TRANSITION FINANCE 2019

What is transition finance?

BACKGROUND

In its 2017 high level meeting (HLM) Communiqué the Development Assistance Committee (DAC) set an objective "to better understand the broad catalytic effect of official support and other resources by understanding the interlinkages among ODA, partner countries' domestic resources, private investment, remittances, philanthropy, trade finance and export credits, and other sources of finance", and to "continue to collaborate with other experts within the OECD and beyond in order to have a global overview and outlook on financing for development" (para 15).

Responding to this call, and aligned within the Addis Ababa Action Agenda (AAAA) to mobilise all available resources – domestic and foreign, public and private – in support of the SDGs, the DAC Secretariat developed a new work stream on transition finance to explore the evolution and interaction of public (Official Development Assistance and Other Official Flows) and private (Foreign Direct Investment and remittances) sources of finance across the development continuum – studying multiple stages of development: low income countries, middle income countries, fragile contexts, and different regions of the world. Its ultimate objective is to advise the DAC in preparing countries for transition (outlining the optimal financial mix and offering policy recommendations) and in building resilience.

DEFINING TRANSITION FINANCE

As a whole, we call "transition" the journey towards the 2030 Agenda and the achievement of sustainable development, and transition finance the financing of that journey.

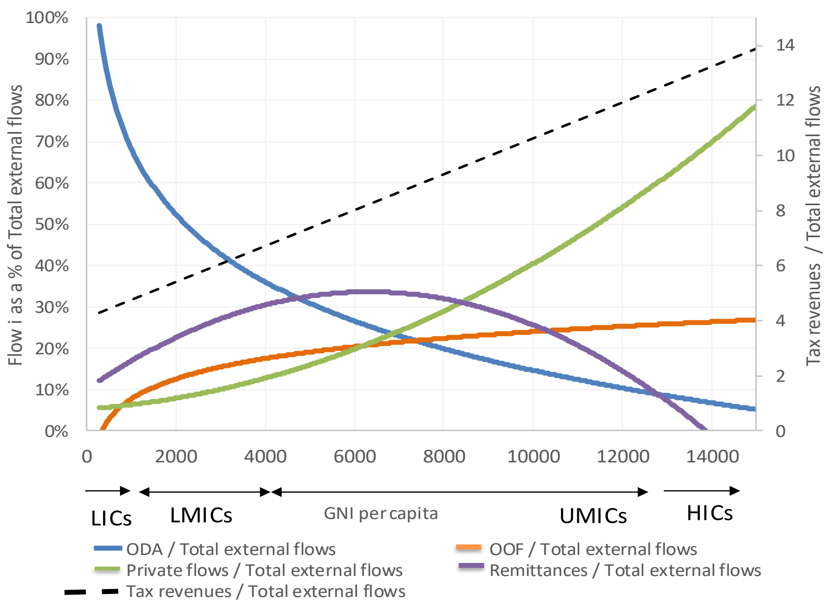
As countries transition through the development continuum, they lose access to certain types of financing, but gain access to a broader variety of actors, tools and instruments. The analysis of transition finance carried out by the OECD/DAC Secretariat attempts, from a DAC perspective, to analyse the substitution, interactions and trade-offs among all of the sources of finance, public and private, domestic and international, that evolve as countries transition.

At any given point of DAC's partner countries transition journey, the ultimate objective of transition finance is to optimise access to finance for sustainable development, ensuring a smooth DAC members' deployment of such financing -avoiding major financing gaps or socio-economic setbacks.

Four questions pertaining to transition finance are of particular relevance to the DAC, and are being explored along the work engaged in this transition finance work stream:

1. How could the DAC facilitate the phasing out of ODA and secure the progressive growth of other sources of financing (e.g. private or domestic), thereby securing long-term sustainable financing (e.g. by preserving debt sustainability)?
2. How could the DAC increase the effectiveness of ODA, identifying the best and most innovative tools, policies and partnerships available along the development continuum to best serve the financial needs of transitioning countries?
3. How could the DAC design long-term support strategies that go beyond ODA? In other words, how could DAC members continue to support countries after ODA graduation to preserve the benefits of ODA in the longer term and avoid setbacks?
4. What kinds of capacity building efforts, promotion of transfers of all kinds (from private investment to technologies or knowledge) and domestic resource mobilisation efforts, could be fostered by ODA while phasing out in anticipation of transition?

As a country's GNI per capita rises, financial inflows shift from official to private sources



A number of conclusions can be drawn from the analysis of this figure, and two major trends are observed:

- First, a substitution of external with domestic resources. From the onset, domestic resources are the largest source of finance for the economy – with a 4 to 1 ratio of tax revenues/external flows. This ratio keeps increasing, however, with tax revenues representing more than 12 times the value of external flows as the country reaches high-income status. Domestic resource mobilisation is therefore a key component of financing sustainable development, and should remain a primary objective of ODA;
- Second, a substitution of public with private resources. Highly dependent on public external support (mainly ODA) in early stages of transition, countries progressively move towards a private financing of their economy. Public financing itself evolves, with a progressive substitution of ODA with OOF, then private flows (foreign direct investments and remittances) take the leading financial role.

The DAC has a major role to play in ensuring a smooth transition of countries**,** and should focus on:

- ✓ Better anticipation and preparation of substitutions – using ODA and OOF to support a sustainable transition finance path;
- ✓ Better support to countries in transition through adequate capacity building (e.g. debt management support), investment in enablers (e.g. domestic resource mobilisation, trade and investment promotion) and in channels (e.g. financial system, business environment);
- ✓ Better mitigation of the effects of ODA phasing-out and resilience building, as well as definition of new forms of co-operation less funding-focused.

THE DAC SECRETARIAT ROADMAP ON TRANSITION FINANCE

The DAC Secretariat roadmap on transition finance has already set the scene with the publication of a concept note that gives the analytical basis of this framework, and has carried out three country pilots on countries facing different transition challenges: Cabo Verde (that graduated from the LDC category), Zambia (having moved from the LIC to the LMIC category), and Uganda (facing migration and financial challenges, this last pilot having been carried out with DCD/GPP colleagues). Upcoming pilot studies include Vietnam, Lebanon, Chile and Uruguay.

The work's concrete findings and reflections demonstrate the need to re-think and re-define the role of the DAC relative to emerging donors and to reflect on how to concretely increase and incentivise the role of the private sector in support of the SDGs.

Looking forward, the transition work is also exploring the possibility to collaborate with OECD/CTP to further engage with domestic tax revenue issues, and IMF/WB on debt sustainability issues. During the second semester 2019, two reports will also be published; the first will present a 'transition finance toolkit', that is a ready-to-go manual to help donors and development partners to analyse transition finance issues in different contexts. The second report will present a 'transition finance compendium' compiling key messages, policy recommendations and lessons learnt from the full work stream carried out in 2018-19.