External Financing for Development

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An outlook on ODA graduation in the post-2015 era

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The OECD's Development Assistance Committee (DAC) is considering the framework for measuring and monitoring external development finance in the post-2015 era. This paper considers the impact of projected growth of per capita Gross National Income (GNI) among developing countries on their eligibility to receive Official Development Assistance (ODA) under current policy settings in the period to 2030.

Key projections

- Over the period until 2030, 28 developing countries with a total population of 2 billion are projected to exceed the income threshold for ODA eligibility;
- These countries accounted for 9.4% of global gross ODA disbursement in 2009-2011; with a regional spread of less than 1% of ODA to Sub-Saharan Africa to 45% of ODA to South America; and,
- All but 14 of 82 countries currently eligible for concessional programmes of Multilateral Development Banks are projected to exceed their income criteria. This would have significant implications for multilateral ODA allocations, as these funds account for 30% of donors' multilateral contributions.

The transformation of the developing world – rapid growth and increasing divergence

An increasing number of developing countries are climbing up the income ladder, are enhancing their ability to access other kinds of finance beyond ODA and are able to mobilise increasing amounts of domestic resources. Indeed, many are themselves becoming providers of assistance. However, there is another group of countries, often the poorest, and ravaged by conflict, which is struggling to make any significant progress.

There often are higher disparities between the richest and poorest of the developing countries than there are between developing countries in the Upper Middle Income Countries group (UMICs) and High Income Countries (HICs). Some examples illustrate this:[1]

- Per capita income in the USA is 4.3 times that in Brazil; while Brazil's per capita income is seven times greater than Nicaragua's and 15 times that of Haiti;
- The UK's per capita income is 3.5 times that of Turkey, which in turn has a 12.6 times greater per capita income than Tajikistan; and,
- Korea, a DAC member since 2010, has a per capita income that is 3.9 times that of China, whose figure is still at a considerably lower level than that of Brazil or Turkey, although catching up fast. Yet, compared to Ethiopia, China's per capita income is 14 times greater.

In terms of ODA definitions and accounting, Mexico and Malawi, China and Chad, or Turkey and Tajikistan are the same; all qualify for ODA based on their income level. Against this background, a longstanding debate has waged on whether the upper limit for ODA eligibility, the demarcation between the UMIC and HIC groups of countries, is too soft. The argument was further fanned when in 2012 several UMICs saw growing ODA, often in the form of loans, while allocations to Sub-Saharan Africa, which typically take the form of grants, fell 7.9%, leading to concerns of a possible trend of ODA shifting towards countries higher on the income scale.

[1] All based on 2012 data, using the Atlas method.

Is ODA graduation ineffective?

Looking back over the past decades, some 55 countries and territories have graduated out of ODA, reflecting substantial improvements in global prosperity. This includes countries that have made the tremendous journey from having some of lowest incomes to becoming high-income countries and world leaders in technology or financial services, such as Korea and Singapore.

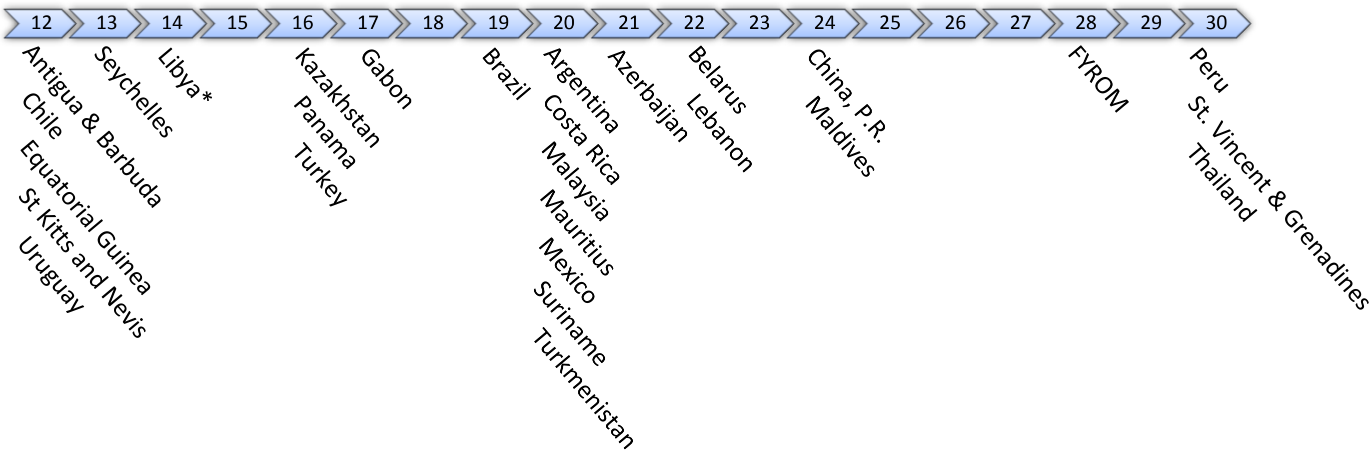
However, so far none of the today's major emerging economies have graduated from ODA. As discussions are underway on a post-2015 development framework and its financing, the question of ODA eligibility takes a central role. To address the question, it is essential to look to 2030 to see which economies would otherwise breach the ODA income qualification ceiling on current projections if this graduation criterion remains unchanged.

To do this, International Monetary Fund projections for Gross National Income (GNI) per capita, in current dollars, have been applied to World Bank GNI per capita figures for countries on the DAC list of ODA recipients. To take account of inflation, an annual increase in the ODA cut-off is applied equivalent to the average increase over the last three years (2010–12) in the deflator for Special Drawing Rights (SDR), which is used for the annual revisions of all income categories: 1.38%. For the period beyond which IMF projections exist, 2019-30, the data is extrapolated based on the mean projected growth rate of the five years from (2014-18). The extrapolated figures are capped at a maximum of 10% per year.

The shrinking ODA universe - extrapolating growth patterns and implications for ODA graduation

The chart below lists the countries that would exceed the income threshold of ODA eligibility in any given year. It should be noted that the process for exiting the DAC's ODA list is that a country has to exceed the benchmark for three consecutive years. However, as reviews of the list only take place every two to three years, it can take up to six years for a country to complete this process since first exceeding the threshold.

Projected year for exceeding per capita income threshold for ODA eligibility (2012-30)

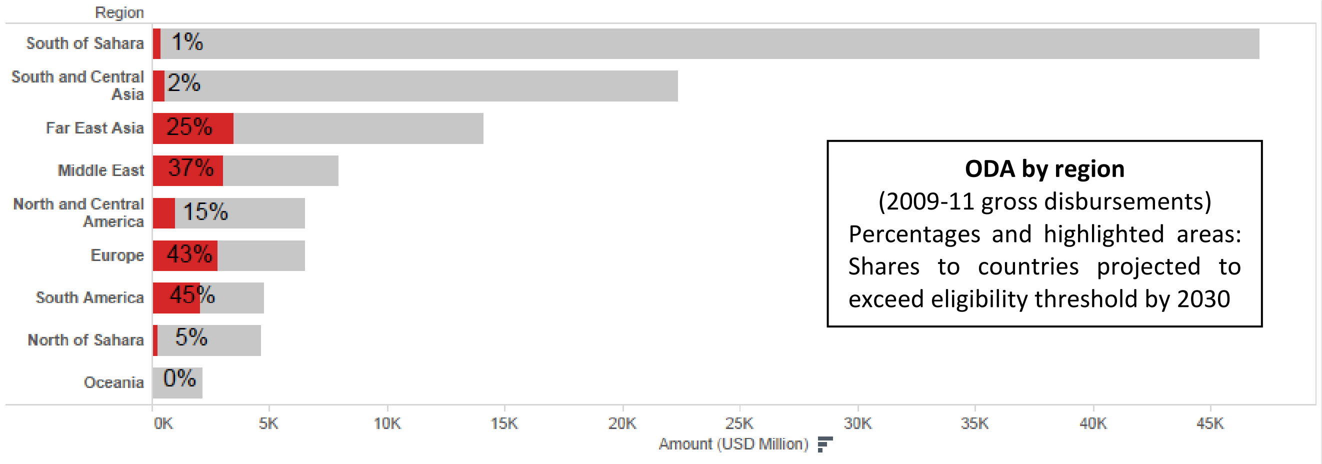


* Libya exceeded the threshold in 2012, but is predicted to drop below for a year again in 2013.
FYROM - Former Yugoslav Republic of Macedonia

The forecast is in many ways positive. The results project that 28 countries, home to two billion people (35% of the population of the 148 countries and territories currently on the list) are expected to exceed the upper income threshold by 2030. Whether or not that threshold is modified, the increase in prosperity reflected in these income gains would be an enormous development success.

Implications for ODA allocation

The chart to the next page shows the gross ODA disbursements by region, highlighting the shares accounted for by countries projected to exceed the upper income threshold for ODA by 2030. The bars reflect averages for the 2009-11 period, at constant 2011 USD. It gives a clear sense of concentration on Sub-Saharan Africa, and to a somewhat lesser extent, South and Central Asia, as the regions with the highest poverty prevalence.



Both regions would remain largely unaffected by ODA graduation, whereas 45% of ODA disbursements to South America go to countries that would have passed the ODA income threshold, and 43% in the case of Europe. Based on current allocation patterns, the projections would imply a trend towards the greater concentration of ODA on today's low and middle income countries; notwithstanding that these countries are also expected to record income growth.

Implications for ODA allocations to multilateral institutions

Income growth projections also have significant ramifications for Low Income Countries (LICs) that currently qualify for funding from the International Development Association (IDA) at the World Bank Group, the African Development Fund at African Development Bank and the Asian Development Fund at the Asian Development Bank. The current per capita GNI cap for IDA, USD 1,205, is less than one tenth of upper income threshold for ODA, USD 12,165. Of the 82 countries that currently qualify for such programs, all but 14 are expected to have exceeded the IDA income threshold by 2030 under current policy settings.[2] The map on the next page shows that all but two of these countries, Afghanistan and Nepal, are in Sub-Saharan Africa.

This has significant implications for donors as programs such as IDA account for around 30% of ODA qualifying contributions to multilateral agencies from DAC donors; more than three times the amount of contributions provided to United Nations Funds and Programmes. The prospect of drastic reductions in the income-based eligibility of the concessional windows of multilateral development banks raises questions about their future use, and discussions on possible adjustment of eligibility policies are already taking place.

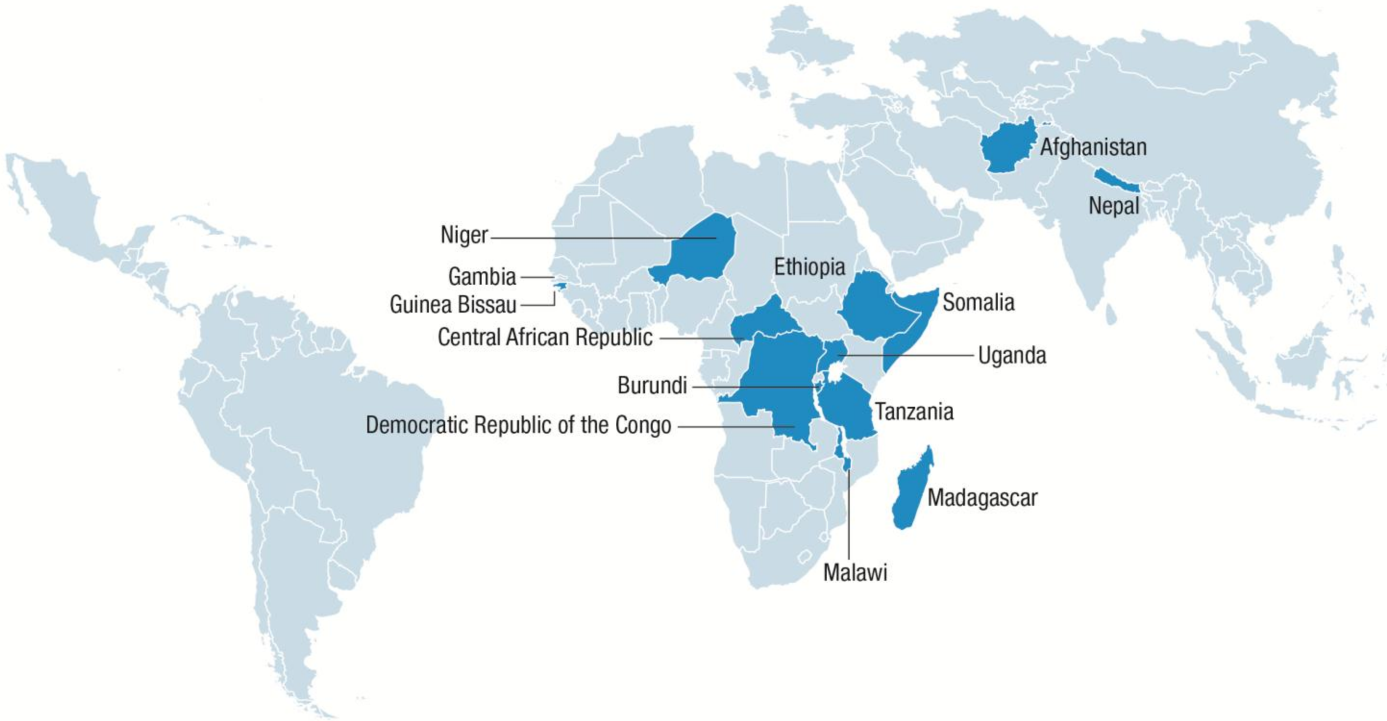
Avoiding a crude choice

ODA has for decades been an essential public resource underpinning international development efforts. It is a measure of its success that it is increasingly being crowded out by other sources of finance across the developing world. The projected graduation of a number of major emerging economies will have a significant impact on ODA allocations. Under current policy settings, perceptions about eligibility would likely evolve, as the share of the world population represented by ODA-eligible developing countries is set to fall sharply.

These trends should inform any considerations of changes to eligibility criteria, but it will be essential to not frame this as a simple in-or-out issue. Such a lack of differentiation invariably leads to a crude, and wrong, choice. Tighter eligibility criteria would imply a verdict that countries that still have enormous development challenges are too rich to warrant international cooperation. On the other hand, failure to differentiate between countries with hugely different needs could result in an ODA concentration on countries where its financial volume would not make a difference. Neither of these outcomes would do justice to reality.

[2] Some countries qualify for IDA based on other criteria, notably the small island economy exemption, which applies to 14 economies. See http://www.worldbank.org/ida/borrowing-countries.html

Developing countries projected to be within the per capita income threshold for IDA in 2030



Focus on context, relevance and impact

The more relevant issue is the role that ODA, and other development resources, can play in different contexts. For Least Developed Countries (LDCs) as a group, ODA represents 71% of total external resources. ODA receipts are equivalent to 46% of tax revenues based on IMF data on government revenues. This figure rises sharply to 92% if Angola is excluded. Yet for the Upper Middle Income Countries (UMIC) group, ODA makes up the equivalent of 0.8% of tax revenues and 6% of total external financing[3]. For many middle income countries, development cooperation has long stopped being primarily a question of financial resources. There is a clear argument for focusing ODA's budgetary firepower on LICs and LDCs.

That argument should not be equated with limiting the role of ODA to contexts where it fills financial resource gaps. Wherever development co-operation made a lasting difference, the role of ODA was not reduced to that of a financial resource. It can be transformational through supporting technology transfer and innovation, policy reform and coordination, and by leveraging further resources to finance development.

A tightening of eligibility that leaves no recognised public resources to work with UMICs on today's development challenges would make no sense, especially if the ambition is to create a truly global development framework in the post-2015 era. Rather than focusing on eligibility as such, a more refined approach to the issue would focus on what ODA can do, what it cannot do, and what it should do:

- ODA should fill essential financial resource gaps where it can; this is the case in LICs (and in individual lower middle income countries). The bulk of financial benefit should accrue to these countries, and clearer targets could be established to ensure this;

- ODA cannot effectively fill financial gaps in UMICs. There should be a clearer focus here on its impact and catalytic role in relation to development challenges, both in and beyond these countries; and,

- ODA can leverage other resources; better utilising this ability to leverage other resources flows, in both middle income countries and LICs, will be essential for the future.

[3] http://www.scribd.com/doc/200161622/The-Where-of-Development-Finance-Towards-Better-Targetting-of-Concessional-Finance