DEVELOPMENT CO-OPERATION DIRECTORATE
DEVELOPMENT ASSISTANCE COMMITTEE

DEVELOPMENT CO-OPERATION IN THE CONTEXT OF THE FINANCIAL CRISIS, INCLUDING STOCKTAKING ON ODA COMMITMENTS

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DEVELOPMENT CO-OPERATION IN THE CONTEXT OF THE FINANCIAL CRISIS, INCLUDING STOCKTAKING ON ODA COMMITMENTS

I. A protracted global downturn is expected

1. The economic crisis comes at a time of strong global interdependence, contributing to its breadth and depth. The OECD forecasts growth in the OECD area to be -0.4% in 2009 and to remain feeble until mid 2010\(^1\). Recovery is expected to be slow. There is still high uncertainty in terms of the depth and duration of the recession, with downside risks particularly large. Much will depend on the effectiveness of the recovery packages now being put in place.

II. Developing countries will be seriously affected

2. The crisis will create serious stresses in developing countries, further compounding the impacts of recent food and fuel prices crises. The IMF estimates that a 1% fall in global growth will translate into a reduction in Sub-Saharan Africa growth rates of 0.3% to 0.5\(^2\). All growth forecasts are being revised downwards – for China and India by 1.5%, for developing Asia from 8.3% to 7.1%, and for Sub-Saharan Africa from 5.5% to 5.1% for 2009\(^3\). The World Bank\(^4\) estimates that every 1% drop in growth could add 20 million people to the poverty count. As growth is the major driver of poverty reduction, these developments put at risk the gains made over the last decade.

III. Financing for development will fall

3. The effects of the OECD economic downturn are transmitted to developing countries through a variety of channels, all of which raise cause for concern. Export demand, particularly for commodities, will be weaker. Private financial flows, including foreign direct investment, are expected to decline by almost half, from USD 1 trillion in 2007 to around USD 500 billion in 2009. Remittances, too, are expected to suffer as migrants’ numbers and earnings fall. And aid may also be under pressure as donor countries reassess fiscal priorities in the downturn\(^5\). Following the 1991-92 recession, ODA fell by 22% and took until 2003 to recover. Some private charities are already scaling back. Overall, some estimates suggest a 25% reduction in financial flows to the developing countries in 2008/9\(^6\).

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\(^1\) OECD Economic Outlook No 84, Nov 2008  
\(^3\) IMF World economic Outlook, Update 6 November 2008  
\(^4\) World Bank, Global Financial Crisis: responding today, securing tomorrow. Background paper to the G20 Summit, November 2008  
\(^5\) See “Aid targets slipping out of reach?” OECD December 2008  
IV. How can donors respond?

4. Fast, effective and co-ordinated responses are needed. What can donors do?

- **Aid pledge**: Many low-income developing countries remain heavily dependent on aid for external support (see figure 1), so any reduction would compound other shocks, further reduce fiscal space, result in sharp contractions in economic activity, and add to fragility in vulnerable states. This is why DAC donors made an aid pledge on 24 November 2008, reaffirming earlier commitments to increase the volume of aid and to maintain aid flows at levels consistent with those commitments. This would be a departure from behaviour typical in past financial crises, when aid budgets have been cut in the fiscal tightening phase (see figure 2).

  - **Rapid Response**: The IMF and the World Bank have in place facilities to help low income countries deal with the exogenous shocks of the crisis, but coordinated packages of assistance from the donor community may be needed to meet the needs. The IMF suggests some 33 LICs are presently vulnerable\(^7\). This will mean providing quick access to funding with fewer conditions, but tailored to each country’s situation. Arrangements for co-ordinated rapid responses capabilities could well be needed.

  - **Pro-poor public expenditures, social protection and safety nets**: The poorest are the most vulnerable to shocks. Pro-poor expenditures (on e.g. health, education, rural infrastructure) are

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\(^7\) Ibid IMF 2008

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Figure 1. Aid, trade and other flows from High Income Countries

Source: OECD, World Bank

Notes:
High Income Countries are most OECD and EU countries, plus Gulf States, Brunei, Hong Kong, Israel, Macao, Singapore, and Caribbean and Pacific countries with high per capita incomes. Low Income Countries include India, with significant exports and receipts of remittances.
particularly difficult to reprioritise in recessions – fiscal space is restricted, and spending on the non-poor is often the most protected. Yet social protection measures can be affordable and are cost effective.

- **Policies to restore growth and increase resilience to external shocks:** Developing countries are likely to need considerable support from donors for growth enhancing investments (e.g. macroeconomic management, aid for trade, infrastructure, domestic resource mobilisation) that build the foundations for the rebound.

![Figure 2. ODA from 1987 to 2007](image)

**V. Issues for discussion**

i) What would a collective donor response look like, immediately (e.g. aid pledge, coordinated rapid response capability, social protection) and over a longer time horizon (growth enhancing interventions)?

ii) The aid pledge reaffirms existing aid commitments, which on the basis of the DAC Survey of forward information, are currently some $30bn above what is so far programmed, so that in principle significant additional resources are available over the next two years to 2010. But realising this potential will require major and urgent fiscal provision from a number of donors. Could there be an aid component in donor countries’ fiscal stimulus packages?

iii) In terms of rapid response capabilities, what is the current assessment of the size and scope of financing needs, and how can donors’ best respond, learning lessons from previous experiences, in the 1980s when debt distress emerged and in the 1990s when aid budgets were cut?
iv) The 2009 DAC Survey on Aid Allocations and Forward Information will be launched in January, with responses due by mid-February. How could the survey be used to provide hard information on crisis response capacities?

5. Better policy coherence will be needed to avoid OECD countries initiating actions (e.g. trade and investment protection) that will exacerbate the situation in developing countries. What measures are donor countries putting in place to avoid counterproductive measures?