation where there is an interest in engagement on the part of both DAC and non-DAC donors, nothing should prevent a recipient country from taking the initiative in rationalizing the operations of those donors in its economy. An example of recipient country donor management is provided by India, which allows only donors whose funding exceeds a minimum level to operate in the country. The expansion of South-South cooperation could help make recipient countries’ national strategies a more important factor if new donors were to play an “anti-trust” role in engaging the current donor community. Private foundations must also accept country leadership in their operations in developing countries, which would entail aligning programmes with the domestic development priorities included within recipients’ national regulatory frameworks (a course those foundations often espouse).

Country leadership in consolidating all aid flows could minimize the costs arising from earmarking restrictions. Countries would access these funds only if they fit the overall national sustainable development strategy.

The United Nations Development Assistance Framework (UNDAF) process of integrating all donor projects into one overall programme aligned with a national development strategy could serve as a model approach for the future if it can distance itself from the existing practice of acting essentially as a collection box for individual donor project financing.

The PRSP experience, governed by the attempt to “plan everything” and obtain agreement from all parties, should be instructive. Because of the high level of uncertainty associated with development programmes, space for experimentation and the possibility of failure should be incorporated in evaluation. Entire responsibility for policy choices should be lodged fully with aid recipients, as is presently the case, at least in formal terms. If aid recipients are to be fully in command of the policy choices they make, however, then outcome evaluation instead of policy conditionality should eventually become the norm for all aid projects and programmes.

Addressing capacity weaknesses by the implementing government is part of the development effort, and as such, upgraded capabilities need to be looked upon favourably in the context of outcome evaluation. Programmes should be deemed “good enough” if they reflect a broad relationship between means and ends. Embedding the identification of external funding gaps within an overall national strategy will require that multi-year progress be determined in terms of domestic resource mobilization and the consequent reduction in aid and external debt dependency.

While there are unavoidable geopolitical considerations that exert pressure on donors to continue support for poorly performing recipients, accountability of the recipient countries is usually inherent in what is in fact a “repeated game” situation: donors can always withdraw in the next funding iteration. It is donor accountability, instead, for which there are no existing sanctions.

Consequently, the proposed aid process requires some ancillary mechanisms to strengthen aid effectiveness. Even in the absence of a fundamental reorientation towards national strategies, these suggestions would be desirable. Irrespective of a fundamental restructuring, progress should be made along these lines:

- All aid flows should eventually be disbursed through general budget support.
- Reducing the number of special global funds is in the interest of both donors and recipients, although one would expect that a few large funding pools, such as, potentially, one for climate change, would continue to exist.

- Donors should begin progressively to budget aid flows in cycles of two or more years at a time, which will necessitate difficult adjustments in donor country political decision-making.
- Some special delivery mechanisms, such as through trust funds (see below), can be established consistent with the overall approach of country leadership.

Reforming channels and resource mobilization for development assistance

While the present target of 0.7 per cent of GNI of OECD/DAC countries has remained unfulfilled in the aggregate, a needs-oriented aid system would redefine the amount of aid to be mobilized. However, in the transition to the new system, the target might still serve as a benchmark to rally political support to address development deficits in the poorest countries. Of course, additional targets may need to be set to ensure sufficient resource mobilization for supporting climate change mitigation and adaptation efforts in developing countries, aid for trade and the delivery of global public goods. There will also be continued need for separate pools of funds for disaster relief and humanitarian aid efforts.

On the way forward, two further fundamental changes are worth considering. The first would aim at a better alignment of aid flows with other domestic and external sources of development financing through the use of trust fund mechanisms. The second change would entail increased use of funding sources encompassing innovative forms of international levies and leveraging of international liquidity for development purposes.

Enhancing aid predictability and aligning all sources of development financing

The use of trust fund mechanisms to support individual countries or groups of countries could further facilitate the alignment of donor funding with country priorities. It could also ensure long-term financing and align traditional ODA resource mobilization with innovative forms of development financing. Bilateral donors and existing global funds would contribute to trust funds that would disburse resources in accordance with programmatic and budgetary needs of recipient countries. The trust funds could also be allowed to purchase government securities of developing countries with a view to tying aid to future domestic resource mobilization

efforts. Experience in this area does in fact exist: in a number of cases, multi-year aid commitments have been converted into bond purchases to fund and front-load resources for research on tropical medicines. Recipient countries, in turn, could also be allowed, periodically, to deposit budgetary savings earned during economic upswings into the trust funds as insurance against external shocks, and to draw upon them in response to shocks.

In sum, the advantages of pooling aid resources into a trust fund are simplification and harmonization of procedures, and better support for national goals, priorities and strategies. It can avoid duplication and overlapping efforts, and minimize the burden of integrating externally supported projects into national development strategies. However, the ownership and management mechanisms of trust funds need to be carefully worked out so that the country ownership is not undermined. Pledges of contributions to trust funds should in principle be neither conditional nor earmarked.

New funding sources to underpin the aid architecture

New forms of international taxation (such as a small levy on international financial transactions) could play an increasing role in providing the resources needed to create a new development finance architecture. The new tax revenues could be channelled through a global fund into country-based trust funds. Mobilizing resources for development assistance through such innovative forms of financing would reduce volatility in available aid flows and vulnerability to political expediency.

Similar approaches have been piloted, relatively successfully, under the rubric of “innovative sources of finance”. The 2002 Monterrey Consensus, for example, spawned a far-ranging worldwide effort to mobilize aid resources from countries at different levels of development and to pilot them towards meeting the internationally agreed MDGs. The Leading Group on Innovative Financing for Development (founded following the Paris Ministerial Conference on Innovative Development Financing Mechanisms held in 2006 and whose action stems from the New York Declaration on action against hunger and poverty issued on 20 September 2004) promotes discussion on these issues. A key distinguishing feature of this approach is the partnership “modality” in resource mobilization established between developed and developing countries (United Nations, General Assembly, 2009a).

Based on the pilot projects in place, innovative funding sources of aid hold the promise of less volatility, greater sustainability in the long run, reduced vulnerability to decisions that are based on political expediency. They also hold the promise of broader participation in fund generation,

extending beyond governments to include, for example, citizens (through direct collection) and the private sector (through the utilization of Web-based checkboxes). Actual innovative sources of finance explored so far include currency transaction taxes, taxes on the arms trade, taxes on carbon emissions, an international financial facility, advance market commitments, “solidarity levies” on items such as international airplane tickets, enhanced efforts to combat tax evasion and illicit financial transfers, and a world lottery (Atkinson, 2005; United Nations, 2012).

An early pilot entailed an international levy on air transport. The level of taxation on air transport is lower than on other means of transport, since aviation fuel is tax-exempt in most countries. One report (United Nations, 2005, chap. IV) estimated that a 5 per cent rate applied to airfares would yield \$8 billion per annum and that an indirect tax on passenger transportation could reach \$20 billion per annum. Estimates of revenue from a currency transaction tax differ widely because of differences in proposed tax rates. Realistically, a currency transaction tax on transactions in major foreign currency markets set as low as 0.005 per cent can raise revenues of about \$40 billion per annum (United Nations, 2012); other estimations (Clunies-Ross, 2004) yield higher revenues, namely, \$ 60 billion per annum.

The original Monterrey innovative financing proposal that referred to the use of special drawing rights (SDRs) for development purposes is expected to draw renewed interest as a result of recent new SDR allocations. Re-channelling the provision of global liquidity managed on an equitable basis, in reserves and payments, to fund poverty reduction and investment in clean energy becomes a more feasible option, given these recent increased allocations of SDRs.

The possibility of improving, through international cooperation, collection of taxes currently evaded has received extensive consideration in the Leading Group. Conservative estimates of the scale of the annual resources potentially available for developing countries from the tax lost on the illicit outflow of profits (profits of both foreign companies and domestic residents) and the tax lost due to the income arising abroad from the accumulated assets owned by residents is, for the mid-2000s, of the order of \$200 billion-\$250 billion,⁶ half of which would be attributable to Asia (FitzGerald, 2010). This estimate, which is more than double the level of ODA from DAC members, suggests that the total amount of international fiscal transfers (aid plus tax) available for development finance could be tripled. All developing countries would be in receipt of these resources, except those developing countries that were themselves tax havens. FitzGerald suggests that, since the tax jurisdictions

concerned are all closely connected with financial centres in advanced economies, it would be possible to reallocate a portion of the increase in tax income to maintaining the incomes of inhabitants of tax havens and providing them with an alternative economic future. The logical (but perhaps still politically farfetched) implication is that external assistance financing mechanisms could be based on principles of fiscal federalism applied at the global level rather than on principles of humanitarian charity.

In the Copenhagen Accord,⁷ agreed at the fifteenth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change,⁸ held in Copenhagen from 7 to 19 December 2009, developed countries committed to a goal of mobilizing jointly \$100 billion dollars per year by 2020 to address the needs of developing countries, with the funding to come from a wide variety of sources, “including alternative sources of finance” (para. 8). The implication is that all the mechanisms in the innovative financing agenda are on the table in terms of achieving the announced target. A global carbon tax is often mentioned (Addison, Arndt and Tarp, 2010); however, because of the potential costs required to compensate for its distributive and environmental effects, a concerted carbon tax mechanism would be most suitable for and effective in developed countries but less so in developing ones (United Nations, 2009a and 2012). Bredenkamp and Pattillo (2010) and United Nations (2012, chapter II) have set out the mechanics by which special drawing rights can be used to raise the required flow of \$100 billion. The recent international discussion concerning a multilateral financial transactions tax sheds new light on a long-standing proposal to apply a currency transactions tax in order to fund climate change-related efforts.

Progress has been most visible in international responses to tropical diseases, through initiatives utilizing the air-ticket solidarity levy, the Advance Market Commitment (AMC) and the International Financial Facility for Immunisation (IFF), among others. Existing mechanisms rely heavily on “earmarking” towards specific ends. The feasibility of a more general development-oriented levy mechanism, one more in line with a needs-oriented international aid system, needs to be tested.

Governing the aid system globally

A coherent aid system centred on putting recipients in the driver’s seat would need to be matched and facilitated by upgrading coordination and accountability at the international level. There is a need, too, for a global process for setting standards, monitoring progress, and learning from ex-

perience that would be broader than that possible under OECD. A larger set of contributor and recipient countries, meeting on a more politically symmetric partnership basis, can build upon the achievements of the process launched pursuant to the principles set out in the Paris Declaration. The Development Cooperation Forum launched by the United Nations Economic and Social Council in 2007 has the potential to serve as the kind of venue in which DAC and non-DAC donors can be brought together to promote mutual accountability and aid effectiveness. The Forum has the mandate to facilitate cooperation among countries receiving aid, multilateral institutions, parliamentarians, local governments and a range of civil society and private sector entities.

Progress in enhancing coherence in the trade, finance and climate change regimes will facilitate the progress of efforts to achieve greater coherence within the international aid regime. Rebalancing towards a focus on “differentiated” responsibilities in the trade system, after decades of emphasis on the “common” ones, will allow developing countries to reduce their dependence on external finance that is often necessitated by a too abrupt international integration. This kind of problem was already well known at the time of, and addressed in, the Marshall Plan (see box III.1; and Reinert, 2005). Ensuring that the international aid system provides long-term development finance and the policy space needed by countries to progressively improve their domestic resource mobilization is certainly the best way to mark out a path towards the most robust country ownership. In addition, it offers the best insurance against aid volatility.

Aid has always been perceived as having a catalytic role in development. It is considered to be time-bound and only supplementary to much larger flows arising from domestic resource mobilization and foreign investment. Nevertheless, a giant step in upgrading the aid system could be achieved by aligning all aid with national development strategies. It is an approach that has already been generally agreed upon in principle and has been shown to be feasible in pilot situations. Even if this approach gives rise to a host of implementation issues, it is without a doubt preferable to the alternative—the current disorganized, bureaucratized and politics-dependent aid system which still struggles to prove its effectiveness in promoting poverty reduction and development.

The next chapter presents suggestions on how to establish a more sustainable and development-friendly global financial regime, one that would be capable of facilitating the flows of financing needed to actualize the trust fund concept presented above.

NOTES

- 1 The Development Assistance Committee is the principal OECD body dealing with issues related to cooperation with developing countries. The DAC donor countries are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, the Republic of Korea (a member since 1 January 2010), Spain, Sweden, Switzerland, the United Kingdom of Great Britain and Northern Ireland, the United States of America and the Commission of the European Union. Non-DAC donors reporting aid to DAC are Taiwan Province of China, the Czech Republic, Estonia, Hungary, Iceland, Israel, Kuwait, Latvia, Liechtenstein, Lithuania, Poland, the Republic of Korea (prior to 2010), Saudi Arabia, Slovakia, Slovenia, Thailand, Turkey and the United Arab Emirates.
- 2 World Council of Churches (1958), “Minutes and reports of the eleventh meeting of the Central Committee of the World Council of Churches: Nyborg Strand, Denmark, August 21-29, 1958” (Geneva), appendix XIV, pp. 124-125.
- 3 See, for instance, Clemens and Moss (2005) for a recounting of the origins of the 0.7 per cent target.
- 4 Volatility is measured as the coefficient of variation against a long-term trend.
- 5 In economics, a deadweight loss is a loss of economic efficiency. In the present case, the efficiency loss is associated with the unpredictability of aid flows.
- 6 Other studies, using different methods, arrive at larger estimates, in the order of \$850 billion-\$1.0 trillion per year (see Kar and Cartwright-Smith, 2008).
- 7 See FCCC/CP/2009/11/Add.1, decision 2/CP.15.
- 8 United Nations, Treaty Series, vol. 1771, No. 30822.