Aid to LDCs:Layout 1 9/1/2017 5:19 PM Page 1

Background

After the success of Marshall Plan in rebuilding Europe devastated by World War II, the concept of development cooperation emerged as a new paradigm. It was based on the premise that development would come quickly to the poorer areas of the world through the provision of capital by a few countries, supplemented by technical know-how. Accordingly, the term 'Official Development Assistance (ODA)' was coined in1969 by the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD), and defined it as official transactions with developing countries and multilateral development agencies that had 'the promotion of the economic development and welfare of developing countries' as their main objective and that were 'intended to be concessional in character'. Eventually, the aid programmes started to take shape and became a more definite commitment with the 1970 United Nations agreement to provide 0.7 per cent of gross national income (GNI) as ODA by 'economically advanced countries'.

Aid in LDCs

In the 1960s, Official Development Assistance (ODA) per capita to the countries that are now Least Developed Countries (LDCs) was approximately equal to that to other developed countries (ODCs), increasing only slowly during the course of the decade. However, following the recognition of the Least Developed Country (LDC) category in 1971, ODA to LDCs increased dramatically, peaking at 3.5 times that for ODCs in per capita terms in 1987 (UNCTAD, 2016). Attention towards ODA has markedly increased over the last decade in large part by international commitment towards the Millennial Development Goals (MDGs) and at present, towards the subsequent Sustainable Development Goals (SDGs). In 2016, development aid reached a new peak of USD 142.6 billion, an increase of 8.9 per cent from 2015. Despite the progress, the 2016 data show that bilateral aid to the LDCs fell by 3.9 per cent compared to 2015 as some countries in Development Assistance Committee (DAC) backtracked on their commitment to reverse past declines in flows to the poorest countries (OECD, 2017).

Although the amount of ODA has increased over the past five decades, the increment seems only margin if the development assistance is measured as a percentage of the donors' Gross National Income (GNI). ODA from OECD-DAC donors has increased little since 1995, from 0.26 per cent in 1995 to 0.32 per cent in 2016 (OECD, 2017). Only a handful of international donors, namely Denmark, Luxembourg, Germany, Norway, Sweden and the United Kingdom have reached the longstanding UN target of 0.7 per cent ODA/ GNI in 2016. The increase in South-South Cooperation and triangular cooperation may offset this to some extent but the overall aid will be inadequate, compared to the amounts needed to support the Sustainable Development Goals (SDGs).

ODA played a major role in the graduation of all five of the countries that have graduated from LDC status so far. Given their small populations, four of the countries that graduated by 2015, namely Botswana, Cape Verde, the Maldives and Samoa had relatively large ODA receipts per capita, averaging around 3.3 and 9.0 times that for LDCs as a whole in 2005–2014 (UNCTAD, 2016). In the case of recent graduate Equatorial Guinea, every additional million dollars of ODA between the years 1985 to 1995 made the GDP grew by 1.3 per cent during the period (Larrú, 2010). Equally important was the graduates' policy towards their ODA receipts. Botswana and Samoa, in particular, adopted a very proactive role in management of ODA receipts, maintaining clear leadership and ownership of their respective development processes, and ensuring that ODA was clearly oriented towards their own development strategies. For the LDCs who have not graduated, aid will remain a critical source of external finance for some time to come because of their structural constraints and their less access to other financial flows including the Foreign Direct Investment (FDI) and export revenues.

Aid Effectiveness in LDCs

Several shortcomings are observed with the current aid architecture undermining the effectiveness of aid. Some of the problems associated with the current development aid model are discussed below.

1. Degree of dependency on aid

Some LDCs such as Comoros, Haiti, Bhutan and Lesotho are highly dependent on aid as indicated by higher ODA as a percentage of the recipient country's gross capital formation. In such cases, the sudden withdrawal of donor funding could be hugely disruptive and catastrophic.

2. The volatility of aid

Aid volatility can be extremely costly, particularly to the LDCs, since it raises the cost of financial management, worsens the composition of government expenditure, and amplifies the fiscal effects of business cycles. For example, with the fall in aid, governments tend to divert resources from capital investment towards recurrent expenditure.

3. The procyclicality of aid

LDCs are least able to cope with external shocks and other crises due to their liquidity constraints and lack of effective countercyclical policy tools combined with weak institutions. In such circumstances, when aid is countercyclical, it can be an important smoothing device or insurance function and can help to enhance macroeconomic stability at times of external shock. However, ironically, development assistance, on average, tends to be procyclical – countries tend to receive more in years when economic activity is on the rise and less when it is on the decline (UNDP, 2011).

Rethinking the Development Aid Model

While the ODA figure suggests substantial increase in aid over the last decade, this masks the extent to which relatively little aid actually reaches the recipient countries. The amount of aid is going up, but billions of people who count on it are receiving less as funds are diverted to refugees and other crises. Significant proportion of aid is also never available for in-country spending. This includes, for instance, aid that is spent in donor countries on assistance to refugees, development awareness-raising and research in donor countries, scholarships for developing country nationals, technical assistance, food aid, humanitarian aid and debt relief. In addition, in February 2016, the Development Assistance Committee (DAC) High Level Meeting decided to revise the reporting directives of ODA on peace and security expenditures paving the way for the eligibility of certain security and defence costs, including measures to prevent violent extremism and provide limited military training. In the days to come, this is feared to promote the use of development and economic assistance for the foreign policy interests of the donor countries.

Moreover, the effectiveness of ODA in promoting structural transformation and productive capacities has been weakened in recent years by a shift in allocations from economic infrastructure and productive sectors towards social sectors, notably health, education and social security. In spite of its solid track record on immediate and tangible development results, this approach can undermine country ownership of the development process and many of these funds are highly fragmented and possibly unsustainable.

Hence, there is a need to rethink on the current aid allocations and the aid modalities. Despite much empirical evidence that direct budget supports are more effective, much aid is channelized via other modalities, such as technical assistance, that have a mixed record on development results. The principles of country ownership, harmonisation, transparency and untied aids should be strictly followed to improve aid effectiveness. Donor countries are to realise that aid allocation in productive sectors and infrastructural development would have greater multiplier effect than those in social sectors.

Global Aid Effectiveness Agreements

In response to the problems of aid allocation and current aid modalities, a number of international efforts have been initiated such as the Paris Declaration on Aid Effectiveness, the Accra Agenda for Action (AAA) and the Busan Partnership for Effective Development Cooperation. In 2005, the Second High Level Forum on Aid Effectiveness recognised that development aids have not been producing expected outcomes and in response, the Paris Declaration was endorsed to improve the quality of aid and its impact on development. The Declaration formulated five central pillars of aid effectiveness – country ownership, alignment with the recipient countries' objectives and systems, harmonisation to avoid duplication, focus on development results and their measurement, and mutual accountability on the part of donors and partners.

Subsequently, the Third High Level Forum on Aid Effectiveness in 2008 endorsed the Accra Agenda for Action (AAA) aimed at strengthening and deepening the implementation of the Paris Declaration. Reviewing the progress towards the Paris Declaration, AAA proposed four main areas for improvement: ownership, inclusive partnerships, delivering results and capacity development.

In 2011, an even greater number and wider diversity of stakeholders gathered in Busan, Korea for the Fourth High Level Forum on Aid Effectiveness. The forum declared Busan Partnership for Effective Development Cooperation (also called the Busan Partnership Agreement) signed by ministers of developed and developing nations, emerging economies, providers of South-South and triangular cooperation and civil society. Besides consolidating the Paris Declaration and the AAA, the agreement was accompanied with an international standard on the principles of effective aid and good development to which all development actors are to subscribe, known as the Global partnership for Effective Development Cooperation. The principles agreed in the Busan Partnership Agreement include – country leadership and ownership of development strategies, a focus on results that matter to the poor in developing countries, inclusive partnerships among development actors, and transparency and accountability to one another.

However, progress towards the adoption of principles reiterated in the consecutive aid effectiveness agreements has been mixed. Despite the commitments at global platforms to improve country ownership, the aid receiving LDCs are often the least involved and least influential stakeholder group in multilateral policy discussions or reform efforts. The LDCs with weak state mechanism have failed to strengthen the quality of public finance management systems. Consequently, donors often create parallel systems to avert risks associated with weak systems. The commitments to untie all aids and improve aid predictability are also largely unfulfilled.

Future of Aid

The ODA landscape has changed markedly over recent years in relation to how much aid is provided, by whom, to which countries, through which modalities, as well as the purposes to which it is put. South-South cooperation (SSC) – a general term often used to describe the exchange of resources, technology and knowledge between developing countries – has become much more prominent over the last decade, as rapid economic growth by many major developing countries has led to a greater role in international affairs. The largest developing country providers of development aid are China, Saudi Arabia, the Bolivarian Republic of Venezuela, and India. There has also been a sharp rise in development cooperation from developing countries like Czech Republic, Hungary, Iceland, Poland, Slovak Republic, Turkey, Taiwan, Israel, Slovenia, Thailand and the United Arab Emirates. Although much lower in absolute terms, ODA provided by these 'emerging' donors has increased sharply over the last decade. The total value of South-South Cooperation is currently estimated to vary between USD 16 billion and USD 19 billion (UNCTAD, 2016). Moreover, private philanthropy and a number of innovative finance schemes are also observed as new forms of development assistance.

The slowing down of economy in the developed countries and the rise of protectionism, as indicated by the results of the US election and the Brexit in 2016, reflect that development aids from traditional donors are likely to fall in near future. With the emerging economies growing at a faster pace compared to the West indicating a shifting power dynamics and the recent world events against globalisation, it is highly likely that the sources, forms and modalities of aid disbursements will change in the near future.

Call for Action and Way Forward

Aid still plays a very important role for poverty alleviation and sustainable development in LDCs. However, it is revealed that aid has also created burden and complication in the process of their development and democratisation. Therefore, the politics of aid should be more transparent and that should be clearly oriented towards strengthening capacity of LDC governments for basic infrastructure development, productivity growth and empowerment of people in need.

The Addis Ababa Action Agenda (AAAA) in 2015 called for a reversal of the trend of declining aid to the LDCs and recommitted the developed countries to provide 0.7 per cent of their GNI as ODA, and 0.15-0.2 per cent of their GNI to LDCs. However, the target has not yet been realised and there is less prospect of meeting it any time sooner. In this regard,

Aid to LDCs:Layout 1 9/1/2017 5:19 PM Page 2

Aid for Trade (AfT)

It has been globally recognised that an active participation in global trade can lift millions of people in LDCs from poverty and can enhance their quality of life. At the Sixth World Trade Organisation (WTO) Ministerial Council held in Hong Kong in 2005, the Aid for Trade (AfT) initiative was launched with an objective to encourage more active players in the global trading system and address the supply side constraints to trade faced by developing countries, particularly the LDCs. In the same year, Enhanced Integrated Framework (EIF) was established with the objective of mainstreaming trade into LDCs' development strategies. The second phase of EIT started in 2016 and will run up to 2022. Meanwhile, target 8.a. of SDG also emphasises on increasing AfT support for developing countries, particularly LDCs through EIF. Statistics from WTO show that more than USD 300 billion has been disbursed under AfT programmes and projects since its inception in 2005, of which 27 per cent has gone to the LDCs. In 2015, AfT commitments to the LDCs increased by USD 4.3 billion, reaching USD 17.2 billion (United Nations, 2017). But, it has been expected that the EIF may be facing shortage of resources in its second phase (2016-2022) as donors have pledged only USD 90 million for the purpose though it had expected to mobilise at least USD 274 million within the period. LDC Watch advocates that trade related aid and technical assistance be ramped up since this would eventually build up productive capacities among LDCs, and calls on the development partners to support the EIF in bridging the resource gap.

LDC Watch would like to call on development partners to fulfil at the earliest their aid commitment – which was also reiterated at the Midterm review of the IPoA. As suggested in the Doha Declaration on Financing for Development, we also encourage all donors to establish rolling indicative timelines that illustrate how they aim to reach their ODA target in accordance with their respective budget allocation process. LDC Watch also calls on all donors to allocate at least 50 per cent of net ODA to LDCs as foreseen in paragraph 52 of AAAA.

The Istanbul Programme of Action (IPoA) for LDCs for the decade 2011-2020 calls for not only increasing the volume of aid to LDCs, but also the quality of aid and the need to align it with LDCs' national interests. Meanwhile, the Sustainable Development Goals (SDGs) lay out a demanding agenda for human progress across many dimensions and ensuring that the aid flows to the poorest countries remain buoyant will be essential for delivering on these. Goal 17 of the Sustainable Development Goals (SDGs) discusses on finance and capacity building as the means of implementation of all the other SDGs.

Education and gender gap in LDCs is very big. In 2015, the United Nations Development Programme's (UNDP) Gender Inequality Index (GII) was 0.555 for LDCs, compared with 0.469 for developing countries and 0.194 for OECD countries. Similarly, although the net enrolment in primary education has considerably improved in the LDCs, the challenges remain in improving quality and completion rates and enhancing enrolment in secondary and tertiary levels. Therefore priority of aid should also be directed towards education, skill development and empowerment of the poor, women and people living and working in the most difficult circumstances.

LDC Watch demands increment in trade-related financial and technical assistance aimed at increasing productive capacity of the LDCs. The IPoA also calls on development partners to enhance the share of Aid for Trade (AfT) to LDCs and support the Enhanced Integrated Framework (EIF). Meanwhile, the Paris Climate Accord makes a number of references to the importance of funding climate action in LDCs. In this regard, we advocate for increased contribution by developed countries to climate funds to ensure climate justice for the LDCs. It is also crucial for development partners to give more priority to productive sectors and infrastructural development while allocating aid. We also urge development partners to uphold the principles of aid and development effectiveness, including predictability and transparency, harmonisation, country ownership and untied aid. In order to improve aid predictability, development partners should develop accurate systems for providing partner countries with spending estimates 3-5 years in advance to enable more effective planning in the medium and long term. LDCs should also be supported in enhancing the capacity of governments to manage Aid Information Management System (AIMS). Meanwhile, the development partners should strongly recommit to the use of country systems as a first option and ensure that the cooperation is aligned with national budget. In addition, civil societies should be given considerable space in policy making and monitoring of the implementation of aid.

LDC Watch would like to call on all concerned stakeholders to focus on South-South, triangular and regional cooperation. We focused on the need for South-South Cooperation (SSC) to be an alternative development paradigm which is a departure from the dominant aid architecture of North-South cooperation guided primarily by political and economic interests. SSC should be focused on social sectors and human development as opposed to the existing trend on trade and investment with corporate interests. SSC should be based on solidarity and equality and should not be a substitute to ODA which is based on historic debt and redistributive justice. We also call for increased inclusion of civil society space in SSC in order to ensure democratic ownership and sustainable partnership for the common cause and interest of LDCs.

We view the inclusion of certain security related costs in the definition of ODA as a step towards militarisation of aid. So, we demand that the DAC revoke its 2016 decision to revise the definition of ODA to include certain security and defence costs on two major premises: firstly, the decision takes the share of aid money away from socio-economic development; and secondly, the decision supports the imperialistic interests of the developed countries, rather than the needs of the poor powerless civilians.

There is a need of concentrated global partnership for development in order to effectively address the full range of financing for development challenges facing the world today. Recognising the significant challenges LDCs face in the area of poverty eradication and socio-economic development, we urge the United Nations system, the international financial institutions including the Bretton Woods institutions, and all other stakeholders to make efforts to address those challenges. As a supplement to ODA, the multilateral development banks, such as the World Bank, regional and sub-regional development banks and other international institutions that promote development, can be important sources of funding for development.

Debt crisis is acute among LDCs with 4 LDCs in debt distress, and 11 in high risk of debt distress (Development Studies Association, 2017). Necessary initiatives should be taken to formulate policies and establish mechanisms to resolve the current debt problems of developing countries, particularly for Africa and the LDCs, in an effective and equitable manner, including through debt cancellation. Debt cancellation of unjust and old loans provides a level playing field for the debt-ridden countries to have an economic rebound as it frees up resources to invest in the recipient country rather than sending them abroad in debt interest payments. We also call for continued flexibility with regard to the eligibility criteria for debt relief under Heavily Indebted Poor Countries (HIPC) Initiative and Multi-lateral Debt Relief Initiative (MDRI). It should also be ensured that the resources provided for debt relief do not detract from ODA resources intended for the LDCs.

On the part of the LDCs, we recommend them to integrate and align ODA with their national priorities, and build synergies among all forms of financing for development to enhance quality of support for development effectiveness. LDC Watch urges governments in LDCs to come up with a clear aid policy to ensure that aid is used transparently and effectively so that it reaches the actual beneficiary. The national attempts towards country-owned aid management must also be complemented by efforts at the global level and donor headquarter level to reduce aid fragmentation.

Finally, a strong cooperation and coordination among the development partners, international financial institutions, governments and civil society organisations can increase the volume and effectiveness of aid which, given their structural vulnerabilities and financing gap, is essential for least developed countries for their graduation and meeting the Sustainable Development Goals.

Underfinanced Climate Fund

With the successful adoption of the Paris Climate Accord in 2015, the issue of climate financing has become more prominent than before, especially to the LDCs who contribute the least but are the most vulnerable against the adverse impacts of climate change. It has been estimated that the cost of all LDCs implementing their post-2020 climate action plans will be around USD 93 billion per year (IIED, 2015). Although the international community has pledged much climate finance (USD 100 billion per year by 2020) to support adaptation and mitigation against climate-related disasters in developing countries, how this finance will be raised still remains unclear. LDCs have access to Green Climate Fund, LDC Fund, Adaptation Fund and Special Climate Change Fund to manage the risks posed by climate change. However, provided that many of these pledge-based funds remain seriously underfinanced, there is a serious question over the effectiveness of these funds aiding LDCs in combating climate change impacts in the long run. Additionally, on June 1 2017, the United States announced the country's withdrawal from the Paris Climate Accord and its decision to stop contribution to the Green Climate Fund. It is crucial that the development partners contribute towards adequately financing the climate funds to support low income countries in combating the impacts of climate change. Besides, any finance that goes towards climate change should be in addition to, that is over and above, the 0.7% GNI commitment, which was made in 1970 when the need for climate financing was yet to be recognised.

Contributors: Gauri Pradhan, Rushka Sthapit, Reshma Shakya & Sudhir Shrestha
Photo courtesy : Jeffrey Coolidge, ***Publication Date***: September 2017

LDC Watch Position Paper

AID TO THE LEAST DEVELOPED COUNTRIES

International Secretariat
P.O.Box: 8130, 288 Gairidhara Marg,
Gairidhara, Kathmandu, Nepal
Tel: +977 1 4004813, 4004985
Fax: +977 1 4004508, 4443494
Email: info@ldcwatch.org
www.ldcwatch.org

European Co-ordination Office
Rue Stévin 115, B-1000
Brussels, Belgium
Tel: +322 231 1659
Fax: +322 230 3780