

## **“Development Finance Architecture: What Flow, Channels and Pools?”**

**Informal Experts’ Workshop, Paris, 3-4 July 2006**

Hosted by the OECD Development Centre and the OECD DAC/DCD

## **Summary of Outcomes: For Discussion**

**(9 August 2006)**

### **Background**

Seeking to improve its dialogue on development with non-member countries and a variety of non-governmental actors, the OECD is launching a new policy-dialogue process in 2006: the OECD Global Forum on Development. Over its first three-year thematic cycle, the Global Forum will focus on policy challenges related to “Development Finance”.

This Informal Workshop officially launched the “Development Finance” cycle. Designed as a “brainstorm”, the aim was to identify major policy themes to be taken forward in future Global Forum discussions. Allocated speaking roles were kept to a minimum and participants were invited to speak in their personal capacities under the Chatham House Rule.

Sessions covered:

- I. Development finance architecture: what are the challenges?
- II. Country perspectives on development finance
- III. Co-ordination across global, regional and national levels
- IV. Finding the right instruments, and using them correctly
- V. Panel discussion on reforming the institutions

In the first section, this document presents some general Workshop outcomes and summarises process-related comments on the Global Forum. In the second, it groups the policy messages and systemic issues raised in the Workshop under four main headings, providing a potential substantive framework for the Global Forum process.

The Workshop Agenda and List of Participants, as well as a calendar of Global Forum events, are now available online at [www.oecd.org/dev/meetings/define](http://www.oecd.org/dev/meetings/define).

### **General Outcomes**

1. A large number of systemic issues and policy messages emerged from the Workshop discussions. They can be grouped into four categories, which provide a potential framework for the first cycle of the Global Forum on Development (see next section for more detail).
  - a. Understanding the present development finance system
  - b. Operationalising ownership
  - c. Matching instruments to needs

- d. Changing the international development finance architecture
2. The Workshop succeeded in bringing together a diverse group of about 100 experts on development finance. We hope that this will be the basis of a core group of engaged participants in the Global Forum process.
3. There was widespread agreement that Southern perspectives needed to be a strong part of the Global Forum process in two ways. Firstly, substantive discussions needed to be rooted in evidence from case studies at the field level. Secondly, participants from developing countries needed to be given a stronger voice in dialogue events. This would help draw out the gap between international dialogue and country-level reality.
4. Non-DAC donors, other emerging donors and non-state actors were also regarded as key participants in the process.
5. The Development Finance Network (DEFINE) was launched on Day 2 of the Workshop. Its aim being to support the Global Forum process with substantive inputs, first ideas for co-operation were tabled, including work on non-state actors and on monitoring the implementation of the Paris Declaration. Participants agreed that DEFINE would focus on systemic issues and complement, not duplicate, existing endeavours

A steering committee was appointed, composed of the Development Centre, the IBON Foundation (Philippines), the Institute of Statistical, Social And Economic Research (ISSER, Ghana), the Overseas Development Institute (ODI, UK) and the North South Institute (NSI, Canada).

Other participants included the Centre for Policy Dialogue (Bangladesh), Développement, institutions & analyses de long terme (DIAL, France), Centre pour la recherche économique et ses applications (CEPREMAP, France), the German Development Institute (DIE-GDI, Germany), Centre de recherches économiques Appliqués (CREA, Senegal), the World Institute for Development Economics Research (UNU-WIDER, Finland), The Centre for International Governance Innovation (CIGI, Canada) and the Center for Global Development (CGD, United States).

6. The Workshop laid good foundations for the joint management of the Global Forum process by the Development Centre and the DCD/DAC.

## **Systemic Issues and Policy Messages: A Potential Framework for the Global Forum on Development**

This section groups systemic issues and policy messages from the Workshop into four categories. Comments are most welcome.

### **a. Understanding the present development finance system**

Introductions to the first Session focused on two key dimensions of the present development finance system. Firstly, they drew attention to the growing importance of private actors and flows for development, and on the need to understand them better. Secondly, they gave an update in progress on scaling up aid volumes and pointed to the need for scaled-up aid to be accompanied by viable exit strategies.

As illustrated by the graphs in the Annex, the development finance system is complex at both global and country levels.

Whilst ODA is rising (US\$35 billion), it is not quite reaching the pledged \$50 billion increase. In the context of the MDGs, this raises important questions about how much of aid is actually additional and how much of it constitutes debt relief. There is evidence, for example, that only 20% of the ODA increase is allocated to project/programme finance, and that most scaled-up aid (up to 80%) is being allocated to Middle Income Countries. Significant progress has been made in

“forward-tracking” ODA flows: a majority of DAC donors now have 3-5 year multi-annual financial envelopes.

Non-ODA flows are very difficult to capture, and are often not included in global and country-level policy dialogue.

A better understanding of the links between the various actors and flows would help policy makers design more effective development and development-cooperation policies. It would, for example, shed light on how aid can act as a catalyst for other flows, thereby assisting the transition away from aid dependency to sustainable growth (i.e. exit strategies). Information about the use of other flows could also help guide aid allocation at country-level. This calls for improved capacity-building for government-operated information systems.

Rising ODA volumes and the emergence of other development finance flows have increased the focus on developing-country capacity to absorb flows and channel them through effective governance and financial systems. In this context, the definition of the IMF's role in macroeconomic management will be of great importance.

## **b. Operationalising Ownership**

Sessions II and III of the Workshop questioned whether the current development finance system supported developing countries in taking the lead of the development process. “Operationalising” the concept of ownership has four major implications for the development finance system.

Firstly, the system must continue to improve its responsiveness to individual developing country needs. Thus, some countries may require support for consumption, whilst others would prefer an emphasis on investment or risk management. The move to a multi-sector approach by the second generation of PRSPs was welcomed in its ability to respond to individual country priorities. However, concerns were raised about a new infrastructure bias replacing the first generation's emphasis on the social sectors.

Secondly, progress in improving harmonisation and alignment in the context of the Paris Agenda must improve. Whilst some actors are making progress, for example by moving towards greater sector and budget support, others are not supporting the process and are contributing to the proliferation of institutions and co-ordinating mechanisms at country-level. The incentives against co-ordination are strong and not fully understood, and Workshop participants agreed that bilaterals are part of the problem, not just the solution. In general, a trend towards “collective action compacts” has become evident, including the World Bank's results and resource matrix approach, budget support compacts (e.g. Ghana, Mozambique and Tanzania), sector compacts (SWAps), multisector (aid for trade / Doha), regional (e.g. energy and transport), and issue-based compacts (global campaigns).

As new actors/channels, global programs (GP) have been welcomed for filling important financing gaps, and several are now endorsing the Paris Agenda. However, some are contributing to a lack of coherence at country level – clearer policies are required on whether they should be regarded as substitutes or complements for traditional mechanisms, and on whether bilaterals channelling ODA through GPs should, by implication, reduce their own activities in particular areas.

Thirdly, donor confidence in recipient country ownership requires confidence in host-country commitment, with repercussions on the design and streamlining of appropriate forms of conditionality. Participants called for the development of appropriate indicators to measure host-country commitment, and for a review of existing ones such as the Country Performance and Institutional Assessment (CPIA). One important indicator of host-country commitment which must be included is the extent to which PRSPs are linked to a country's budget process.

Finally, renewed consideration must be placed on the issues of capacity-building and technical assistance, and specifically on the capacity of developing countries to access and coordinate different sources of development finance. With more understanding about how different countries access development finance, ODA could be better tailored towards raising non-ODA flows. Capacity-building and system support have strong roles to play in empowering developing countries for better choices, but incentives are lacking to encourage donors to provide them, as is illustrated by the trend towards issue-specific funding.

### **c. Matching instruments to needs**

In Session IV of the Workshop, a general consensus emerged that a combination of instruments, rather than a single instrument, is required to respond to different development finance scenarios. A further focus of the Session was the emergence of new development finance instruments, which has provoked discussions about the evolving role of ODA, and about how instruments can catalyse domestic resource mobilisation.

Rather than promoting a general choice of one instrument over another, the role of policy makers ought to be to tailor a blend of instruments to particular country contexts, and to sequence their use appropriately (discussions on “loans *versus* grants”, for example, ought to be refocused on “loans *and* grants”). Additional considerations in designing instruments would include the currency (e.g. local currency?), the amount, the timing and the objective of financial contributions. With respect to differing country contexts, low-income countries subject to asymmetric shocks will generally require a high degree of concessionality in development finance, as well as support for debt sustainability. Middle-income countries, by contrast, may be better served with pooled funds and insurance-based concessional financing instruments.

The current trend towards grants was questioned with evidence that soft loans can provide positive incentives, have a smoothing function at country-level, and are well-adapted to financing infrastructure projects. Grants, on the other hand, were particularly suited to fostering private sector development. Moreover, the move towards grants risks undermining the position of the multilateral development banks.

Several actors appear to be contributing to a change in culture in favour of loans. Emerging donors such as China are providing soft loans to fragile states with natural resources. Bilaterals with small aid volumes often opt for loans as this gives them greater policy leverage. In general, the debt reduction process appears to have given rise to the emergence of “opportunistic lenders”.

Given the challenge in starting new loan projects, calls were made to keep rules simple and easy to monitor. Experiences with a copper-indexed bond in Zambia have been positive, whereas an agricultural loan linked to shrimp turnover had failed due to strong moral hazard.

Participants agreed that ODA was evolving into the role of a “catalyst” for other sources of development finance, with emphasis on the mobilisation of domestic resources and the development of stronger local tax bases. In line with this role, a number of key objectives for innovative instruments were cited: address risk (e.g. full-risk financing loans for copper and agriculture under the Cotonou Investment Fund; infrastructure guarantees), mobilise long-term savings (guarantees); improve debt solvency; engage the private sector (through risk reduction); reform policy to enhance the investment environment; and promote capital markets.

Incentives for such innovation in the design of ODA instruments are also linked to the definition of ODA and DAC data collection, and particularly the extent to which contingent liabilities and guarantees are counted as ODA. In this context, there were proposals to revisit the measurement of concessionality.

Linking to the final Closing Panel, Session IV also discussed the division of labour between different development finance institutions, notably whether particular institutions ought to specialise in the use of particular instruments. With respect to risk mitigation, the Multilateral Investment Guarantee Agency and International Finance Corporation (IFC) were proposed as appropriate institutions to address political risk, with the IFC and International Financial Institutions (IFIs) more suited to addressing credit risk. The IFIs, for their part, are seen as good in mitigating the pro-cyclicality of markets as they are able to lend over longer time-horizons. The comparative advantage of public banks versus private markets was considered as an issue for further research.

### **d. Changing the international development finance architecture.**

The Closing Panel of the Workshop was devoted to options for institutional reform, with many participants agreeing that the term “architecture”, by implying a possibility for “redesign”, may not be appropriate to describe the institutional context of development finance.

Given recent discussions on the UN, many participants felt that reform proposals were disjointed and allowed for only slow progress, and acknowledged that the difficulty in promoting reform lies in separating political governance of the UN system from its development finance activities. UN reform was also hampered by the need to bring a multitude of policy issues under one roof.

The emergence and growth of new actors in development finance was seen as a symptom of failures in the current multilateral system, with regional banks and global funds growing at faster rates than the IFIs. The growth of private foundations (notably the Bill and Melinda Gates Foundation with recent financing from Warren Buffet) were discussed as further evidence for the fact that development finance could no longer be seen as an intergovernmental process.

In this new context, questions were raised about the possibilities for multilateralising aid, with the bilateral-multilateral split currently lying at around 70:30. At country-level, this picture is complicated by the implementation of bilateral aid by multilateral agencies. There was general agreement that bilateral policies towards multilateral agencies would warrant further discussion, with particular attention to be paid to various proposals for multilateral performance evaluation (N.B. The next Informal Experts Workshop of the Global Forum on Development will focus on multilaterals in February 2007).

Finally, discussions focused on how to move forward with reform. The debate revisited discussions on the “competitive” vs. “planned” models of aid delivery.<sup>1</sup> Some participants argued for the creation of new authorities and institutions (e.g. a World Finance Organisation), to regulate the development finance system, bring together various stakeholder groups and conduct research, for example on financial engineering.

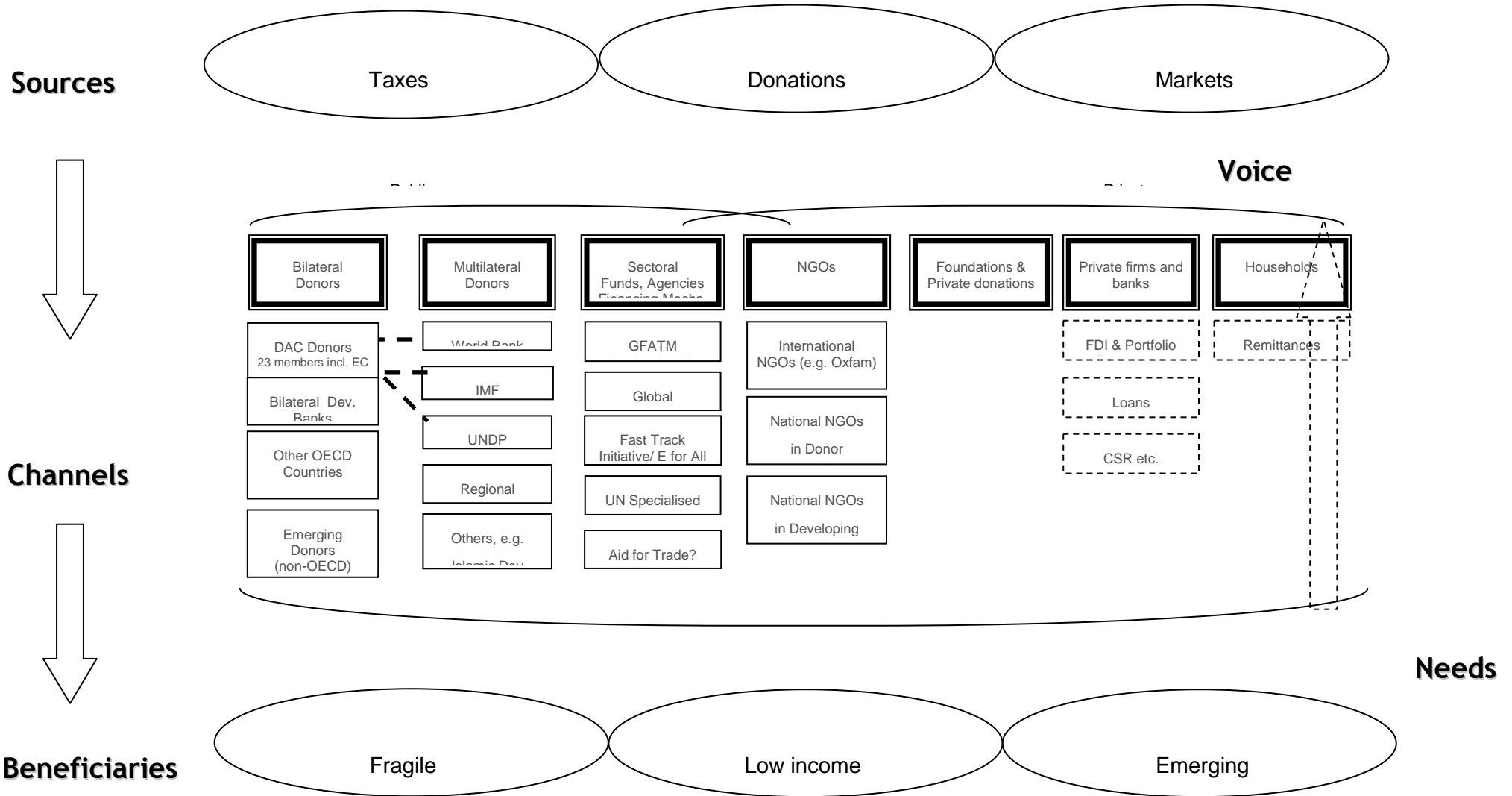
Others argued for a slower process of strengthening the voice of reformers. Doing so would, first and foremost, imply the provision of support for stronger developing country voices in international policy debates and dialogue processes such as the Global Forum on Development.

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<sup>1</sup> see summary of ODI/Development Centre Workshop on “The International Aid System: What Next?”, held in Paris on 4 February 2005 – [www.oecd.org/dev/meetings/aidworkshop](http://www.oecd.org/dev/meetings/aidworkshop)

# The International Development Finance Architecture: Global Level

Source: DCD and DEV, 2006; comments and suggestions welcome.



# The International Development Finance Architecture: National Level (Case of health national system in Ghana)

Source: Drechsler, D., 2006, "Financing Health: Findings from a Ghana field study"

